IMPACT OF WORKING CAPITAL MANAGEMENT ON SME’S

A. Yashoda
Associate Professor
Dept. of Business Management
Vaageswari College of Engineering
Karimnagar (TS), India
Email: sriyashoda26@gmail.com

ABSTRACT
Small & medium enterprises play an important role in the development of our country in various ways by creating employment for rural & urban growing labor force, providing desirable sustainability & innovation in the economy as a whole. Small firms are giving boost to the low income group peoples.

Working capital management is essential not only for firm’s profitability & risk but also in its value. This paper is focusing on the impact of working capital in small and medium enterprises.

Keywords: Working capital management, components of working capital, small and medium enterprises, influencing factors of WCM

INTRODUCTION
In financial management two important decisions are very vital and crucial. These decisions are taking regarding the fixed assets/fixed capital and decisions regarding the current assets and current liabilities.

Both are important for analyzing their effect to final impact on profitability and loss of the firm. Fixed assets refer to the funds invested in such fixed or permanent assets such as land, building and machines etc. Whereas current assets means this easily converted into cash such as stock, debtors. Thus in very simple words, working capital may be defined as capital invested in “current assets”

Here working capital play important role as it is used to meet the day-to-day requirements of the firm. So in order to meet these requirements we want to utilize these resources very carefully. Fixed assets it gives the long term benefit to the company. So the working capital is circulating system i.e. converted into cash and again cash converted to stock. Hence working capital is also known as circulating capital or floating capital.

Need for working capital management
A proper management of working capital is essential for the firm and to become health and operational success of a business. As such companies using these resources very negligence or not using in a proper way then the company leads to become losses. It is necessary for

1) Proper utilization of fixed assets and current assets
2) Make the receipts and payments balancing
3) To improve the productivity, competitiveness and capacity building of SMEs,
4) To make the strong and healthy financial position of SMEs.
Challenges of small and medium enterprises

Small and medium enterprises would face cut throat competition from the technological advanced industries of distant lands. In order to maintain such competition, SMEs in India would need highly skilled labor and maintain the proper utilization of fixed assets and current assets.

Lack of adequate credit to SMEs is a major obstacle for the growth of SMEs. Relatively high cost of credit, requirement of collateral and limited access to equity capital often put such firms outside the net of institutional credit. Other challenges encountering the SMEs include lack of infrastructural facilities, high cost of Raw-material, limited access to modern technology, lack of limited manpower, lack maintaining the working capital requirement.

In order to make SMEs more strong so there is a need of efficient management of working capital

Concept of working capital

There are two concepts of working capital.

1. Gross working capital
2. Net Working Capital

Gross Working Capital

The gross working capital, simply called as working capital refers to the firm’s investment in current assets. Current assets are the assets, which can be converted into cash within a financial year or operating cycle. Thus, Gross working capital, is the total of all current assets. It includes

1. Inventories (Raw materials and Components, Work-in-Progress, Finished Goods, Others)
2. Bills Receivables
3. Cash and Bank Balances
4. Loans and Advance
5. Trade Debtors
6. Short-term Investment
7. Interest received in advance

Net Working Capital

Net working capital refers to the difference between current assets and current liabilities. Current liabilities are those claims of outsiders, which are expected to mature for payment within an accounting year. Net working capital may be positive or negative. A positive net working capital will arise when current assets more than current liabilities and a negative net working capital will arise when current liabilities exceed current assets i.e. there is no working capital, but there is a working capital deficit. It includes

1. Trade Creditors.
2. Bills Payable.
3. Trade Advances
4. Accrued or Outstanding Expenses.
5. Short Term Borrowings (Commercial Banks and Others)
7. Bank Overdraft
8. Outstanding expenses

Impact of working capital management

The impact of working capital on the profitability of the firm is most affecting as it will lead to running of the organization as smoothly or if that assets and resources are not using properly then it will lead to running the organization into losses. As it effect should be going immediately.

Impact of working capital on profitability of the firm

Working capital is one of the important measurements of the financial position. “Working Capital is the life-blood and nerve centre of the business.” In the words of Walker, “A firm’s profitability is determined in part by the way its working capital is managed.” The object of working capital management is to manage firm’s current assets and current liabilities in such a way that a satisfactory level of working capital is maintained. If the firm cannot maintain a satisfactory level of working capital, then losses will be increasing and it is likely to become insolvent. Thus, need for working capital to run day-to-day requirements of business

Significance of working capital management
Features of working capital

1. **Smooth flow of business operations**: Adequate amount of working capital enables the business to conduct the business operations smoothly. It is, therefore, called the “flesh and blood” of the business.

2. **Liquidity**: the assets represented by the working capital can be converted into cash quickly within a short period of time except fixed assets.

