RAMA UNIVERSITY

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FACULTY OF COMMERCE AND MANAGEMENT

COURSE: BCH V SEM..

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LECTURE-34

WORKING CAPITAL POLICY

Working capital policy can also be known as working capital management. Working capital management refers to a strategy which mainly focus on maintaining adequate level of current assets and current liabilities in a firm, so that appropriate level of working capital can be maintained.

The ratio helps to examine the following alternative working capital policies:

1.Conservative Policies: Assuming a constant level of fixed assets, a higher current assets to fixed assets ratio, refers to conservative policies. It indicates the firm's sound liquidity position and lower risk to meet its current obligations and investments. This policy is also termed as flexible policy. It also indicates that the current assets are efficiently utilized at every levels or output.

Conservative Policy Indicates

(i) Sound liquidity
(ii) Lower risk
(iii) Current assets are efficiently utilized in production
(iv) No bottlenecks in production, because of the mainetenance of huge stock
(v) Prompt payment of accounts payable, because of huge liquid cash in hand

2. Moderate Policies: Moderate policy is otherwise termed as average current assets policy. This ratio occurs between higher and lower ratio of current assets to fixed assets ratio. In other words, the current assets policy of most firms may fall between the conservative policies and aggressive policies. This indicates moderate risk and average liquidity position of a firm.

Moderate Policy Indicates:

(i) Moderate risk
(ii) Average liquidity position
(iii) Current assets are used in production
(iv) Maintenance of stock of raw materials, work-in-progress

and finished goods are at an average level.

3. Agressive Policies: Lower level of current assets to fixed assets ratio represents aggressive policy. This aggressive policy indicates higher risk and poor liquidity position of a firm. It also indicates that the current assets are inefficiently utilized at all levels of output. This policy is also termed as restrictive policy.

Aggressive Policy Indicates

- (i) Poor liquidity position
- (ii) Higher risk
- (iii) Current assets are utilized at lowest in all levels of output
- (iv) Maintenance of small stock levels
- (v) Declining size of sales because of rare credit sales facilities
- (vi) Stoppage and bottlenecks in production, due to lack of stock
- (vii) Slower accounts payable payments, because of low cash balance in hand