

Working Capital Management in Small Scale Industrial Units - A Study of Selected Units in A.P.

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Abstract

Working capital planning and control is an integral part of overall financial planning and control. It plays a significant role in attaining the corporate goals in that short term survival which depends upon efficient working capital planning and control is a pre-requisite to long term success working capital planning and control is concerned with the efficient utilization of current assets.

Working capital is the amount of funds which an enterprise requires to finance for day to day operations. It can also be said that is that portion of an enterprises total capital which is employed in short-term operations. The question now arises is that whether such amount should be available at all times in the form of cash? Infact it is not necessary that working capital be only in cash but it is not necessary that working capital be only in cash but it can be in the form of near cash also, which is in the process of moving towards the cash from in short period.

Every developing economy will have immense unutilized natural resources which needs optimum utilization the increase in labour force of rural economy cannot be absorbed for with elsewhere in developing economies due to paucity of economic activity in neighboring areas.

The Industrial policy of a country reflects the directions and patterns of Industrial development that it desires to achieve for socio-economic and political objectives of the country.

Small scale Industries (SSIS) have to play a catalyst role in bringing out Industrial and wide dispersal possibilities. SSI units require relatively less capital and could utilize the local resources of backward regions more effectively by providing potential employment opportunities for the mass of unemployed in the economy.

Several Entrepreneurship development programs had been started to develop the skill, knowledge on competence along with entrepreneur inspite of major entrepreneurship development programmes launched by the government and non-governmental agencies. The entrepreneurs are encountering a number of problems for establishing for economically viable small scale industries like lack of physical facilities like communication transport and storage, lack of quality control measures, non-availability of right type of raw material, lack of managerial competence, poor linkage with marketing bodies, lack of trained workers, low scale of production, long and complicated procedures to avail institutional help, lack of government support and incentives (Shehrawat, 2006).

Every industry needs working capital to run the day to day business activities, particularly in Small Scale industries. The enterprise is going to collapse without adequate supply of working capital. According to SC Kanchal, working capital is business enterprises may be compared to the blood of the human body, blood gives life and strength to the business organization. It has been pointed out RBI that a firms profitability may be increased as more working capital is added to fixed capital provided the firm does not exceed cent percent capacity to examine the needs to working capital basically there are two types of permanent as well as temporary working capital to examine the source of working capital there are three sources such as long term, short term and transitory source.

Keywords: financial planning, working capital, short term finance, business activity, entrepreneurship.

Introduction

Proper management of working capital is very important for the success of an enterprise. It aims to protect the purchasing power of the respective assets and maximizes the return on Investment. Constant management is required to maintain the various working capital components at appropriate level. Shortage of working capital which has become main cause for the failure of concerns is due to either mismanagement or poor management of the working capital manufacturing units of small scale sector claim for a very large portion of their total investment is current assets. With efficient management of working capital not only it improves the profitability of a concern but also reduces its dependence for funds either on commercial banks or on personal borrowings. For earning a reasonable rate of return the functional complementary, proportional and technical roles of working capital play a great part. It is the working capital which generates revenue for business depends upon the manufacturing cycle as well as on collection cycle.

Working capital has also a technical role to play in maximizing the rate of return, when a firm has not reached its full installed capacity, its profitability can be increased by increasing its working capital to the fixed capital. This it Indicates that for a given fixed capital investment with and increased working capital optimum utilization of fixed assets is ensured.

Structure of Working Capital

Cash is a prominent component of working capital both as a means and an end for an enterprise since cash has only everlasting purchasing power of men, material and other factors. It can alone keep the operation of a business without stoppage. Inventories occupy the most strategic position in the structure of working capital maximization of Income of an enterprise mainly depends upon the turnover of working capital. Turnover of working capital in turn is determined by the turnover of Inventories therefore inventory is acknowledged as most important item in current assets. The term "Inventory" according to the American Institute of accountants designates the aggregate of those items of tangible personal property which (i) are held for sale in the ordinary course of business; (ii) are in the process of production for sale or; (iii) are to be currently consumed in the production of goods or services to be available for sale.

Here it is proposed to study the management of basic elements of current assets viz, inventory, cash, cash and receivables.

Inventory comprises of raw material, supplies, goods in process and finished goods. It must be noted that maximization of profit largely depends upon the optimum use and allocation of working capital in the above mentioned components of inventory.

