



B.Com Honours

Semester III

Calicut University

FINANCIAL STATEMENT ANALYSIS

Course Code: COM3MN204 • Module 4 Notes

Module IV: Working Capital Management & Estimation

Working Capital Management involves forecasting and controlling short-term assets and liabilities to guarantee liquidity for uninterrupted business operations while optimizing return on assets.

Unit 13: Working Capital – Concepts, Types, & Importance

- 1. Concepts:** Gross Working Capital (total current assets) vs. Net Working Capital ((CA - CL)).
- 2. Types:** Permanent/Fixed Working Capital (minimum capital required continuously throughout the year) vs. Temporary/Variable Working Capital (seasonal capital needed for peak business demand).
- 3. Importance:** Ensures solvency, preserves credit reputation, enables cash discounts, and mitigates crisis shocks.

Unit 14: Factors Influencing Working Capital & Principles of Management

Influencing Factors: Nature of business (manufacturing vs trading), scale of operations, length of production cycle, credit terms granted to debtors, inflation rates, and seasonal fluctuations.

Core Principles: Principle of Risk Variation, Principle of Cost of Capital, and Principle of Maturity of Cash Flows.

Unit 15: Estimation Techniques – Operating Cycle Method

Calculates the time duration (in days) required to convert cash inputs back into cash inflows:

$$\text{Operating Cycle (Days)} = R + W + F + D - C$$

Where: R = Raw Material Holding Period, W = Work-in-Progress Period, F = Finished Goods Storage Period, D = Debtors Collection Period, and C = Creditors Payment Deferred Period.

Unit 16: Estimation Techniques – Projected Balance Sheet Approach & Solved Problem

Estimates working capital requirements by projecting individual elements of current assets and current liabilities based on budgeted production units and cost structure ratios.

Practical Problem 2 (Working Capital Estimation Calculation): A manufacturing firm plans a production level of 52,000 units per year. Cost structure per unit: Raw Material = Rs. 100; Direct Labour = Rs. 40; Overheads = Rs. 60; Profit = Rs. 50 (Selling Price = Rs. 250). Average time periods: Raw Materials in stock = 4 weeks; Work-in-Progress (100% material, 50% labor & overheads) = 2 weeks; Finished Goods in warehouse = 4 weeks; Credit allowed to Debtors = 8 weeks; Credit allowed by Suppliers = 4 weeks. Cash in hand = Rs. 1,00,000. Calculate Net Working Capital required (Assume 52 weeks in a year).

Step-by-Step Solved Working Capital Estimation:

- Weekly Production = $52,000 / 52 = 1,000$ units per week.
- **1. Raw Materials Stock (4 weeks):** $(1,000 \text{ imes } 100 \text{ imes } 4 = \text{Rs. } 4,00,000)$.
- **2. Work-in-Progress (2 weeks):**
 Material (100%): $(1,000 \text{ imes } 100 \text{ imes } 2 = 2,00,000)$.
 Labor & Overheads (50% of Rs. 100): $(1,000 \text{ imes } 50 \text{ imes } 2 = 1,00,000)$. Total WIP = Rs. 3,00,000.
- **3. Finished Goods Warehouse (4 weeks - Cost Rs. 200):** $(1,000 \text{ imes } 200 \text{ imes } 4 = \text{Rs. } 8,00,000)$.
- **4. Debtors Credit (8 weeks - Cost Rs. 200):** $(1,000 \text{ imes } 200 \text{ imes } 8 = \text{Rs. } 16,00,000)$.
- **5. Minimum Cash Balance:** Rs. 1,00,000.
- **TOTAL CURRENT ASSETS (A):** $(4,00,000 + 3,00,000 + 8,00,000 + 16,00,000 + 1,00,000 = \text{Rs. } 32,00,000)$.
- **6. Creditors Deferral (4 weeks - Material Rs. 100):** $(1,00,000 \text{ imes } 100 \text{ imes } 4 = \text{Rs. } 4,00,000)$ (Total Current Liabilities B).
- **NET WORKING CAPITAL REQUIRED (A - B):**
 | **Net Working Capital = Current Assets (32,00,000) - Current Liabilities (4,00,000) = Rs. 28,00,000**

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