

KNOWLEDGE SESSION

27 APRIL
2019
5:00 PM

Venue
TiE Rajasthan Office
C -97, Janpath, Lal Kothi, Jaipur

WORKING CAPITAL

**THE LIFE BLOOD OF ANY BUSINESS
IN ANY SECTOR**

Prevent **BUSINESS FAILURES**
by learning how to manage and
optimize working capital.

Led by
Dr. Ravi Modani
Founder & MD, 121 Business Finance

Working Capital

The life line of every business

**The more you work, the more you
need working capital !**

Short Term Pains, are Long Term Gains!

Short Term Gains, are Long Term Pains!

औछी पुँजी धनि ने ख़ाए !

अमीर बाप की बिगड़ी औलाद !

What you can't measure, you cannot manage!

What is Working Capital

Working capital is the money required to run the day-to-day operations of a business

Working capital also called as circulating capital or current capital

Current Assets

- Inventories
 - Raw Materials
 - Work-in-progress
 - Spare Parts
 - Finished Goods
- Accounts receivables
 - Debtors, below 90 days
 - More than 90 days
- Cash and Bank Balance
- Short term Investments
- Prepaid Expenses
- Loans & Advances

Current Liabilities

- Creditors for Goods, Services, Expenses
- Outstanding Payment
- EMI's & Interest payments loans
- Bills Payable
- Bank Overdraft/CC limits
- Short-term Loans
- Proposed Dividends

- Provision for Taxation, etc.
- As per accounting norms, all 1 year repayment of loans are considered as CL

Gross Working Capital = Total Current Assets

Net Working Capital = Excess of Current Assets over Current Liabilities

Deficit Working Capital = Excess of Current Liabilities over Current Assets

So when we talk about WC it is the Gross WC, or the qualitative type, but when we measure it, it is the quantitative type or the Net WC, ie CA-CL

Fixed Assets are the Hardware,
Current Assets are the Software!

Working Capital/Blood Test Parameters

1. Current Ratio
2. Quick Ratio
3. Quick Assets as % of Current Assets
4. Inventory Turnover Ratio
5. Inventory as % of Current Assets
6. Number of days inventory being carried
7. Average Receivables as number of days of Sales
8. Debtors as % of Current Assets
9. Working Capital Turnover Ratio

CURRENT RATIO “ Working Capital Ratio”

This gives the overall state of affairs of a Business

How To Calculate

Current Assets/Current Liabilities

Good Range

BEST - 2:1

GOOD - 1.5:1

CAUTIOUS - 1:1

SOMETHING WRONG - 0.75-0.9::1

Anything below $<0.50:1$, means the business is about to collapse

QUICK RATIO “ ACID Test Ratio

This gives a more realistic and an instant picture about the liquidity of a business

How To Calculate

Quick Assets/Current Liabilities

Good Range

BEST - 1:1

GOOD - 0.85:1

CAUTIOUS - 0.75-0.85:1

SOMETHING WRONG - 0.5-0.75::1

Anything below $<0.5:1$, something terribly wrong

- **INVENTORY TURNOVER RATIO**

Net Sales/Average Inventory

- **INVENTORY CYCLE**

(Inventories/Net Sales) x 365 Days

- **AVERAGE DEBTORS CYCLE**

(Sundry Debtors/Net Sales) x 365 Days

- **WORKING CAPITAL TURNOVER RATIO**

Net Sales/Net Working Capital

General Ratio of Current Assets Across Businesses

Current Assets (%)	Fixed Assets (%)	Industries
10-20	80-90	Hotels/Restaurants/Hospitals
20-30	70-80	Electricity Generation and Distribution
30-40	60-70	Aluminium, Shipping
40-50	50-60	Steel, Basic Industry, Cement etc
50-60	40-50	Tea Plantation
60-70	30-40	Cotton Textiles, Sugar
70-80	20-30	Edible Oils, Tobacco, FMCG
80-90	10-20	Trading, Service Industry