3. **Life span is short**: Working capital changes in its form: from cash to stock; stock to debtors; debtors to cash. The cash balances may be kept idle for a week or so, debtors have a life span of a few months, raw materials; are held for a short-time until they go into production; finished goods are held for a short-time until they are sold.

4. **Amount of working capital**: The amount of working capital of a business depends on many factors such as size and nature of the business, production and marketing policies, business cycles and so on. These are discussed in detail in the following section.

5. **Utilized for payment of current expenses**: The working capital is used to payment of current expenses such as payment of wages and salaries, suppliers of raw materials, rent and other expenses and so on.

**Working capital cycle**

The flow of money in the business is referred to as ‘working capital cycle’ and is important for smooth running of any business. The money invested in working capital is continually moving towards purchase of material inputs, salaries and wages and other expenses.

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**Operating cycle**

[Diagram showing the cycle with labels for Cash to Cash Cycle, Orders, Raw Materials, Cash, Manufacture, Finished Goods, Realization, Sales, and WC Cycle with time durations.]
Factors influencing working capital management

1) **Nature of the Industry / Business**: The management of working capital is different from industry to industry. In a service industry, there is no inventory and therefore one big component of working capital is already avoided. So, the nature of industry is a factor to determining the working capital requirement.

2) **The length of manufacturing cycle**: Longer the manufacturing cycle is, more is the requirement of working capital. The length of manufacturing cycle refers to the time taken from point of first stage to the last stage of the manufacturing process.

3) **Seasonality of Industry and Production Policy**: Businesses based on seasons like manufacturing of coolers whose demand peaks in summer and dips in winter. Requirement of working capital will be more in summer compared to winter if they are produced in the fashion of their demand. The policy of producing throughout the year can smoothen the fluctuation of working capital requirement.

4) **Production Cycle Time**: The production cycle time refers to the time required for converting the raw materials into finished goods. Higher this time, higher would be the time of blocking funds in the working capital.

5) **Dividend Policy**: Dividend policy determines the level of retained profits with the business and retained profits are also used for working capital. This is how; dividend policy affects the need for working capital.

6) **Growth and Expansion**: Some industries are static and others are growing. Obviously, growing industry grows the requirement of working capital also as compared to static industry.

7) **Dividend Policy**: Dividend policy determines the level of retained profits with the business and retained profits are also used for working capital. This is how; dividend policy affects the need for working capital.

8) **Reserve policy**: Reserves are important for future contingency. The future is uncertain so it is most important. From the annual profits, certain amount is provided as a reserve for a general or specific purpose. These reserves are useful for a number of expenses in future.

9) **Bottlenecks in the supply of raw materials**: the more the bottlenecks, the more is the need for working capital. To minimize such problem, the current trend is to develop a chain of reliable suppliers; they must operate under “just-in-time” stock holding philosophy.

10) **Fluctuations in the demand**: Seasonal fluctuations are common phenomenon for most of the businesses. It is necessary to determine the need for working capital during the month of season and off-season. The requirements of funds also can be planned accordingly.

11) **Degree of competition**: Where there is a high degree of competition, products of larger variety has to be offered at competitive terms and conditions. Maintain variety of stocks, allowing more credit period.

12) **Profit margin**: Higher profit volumes generate larger amount of working capital and hence there is no need for borrowing from outside for interest. Where there are low profits then it is necessary to concentrate on cash inflows & cash outflows.

13) **Price Levels**: The price levels of inventory and other expenses such as labor rates etc increase the working capital requirement. If the company also is able to increase the price of their finished goods, it reduces this impact.

14) **Amount of taxes**: Tax is compulsory to the pay the government as according to the profits of business. There are some taxes such are direct and indirect taxes. Direct taxes such as income tax as on the basis of profits. Indirect taxes such as sales tax, excise duty and so no.
15) **Depreciation policy:** Depreciation is a charge against the current year’s profits. Thus depreciation is the source of working capital. It is a book cost & hence does not involve outflow of funds.

16) **Terms and conditions of purchase and sale:** Every business having some cash and credit payments. It is necessary to monitor the amounts receivables and accounts payable by maintaining debtor’s age analysis and creditor’s age analysis.

17) **Operating efficiency:** operating efficiency can be attained by following strategies such as cost reduction and cost control, inventory control, waste elimination, improved layout, zeroing the idle time, highest capacity utilization, reserves, and dividends and so on.

**CONCLUSION**

Small and medium enterprises continue to play an increasingly important role in major economies. The SMEs sector produces a wide range of industrial products such as cotton textiles, wool, silk, wood and wood products etc. The SMEs is providing a number employment opportunities particularly for rural peoples where they illiteracy peoples. Due to maintain the efficient working capital as the company is knowing every time what is the position of his company so according to that they will solving the financial problems thus it will leads to expand its scale of operations and provide more and more employment opportunities.

**REFERENCES**