



B.Com Honours

Semester VI

Calicut University

FINANCIAL MANAGEMENT

Course Code: COM6EJ302 • Module 2 Notes

Module II: Working Capital Management & Operating Cycle

Covers gross vs net working capital, cash & marketable securities management (Baumol Model), receivables & inventory control (EOQ), float management, operating conversion cycle, and financing strategies.

Unit 2.1: Factors Affecting Working Capital Requirements

Working Capital Concepts: Gross Working Capital (Total Current Assets) vs Net Working Capital ($\text{CA} - \text{CL}$). Factors: Business nature, production cycle length, credit policy terms, & seasonal fluctuations.

Unit 2.2: Management of Cash & Marketable Securities

Cash Motives: Transaction, Precautionary, & Speculative motives. Baumol Model for Optimum Cash Balance ($C^* = \sqrt{\frac{2 \cdot F \cdot T}{i}}$).

Unit 2.3: Receivables & Inventory Management (EOQ)

Receivables: Credit evaluation (5 Cs of credit), credit terms (e.g. 2/10 net 30), aging schedule. Inventory: Economic Order Quantity ($\text{EOQ} = \sqrt{\frac{2 \cdot D \cdot S}{H}}$).

Unit 2.4: Float Management & Operating Conversion Cycle

Float Types: Billing float, Mail float, Check processing float, & Availability float.

Cash Conversion Cycle (CCC):

$\text{CCC} = \text{Inventory Holding Period (ICP)} + \text{Receivables Collection Period (RCP)} - \text{Payables Deferral Period (PDP)}$

Unit 2.5: Working Capital Financing Strategies

Strategies: Conservative Approach (High liquidity), Aggressive Approach (Short-term funds for long-term assets), & Hedging/Matching Approach (Maturity of source matches asset life).

Practical Solved Problem 1 (Cash Conversion Cycle CCC Calculation): Firm data: Inventory Holding Period (ICP) = 60 days, Receivables Collection Period (RCP) = 40 days, Payables Deferral Period (PDP) = 35 days. Annual Operating Outflows = ₹36,00,000 (360 days/year). Calculate Cash Conversion Cycle (CCC) and Minimum Required Working Capital.

CCC = ICP + RCP - PDP; Working Capital = Daily Operating Cost * CCC

Step-by-step Solution:

1. Cash Conversion Cycle $\text{CCC} = 60 + 40 - 35 = 65$ days.

2. Daily Operating Cost = $\frac{36,00,000}{360} = \text{₹}10,000 \text{ per day}$ \$.
3. **Minimum Required Working Capital** = $10,000 \times 65 = \text{₹}6,50,000$ \$.

Practical Solved Problem 2 (Economic Order Quantity EOQ Computation): Annual Inventory Demand \$ D = 10,000 \$ units, Ordering Cost per Order \$ S = ₹200 \$, Annual Holding Cost per Unit \$ H = ₹4 \$. Calculate Economic Order Quantity (EOQ) and Total Orders per year.

$$\text{EOQ} = \sqrt{(2 * D * S) / H}$$

Step-by-step Solution:

1. Numerator = $2 \times 10,000 \times 200 = 40,00,000$ \$.
2. Fraction = $\frac{40,00,000}{4} = 10,00,000$ \$.
3. **EOQ** = $\sqrt{10,00,000} = 1,000 \text{ units}$ \$.
4. Number of Orders per Year = $\frac{10,00,000}{1,000} = 10 \text{ orders}$ \$.

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