

Al-Saudia Virtual Academy
Pakistan Online Tuition

(9) FACTORS INFLUENCING WORKING CAPITAL OF A BUSINESS

What is working capital?

Working capital is a short term capital which is required to cover the cost of operating an enterprise. The need for working capital arises due to the time gap between production and realization of cash from the sale of goods in the market. A business needs working capital for the purchase of (i) raw materials (ii) payment of wages, gas, electricity bills (iii) meeting the costs of packing and advertising (iv) maintaining the inventories of stocks such as raw material, stores and spares, finished goods etc. in other words, it is the capital which is utilized in meeting current liabilities by cash payment in the ordinary course of business.

The need for working capital in a business is constant. It is necessary for the smooth running of a business. It helps in continuity of production. It also enables a business to earn good name in the market. It helps the business to face crisis. It also helps in creating an environment of security, confidence, and high moral and overall efficiency in business. In balance sheet terms, working capital is shown as the difference between current assets and current liabilities.

Factors affecting working capital.

The amount of working capital required by a business depends upon a number of factors, which in brief, are as under.

- (1) Nature of business. The amount of working capital required depends upon the nature of business. A trading concern, for instance, requires less amount of fixed capital but more amount of working capital to invest in current assets such as stocks, receivables etc. whereas, public utility undertakings such as Electricity, water supply need limited amount of working capital for meeting current or day to day expenditure.
- (2) Size of business. The amount of working capital depends upon the size of business. The greater the size of business unit the larger is the requirement of working capital and vice versa.
- (3) Time of manufacturing. If in a business, the time taken for final production of a good is very long such as ship building, locomotives etc., the amount of working capital required is large to pay the bills of labor, raw material, electricity, gas etc. in case the time required to manufacture a product is short such as bakery industry, ice cream concerns, etc, the requirement of working capital is small.
- (4) Terms of conditions for purchase and sales. If a business concern is able to purchase the goods on credit and sells it on cash, it will need less amount of working capital. However,

if a business is paying for goods in cash and does all buying and selling of goods on credit, it obviously needs more working capital.

- (5) Size of labor force. If the size of labor force employed in the production of a goods is fairly large for instance, in brick making, football sewing etc. the business will need a greater amount of working capital. On the contrary, in highly mechanized industries, the amount of working capital required is comparatively less than labor based industries.
- (6) Turnover. If in a business, the sale is faster i.e. large turnover, the requirement of working capital is then small as more money is realized through rapid sales. However, in a business if the sales move up slowly or the turnover is slow, then it will require more working capital for the smooth flow of business.
- (7) Stock position. In certain industries like cotton, cement industry etc which keep huge stocks in raw material or in finished goods, they therefore need a huge working capital.
- (8) Seasonal variations. In certain industries like cotton, rubber etc, the raw material is not available throughout the year. These industries purchase raw materials in bulk in production season and process them during the entire year. A huge amount of working capital is blocked in the form of material inventories during such seasons which given rise to more working capital requirements. Generally, these industries require larger working capital for the purchase of raw material and then it is reduced in the processing period.
- (9) Competition in the market. The present ay business is characterized by mass production and is faced with stiff competition in the market. The business concerns, changing the design and quality of goods and for inventory of stocks.
- (10) Price level changes. If the price level is rapidly rising in a country, the business will require larger amount of working capital to maintain the same level of current assets.