Though raw materials have to be stored to provide for an uninterrupted flow of production and also to gain the economies of purchases, but excessive investment in raw materials will lead to locking up of funds, which causes an enterprise to bear the burden of carrying cost and also loss in physical deterioration.

The following are constituent parts of working capital current assets.

1. Inventories:
 - Raw material and components
 - Work-in-progress
 - Finished goods
2. Accounts receivable
 - Trade debtors
 - Loans and advances and others
3. Investments short term securities
4. Cash and bank balances
 - Cash on hand
 - Bank Balance

Analysis of Working Capital

In Allwyn working capital comprises Inventories receivables and loans& advances, cash of Bank balances and other current assets. The current liabilities include acceptances, sundry creditors, unclaimed dividends trade advances, other liabilities like Interest accrued but not due loans of deposits, provision for taxation proposal dividends and bonus to be paid.

Importance of SSI

Starting from the first five year plan itself SSI sector has been assigned an important role, which can be seen from the actual outlay made for the development of this sector over a plan period Even though the outlays made for this sector registered a phenomenal growth from the beginning of first plan. But in relative terms the (%) percentage share in the total plan outlay is not significant as it varied between 1.3% to 4% of the total plan outlay.

The importance assigned to small scale sector can be gauged from the plan out lay for the sector increased by 30%, which explains the role of SSI units as catalyst in the proposed gigantic Industrial development programme of the plan. There was marginal increase in the outlays made for this sector over the previous plans.

An answer to the problems of developing economies is to promote Industries in such a manner which will bring down the regional disparities socio economic justice to the people. In this context the role of small scale Industries keeping in view its unique features will be

the means to cure several ills of the economy. With the expansion of this sector even unskilled and semi-skilled persons could also be employed effectively in labour surplus economies. In India under every 5 year plan significant Importance is being given for the development of SSIs in the economy.

Growth of SSI Sector in India

With the policies and programmes followed during the plan period. The growth of the sector can be visualized the number of SSI units increased by 46 times during first plan to sixth plan period. 1986-87 the growth in terms of registered units discloses 98.5% Increase. In the first 2 years of seventh plan period the number of registered SSI units increased by 17.3. Besides the Increase in the number of registered units the out put of the sector also discloses significant progress. At the end of the first plan value added by this sector at current prices was Rs.8.40 crores. This was increased to 15,790 crores by the end of the fifth plan, end of the seventh plan it was increased 29,350 crores.

This industrial system is more suitable to the labour surplus economy as such SSI units require relatively lesser capital and Technology than the large scale units and provides more employment for the capital Invested. Total man power employed under this sector at the end of second five year plan period was 10.61 lakhs and this increased to 63.8 lakhs by the end of the fifth plan. This discloses a six times increase over the first plan to fifth plan period. At the end of the sixth plan the total manpower employed was 90 lakhs which was 1.4 times more over the previous plan achievement. Further, during the first two years of seventh plan period there was about 11.6% increase in certain of the employment under this sector over the previous plan position. It is also estimated that at the end of this year. This sector would be employ around 709 lakhs persons. With this phenomenal employment potentiality the sector provides further scope for the upliftment of society with the higher standards of living.

This sector besides creating large employment potentiality and contributing a significant share in the total gross National Product, also enables to earn significant amount of foreign exchange to the exchanger.

More impressive than the above information that very wide variety of products are being manufactured in the small scale sector during the recent years beginning with the production of simple consumer goods, by this sector, it branched off to the products with a higher degree of precision and also capital equipment needed by SSI sector.

Growth of SSI in Andhra Pradesh

An attempt is made here to project growth of this sector in the state of Andhra Pradesh as the study restricted its area to the state. In Andhra Pradesh the total number of registered units were 41,081 at the end of the sixth plan of this 43.5 percent were in coastal Andhra region about 44.5 percent were in Telangana region and 12 percent were in Rayalaseema region. The progress of the registered units over the plan period discloses during fourth, fifth, sixth, seventh, plan periods an average of 4,400 units were registered in each plan period. At present 9,600 units are registered in each plan period.

For the development of the sector with the assistance provided by various institutions the total investment made under this sector over the plan period discloses that by the end of last plan period 34.7 percent was in coastal Andhra Pradesh, 56.1 percent was in Telangana region and 9.2 percent was in Rayalaseema region.

With regard to the creation of employment by this sector in the state discloses that at the end of last plan period 37.3 percent was in coastal Andhra region, 52.7 percent was in Telangana region and 10 percent was in Rayalaseema.