Standard Ratio Range

		BEST	CAUTIOUS	DANGER	CEMENT
LIQUIDITY MANAGEMENT					
Current Ratio	Current Assets/Current Liabilities	2:1	1:1	<0.75:1	1.921
QUICK ASSETS MANAGEMENT					
Quick Ratio	Quick Assets to CL	1:1	0.75:1	<0.5:1	0.851
Quick Assets to CA	Quick Assets/CA	>40%	25%	<10%	44.30%
Cash to CA		1%	0.75-1%	<0.75%	0.91%
Cash to CL		2%	1.5-2%	<1.5%	1.74%
INVENTORY MANAGEMENT					
Inventory turnover	Net Sales/Average Inventory	>6	5	<4	6.475
Inventories as % of CA	Inventory/CA	<25%	25-40%	>40%	27.53%
No. of Days Inventories being carried	Inventory/Av Daily Sales	<35 days	40-60	>65	56.370
DEBTORS MANAGEMENT					
Average Receivable as number of days sales					16.499
Debtors as % of CA	Debtors/CA	<15%	15-35%	>35%	8.06%

Standard Ratio Range

		BEST	CAUTIOUS	DANGER	SHREE CEMENT
WORKING CAPITAL MANAGEMENT					
Working capital turnover	Sales/WC	>7	4-7	<4	3.717
Debtors-Creditors					-268
Interest as % of Sales					1.33%
Net Worth					8897
Debt Long Term					2208
Debt Equity Ratio					1.702
Total Assets / Liabilities					15142
Current Assets as % of Total Assets (BS side)					37.65%

Comparison of Ratios	JVL Agro	Infosys	Jet Airways	ITC	Shree Cements	Apollo Hospitals	RIL	Indian Hotels
CURRENT ASSETS AS % OF TOTAL ASSETS (BS SIDE)	80.21%	62.61%	56.35%	41.05%	37.65%	25.78%	22.51%	13.01%
LIQUIDITY MANAGEMENT								
Current Ratio = CA/CL 2:1 is good	1.155	3.546	0.503	2.853	1.921	1.417	0.586	0.875
QUICK ASSETS MANAGEMENT								
Quick Ratio = Quick Assets to CL	0.171	2.333	0.178	1.602	0.851	0.406	0.224	0.514
Quick Assets to CA = Quick Assets/CA	14.81%	65.80%	35.36%	56.16%	44.30%	28.63%	38.25%	58.70%
Cash to CA	14.81%	26.33%	4.40%	0.58%	0.91%	13.80%	2.32%	17.04%
Cash to CL	17.11%	93.36%	2.21%	1.65%	1.74%	19.55%	1.36%	14.92%
INVENTORY MANAGEMENT								
Inventory turnover	4.393	-	50.264	6.363	6.475	14.569	6.711	47.872
Inventories as % of CA	54.77%	0.00%	6.68%	28.40%	27.53%	25.49%	33.10%	7.03%
No. of Days Inventories being carried	83.09	0.00	7.26	57.37	56.37	25.05	54.39	7.62

Comparison of Ratios	JVL Agro	Infosys	Jet Airways	ITC	Shree Cements	Apollo Hospitals	RIL	Indian Hotels
DEBTORS MANAGEMENT								
Average Receivable as no. of days Sales	28.71	68.02	19.07	20.53	16.50	39.17	15.69	29.22
Debtors as % of CA	18.92%	26.28%	17.55%	10.16%	8.06%	39.85%	9.55%	26.94%
WORKING CAPITAL MANAGEMENT								
Working capital turnover = Sales/WC	17.936	1.964	-3.402	2.782	3.717	12.627	-3.139	-23.596
Debtors-Creditors	-773	12448	-5433	-814	-268	296	-89306	-23
Interest as % of Sales	1.64%	0.00%	3.46%	0.19%	1.33%	3.58%	1.97%	6.56%
Debt Equity Ratio	3.58	1.23	-1.81	1.22	1.70	2.65	2.78	1.89
Net Worth	613	64924	-7139	52510	8897	3252	293506	4958
Debt Long Term	12	61	5086	12	2208	2924	144175	2329
Total Assets / Liabilities	2195	79890	12955	64289	15142	8613	816348	9375

