SOS POLITICAL SCIENCE AND PUBLIC ADMINISTRATION
MBA FA 403
SUBJECT NAME: WORKING CAPITAL MANAGEMENT

TOPIC NAME: OPERATING ENVIRONMENT OF WORKING CAPITAL

WORKING CAPITAL:

- Current assets – Current liabilities
- It measures how much in liquid assets a company has available to build its business.
- A short term loan which provides money to buy earning assets.
- Allows to avail of unexpected opportunities.
- Positive working capital is required to ensure that a firm is able to continue its operations and that it has sufficient funds to satisfy both maturing short-term debt and upcoming operational expenses. The management of working capital involves managing inventories, accounts receivable and payable and cash.
- An increase in working capital indicates that the business has either increased current assets (that is received cash, or other current assets) or has decreased current liabilities, for example has paid off some short-term creditors.

OPERATING ENVIROMENT OF WORKING CAPITAL:

- The operating environment of the working capital as analyzed in the context of monetary, credit and financial policies. The term environment refers to the ‘surroundings’ or circumstances, which affect the life of an object or individual. As applied to business establishments, people talk of various types of environments like micro, macro or mega environments. Some people also talk of internal and external environments. Nevertheless, the term environment is meant, to a large extent, to signify the surroundings or factors that are external to the firm, affecting the ability of the firm in achieving its desired objective. The nature of the environment is such that the firm will have no control on the elements constituting the environment. What the firm can do is to tailor its own policies and practices in such a way so as to gain from the changes taking place in the environment.

- These changes may pertain to economic, legal, social, cultural or ideological aspects. Whatever be the aspect, the firm has to gear itself to meet the challenges posed by the changing environment.
- As applied to working capital decisions, the following elements of environment are considered relevant:

1) Changes in the Monetary and Credit, Policies
2) Changes in Inflation
3) Changes in Financial Markets

MONETARY AND CREDIT POLICIES:

- Monetary policy is the process by which the govt. central bank, or monetary authority of a country controls (i) the supply of money, (ii) availability of money, and (iii) cost of money or rate of interest, in order to attain a set of objectives oriented towards the growth and stability of the economy.
- Monetary policy is the process by which the government, central bank, or monetary authority of a country controls (i) the supply of money, (ii) availability of money, and (iii) cost of money or rate of interest, in order to attain a set of objectives oriented towards the growth and stability of the economy. Monetary theory provides insight into how to craft optimal monetary policy.
- Monetary policy involves variations in money supply , interest rates , lending by commercial banks etc.

CREDIT POLICY

- Credit gives the customer the opportunity to buy goods and services, and pay for them at a later date.
- Clear, written guidelines that set (1) the terms and conditions for supplying goods on credit , (2) customer qualification criteria (3) procedure for making collections , and (4) steps to be taken in case of customer delinquency . Also called collection policy.
- Where delinquency means Failure to repay an obligation when due or as agreed. Thus in consumer installment loans, missing two successive payments will normally make the account delinquent

ADVANTAGES OF CREDIT TRADE:

- Usually results in more customers than cash trade.
- Can charge more for goods to cover the risk of bad debt.
- Gain goodwill and loyalty of customers.
- People can buy goods and pay for them at a later date.
- Farmers can buy seeds and implements, and pay for them only after the harvest.
- Stimulates agricultural and industrial production and commerce.
- Can be used as a promotional tool.
- Increase the sales.

DISADVANTAGES OF CREDIT TRADE:

- Risk of bad debt.
- High administration expenses.
- People can buy more than they can afford.
- More working capital needed.
- Risk of Bankruptcy.

INSTRUMENTS OF MONETARY POLICY IN INDIA:

- Money Supply
- Bank Rate
- Reserve Ratios
- Interest Rates
- Selective Credit Controls
- Flow of Credit

- **Money Supply:** This is the sum total of money public funds and can be used for settling transactions to buy and sell things and make other payments constitutes the money supply of a nation. Money supply = Notes and coins with public + Demand deposits with Commercial papers
- **Bank Rate:** Standard rate at which bank is prepared to buy or rediscount bills of exchange or other commercial papers eligible for purchase under Reserve bank of India Act,1934. The rate of interest charged by central bank on their loans to commercial banks is called bank rate(Discount rate). An increase in bank rate makes it more expensive for commercial banks to borrow . This exerts pressure to bring about the rise in interest rates (lending rates) charged by commercial banks on their lending to public. This leads to a general tightening in economy. Whereas decrease in bank rate has the opposite effect and leads to general easing of credit in the economy.

- **Reserve requirements:** The reserve requirement (or required reserve ratio) is a bank regulation that sets the minimum reserves each bank must hold to customer deposits and notes. These reserves are designed to satisfy withdrawal demands, and would normally be in the form of fiat currency stored in a bank vault(vault cash), or with a central bank. The reserve ratio is sometimes used as a tool in the monetary policy, influencing the country's economy, borrowing, and interest rates .Western central banks rarely alter the reserve requirements because it would cause immediate liquidity problems for banks with low excess reserves; they prefer to use open market operations to implement their monetary policy. Thus central bank makes it legally obligatory for commercial banks to keep a certain minimum percentage of deposits in reserve. These are of 2 types:- 1. Cash reserves 2. Liquidity reserves

- **Interest rates:** This is generally done by stipulating min. rates of interest for extending credit against commodities covered under selective credit control. Also, concessive or ceiling rates of interest are made applicable to advances for certain purposes ago to certain sectors to reduce the interest burden and thus facilitate their development. Further obj. behind fixing rates on deposits are to avoid unhealthy competition amongst the banks for deposits and keep the level of deposit rates in alignment with lending rates of banks for deposits.
- **Selective Credit Controls :** These are Qualitative instruments which are aimed at affecting changes in the availability of credit with respect to particular sectors of the economy. Thus selective controls are called selective because they are aimed at movement of credit towards selective sectors of the economy. The general instruments such as Reserve ratios, Bank rate and open market operations. They are called so because they influence the nation’s money supply and general availability of credit. Quantitative instruments are called quantitative because they affect the total volume(quantity) of money supply and credit in the country.