A CASE STUDY

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Working capital analysis public state undertaking

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ABSTRACT

Evaluation was done of working capital of MPSEB during the period from 1995-96 to 2004-05. With concept of working capital, working capital policy, components of working capital and factors affecting working capital of MPSEB during the last 10 years and identify which factors are responsible for the improvement of working capital of the company. Working capital position of MPSEB was analyzed under four categories like analysis of liquidity ratio, analysis of liquidity position, component wise analysis of working capital and analysis of liquidity ranking. It was found that working capital position of MPSEB is not satisfactory during the study period and also found that current assets are less than current liabilities which leads to negative and unfavourable working capital. In this light MPSEB should try to increase the current assets specially in cash and bank and inventory and try to curtail the current liabilities specially creditors and outstanding expenses for improvement of short term solvency and liquidity position as well as expedite benefits of working capital.

Key words : Working capital, Liquidity, Inventory

Management of working capital is one of the most important and key resources of an organization for caring its day to day operations. Working capital can be taken as funding resource for routine activities of business. As routine activity becomes the material part for revenue generation for the business, which gets funded by working capital. Thus, making working capital is the most vital and important part of fund management and profitability for business. It may be needless to maintain that without proper management of working capital the business will start struggling for its existence and solvency. Managing working capital is an art which can only be excelled through proper study and scenario analysis. Working capital can be generated by numerous short term funding resources and short term credits and loans (Chandra, 1992; Banerjee, 2000).

The major common sources contributing to working capital of an enterprise may be categorized as trade credits extended by suppliers, advances by customers, by discounting of bills, Banks overdrafts from state Government reserves and reserves funds, subsidies grants and contribution from also central and state Government borrowings etc. As already stated, management of working capital is a vital dimension in determining profit and growth of an enterprise. Planning and projection of working capital needs careful integration of targets of various business targets. Determination of optimum capital may be derived by budgeted performance of various business segments. After determination of optimum capital requirement for the business, the next target of designing the working capital structure is taken up. Working capital structure is designed with the objective of minimizing the cost of working capital, thus reducing the burden of cost of working capital of profit. The optimally designed capital structure not only guards solvency of the company but also enriches its earning by protecting its cash outflow (Sharma and Gupta, 1995; Van Horne, 1998).

As already mentioned, it is extremely important that optimally designed working capital should be adequate enough to steer the organization to its target at minimum cost. Designing adequate optimum working capital structure is not only liability of managers of the company but also an honest duty towards the holders of the company. Adequate and optimum working capital add to economic value aided of the organization. This increase in the economic value of the company not only adds to earning per share of the company but also yield to increase in goodwill market value and creditability of the company. The increase in creditability and goodwill of the company further be used for generating low cost funds from market and also for gaining better credit turnover ratio. The above scenario clearly highlights the fact that optimum or adequate capital not only improves profitability of the company but also develops its own cycle of perpetual earning for the company (Gitman, 1989).

One most important aspect to be considered in deciding the working capital is to arrive at a reliable estimate of requirements of funds, which can made by

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