SHREE CEMENTS	2018	2017	2016	2015	2014
NET WORKING CAPITAL	2733	1293	1068	872	858
Current Assets as % of Total Assets (BS side)	37.65%	29.39%	23.95%	29.79%	32.93%
LIQUIDITY MANAGEMENT					
Current Ratio = CA/CL	1.921	1.650	1.704	1.596	1.588
QUICK ASSETS MANAGEMENT					
Quick Ratio = Quick Assets to CL	0.851	0.429	0.318	0.396	0.638
Quick Assets to CA = Quick Assets/CA	44.30%	25.97%	18.66%	24.79%	40.19%
Cash to CA	0.91%	1.39%	13.93%	11.59%	9.14%
Cash to CL	1.74%	2.29%	23.74%	18.51%	14.52%
INVENTORY MANAGEMENT					
Inventory turnover = Net Sales/Average Inventory	6.475	7.224	6.873	7.079	7.856
Inventories as % of CA	27.53%	40.05%	40.44%	38.22%	31.94%
No. of Days Inventories being carried	56.37	50.52	53.11	51.56	46.46
DEBTORS MANAGEMENT					
Average Receivable as number of days sales	16.50	12.88	22.76	24.95	18.91
Debtors as % of CA	8.06%	10.21%	17.33%	18.49%	13.00%

SHREE CEMENTS	2018	2017	2016	2015	2014
WORKING CAPITAL MANAGEMENT					
Working capital turnover = Sales/WC higher the better	3.717	7.344	6.724	7.242	6.774
Debtors-Creditors	-268	-17	116	165	140
Interest as % of Sales	1.33%	1.36%	1.47%	1.95%	2.51%
Debt Equity Ratio	1.70	1.45	1.41	1.40	1.57
Average WC	2013	1181	970	865	
Quick Assets	2525	852	482	578	931
Average Inventory	1442	1180	968	816	
Cash Profit	2284	2554	1703	1348	1363
Current Assets	5700	3282	2584	2333	2317
Current Liabilities	2967	1989	1516	1461	1459
Inventories	1569	1315	1045	892	740
Sundry Debtors	459	335	448	431	301
Net Worth	8897	7698	7646	5575	4494
Debt Long Term	2208	519	621	413	446
Total Assets / Liabilities	15142	11166	10788	7831	7037

Who feeds Working Capital, Cash or Profit?

**Turnover is Vanity,
Profit is Sanity,
Cash flow is Reality**

When to get the WC analysis done?

Why businesses Fail ?

BECAUSE of MISMANAGEMENT of THEIR SHORT TERM FUNDS!

Short term funds means both surplus or deficit. If the right decisions or prudence is to shown, then the deficit can be converted into surpluses and vice versa!

Common Mistakes in Working Capital Management

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PROBLEMS OF EXCESSIVE WORKING CAPITAL

1. Unrelated Diversification : The moment you start showing that you are richman's son, you start getting consultants with ideas, which are unrelated and not to core
1. Diversion of Funds: Into investments, drawings, etc.
1. Heavy investment in fixed assets: A concern may invest heavily in its fixed assets which is not justified by actual sales. This may create a situation of over capitalisation
1. Reckless purchase of materials :Inventory is purchased recklessly which results in dormant slow moving and obsolete inventory, watages, etc.
1. Speculative Tendencies: Speculative tendencies may increase, adventure in nature of trade
1. Liberal Credit : Due to liberal credit, size of accounts receivables will also increase. Liberal credit facility can increase bad debts and wrong practices will start, regarding delay in payments.
1. Carelessness: Excessive working capital will lead to carelessness about costs which will adversely affect the profitability

औछी पुँजी धनि ने खाए !