The employment potentialities of this sector increased from fourth plan period in coastal Andhra but in Telangana region it decreased as it was relatively than the employment generation made during the third plan period under this sector.

Since the state is basically on agricultural sector, the scope for the development of agro-based Industries is quite favourable. Based on this hypothesis the growth of this sector from line of activity is being examined.

Objectives of the Study

- i) To assess in general, the overall liquidity and profitability of the selected units
- ii) To examine specifically, whether the selected units utilised the investment in current assets effectively or not
- iii) To enquire into the marketing potentials of the entrepreneurs based on the past performance of the sample units in relation to the general sales performance of the product of the industry
- iv) to enquire into the forecasting techniques, if followed by the entrepreneurs in formulating production and marketing programmes
- v) To enquire into the utilisation of cash resources as to ensure an effective operation of cash cycle

Review of literature

Though the literature on working capital management of selected enterprises in both public and private sector is numerous but pointed exposition of the problems of working capital management in SSI units in Andhra Pradesh is scant and peripheral. Even the studies made on working capital management in SSI units - in Andhra Pradesh have paid the attention either to one line of activity i.e., electrical or metal industry or compound line of activity with the units situated in Industrial Estates or outside pertaining to the problems of inventory management or cash and receivables management as exclusive studies or exhaustive studies comprising of all the components of working capital. Most of the studies have pointed out the financial position with the help of ratio analysis with regard to inventory and receivables management. Studies which attempted to identify the causes for ineffective management of working capital and the importance of availability of know-how on working capital management is not much found. An attempt is made here to present a brief review of some of the literature on working capital management, but not to give up the importance of those literature which are not quoted here, due to the limitation of the scope of the study.

A detailed study was made by Dr. R.K. Mishra, on problems of working capital management of selected public enterprises in India. Similarly, a study was made by N.K. Agarwal, on the management of working capital in selected undertakings of the private sector in India. - Further, Dr. K. Rajeshwar Rao made a study on Working Capital Planning and Control in Public Enterprises In India. Most of these studies have thrown light upon the aspects of controlling measures followed in the respective sectors and their differences have been highlighted.

In addition to these studies, Dr. Ghan Shaia Panda made a study on management of working capital in SSI units. It is one of the important contributions on working capital management with specific reference to SSI. He pointed out in his study that the poor performance of SSI units is due to ineffective management of working capital. He highlighted the problems of working capital in small manufacturing companies. Basically, it is a study of sources and problems of raising working capital. Similarly, Dr. N.M. Khandalwal also made a study on working capital management in SSI selected units by making analysis of the component of working capital by shedding light upon financing problems and working capital management practices adopted by the selected sample units. He opined that SSI units start with inherent weakness of lower shock bearing capacity as compared to large scale units, any trouble in the area of working capital management becomes a major factor contributing to higher degree of incidence of sickness.

Besides the above, Dr. Radhe Pradhan made a study on management of working capital which is also on the same line with that of other studies but the sample units are from public enterprises of Nepal. He has studied structure and utilisation of working capital and also estimated demand functions of working capital. His study throws light upon the risk-return-trade off in working capital management of sample units.

Further, the work done for M.Phil. and Doctoral degree of various Indian Universities on the subject of working capital management was either in general or with specific reference to public or private sector or any specific sector. A good number of research articles had been published in reputed journals at various times. In this regard, John Sagan's article in Journal of Finance indicated the need to build up a theory of working capital and the emphasis was laid on cash management. He suggested that preparation and analysis of cash flow schedule was a basic factor to achieve success in cash management.

James E. Walter emphasised in his study that the lower the level of liquid assets, the greater the risk of not being able to meet current obligations.

Conclusion

The problem of working capital management of small scale industries is not new it is prevailing in India. The Small scale industrial units are low capital base where investment on fixed assets found to be less without the help of government support and financial institutions co-operation, it is very difficult to solve the problems of working capital management of small scale industrial in selected units of Andhra Pradesh.

Small scale industries tend to collapse few years after they have been established or at best perform poorly in subsequent years lack of adequate financial resources, renovation one of the perennial problems affecting the development and organization of entrepreneur activities in Andhra Pradesh for expectation of business.

The financial institutions should monitor the savings habits or their clients especially their peak and lean periods and improve their advisory services to enable the entrepreneurs invest in short term instrument. The small scale industries should use their associations in a cooperative manner to procure inventory by so doing they can take advantage of bulk purchase and also reduce cost of operations especially.

References

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