PROBLEMS WITH SHORT WORKING CAPITAL

Paucity of working capital is also bad and has the following dangers

1. Implementation of operating plans becomes difficult and a concern may not achieve its profit target.
1. Bargaining capacity is reduced in credit purchases and cash discount could not be availed.
1. An enterprise loses its reputation when it becomes difficult even to meet day to day commitments.
1. Operating inefficiencies may creep in when a concern cannot meet its financial promises.
1. Stagnates growth as the funds are not available for new projects.
1. A concern will have to borrow funds at an exorbitant rate of interest in case of need.
1. Sometimes, a concern may be bound to sale its product at a very reduced rates to collect funds which may harm its image.

Why Businesses Fudge their books for Current Assets

- Siphoning off of funds
- Black holes - losses; bad debts; stock markets;
- Fraud/Criminal intentions
- USL, high leverage, covering of losses
- Cash Component in business leading to poor control
- Drawings from Business without ascertaining the profits
- Vicious circle of interest cost, debt trap

STATEMENT OF WORKING CAPITAL OF GTC INDUSTRIES LTD.

(Rs. In Lakhs)

	1989-90	1990-91	1991-92	1992-93	1993-94
CURRENT ASSETS	A				
Inventory – Raw Material	3090.25	3020.84	2358.00	2477.84	2500.88
Inventory – Work in Progress	1483.47	70.27	98.51	96.83	155.11
Inventory – Finished Goods	87.90	160.68	179.20	333.58	604.31
Inventory – Other	273.35	1364.13	1158.40	1232.25	1122.99
Trade Receivables	5256.46	5903.47	6686.36	6837.85	8990.60
Loans & Advances	1558.20	2167.13	2891.89	6714.15	8965.01
Cash & Bank Balances					
	11749.63	12686.52	13372.36	17692.5	22338.90
Reported Net Profit	539.64	705.13	934.49	974.4	1202.2
CURRENT LIABILITIES	B				
Current Liabilities & Provisions	6143.33	6202.85	4937.20	8318.79	9070.27

Do's & Don't for Effective WC Management

- उधारी राम v/s नगदी राम
- No जुगाड़ ; let the जुगाड़ be on the shop floor and not on your financial books
- Don't use short term funds for long term use
- DO NOT DIVERSIFY - FOCUS - Use the Power of Focus - expansion is different than diversification
- Debt is not a liability, it is an asset! Use Assets judiciously
- You do not get anything for free, if you are Debt Free!
- Working Capital is for hard working managements
- Corporate Governance/Ring Fence Business
- Have Financial Coaches, not advisors!

Financial Control/Changes for good WC Management

- Apart from Production/Sales, start to monitor the **Current Ratio** of your business
- Start to Work on Cash BEP instead of general BEP
 - Use EMI as Fixed Costs instead of just Interest component
- Start to work for your Business- Draw Salary, just as you pay to others and take dividends like you give bonus to staff
- If there has been any loss, immediately recoup it by additional equity/cash from asset sale
- Absolute is important than Relative %

Thank You

KNOW YOUR SPEAKER

Dr. Ravi Modani



Dr. Ravi Modani, is an expert in Working Capital Management, Capital Structuring and Balance Sheet Analysis. He is the Founder and Managing Director of 121BusinessFinance.com, registered as a NBFC, called Yarrow Finance & Investments Pvt Ltd., which is World's 1st NBFC for Very Short Term Working Capital Finance.

He is a 3rd generation entrepreneur, with a diversified business knowledge, spanning more than 27 years, across domains as diverse as Minerals to Money Market. He has had a global business experience, have been managing manufacturing on 2 continents, having done business with 32 countries, advised/have been part of companies doing IPO's, GDR's etc..

He has done his Doctorate on Working Capital Management on Tobacco Companies in India; has studied more than 1000 IPO's and several thousand companies since 1989. While Finance remains his core, he also loves to develop Systems and Processes and Marketing strategies.