



# RAMA UNIVERSITY

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**FACULTY OF COMMERCE AND MANAGEMENT**

**COURSE: MBA III SEM..**

**SUBJECT: WORKING CAPITAL MANAGEMENT**

**SUBJECT CODE: MBAFM01**

**LECTURE: 17**

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## LECTURE-17



## **Need to Hold Inventories:**

Holding of inventories involves tying up funds of the company and storage and handling costs.

There are three general motives for holding inventories:

(i) The Transactions Motive:

It expresses the need to maintain inventories to facilitate production and sales operation smoothly.

(ii) The Precautionary Motive:

It necessitates holding of inventories to guard against the risk of unpredictable change in demand and supply forces.

(iii) The Speculative Motive:

It influences the decision to increase or reduce inventory levels to take advantages of price fluctuations. In order to maintain an uninterrupted production it becomes necessary to hold adequate stock of materials since there is a time lag between the demand for materials and its supply due to some unavoidable circumstances.

Besides, there are two other motives for holding of inventories — viz., to receive the benefit of quantity discount on account of bulk purchases and to avoid the anticipated rise in price of raw material.

The work-in-progress builds up since there is production cycle. Actually, the stock of work-in-progress is to be maintained till the production cycle completes. Similarly, stock of finished goods has also to be held since there is a time lag between the production and sales.

When goods are demanded by the customers, it cannot immediately be produced and as such, for a continuous and regular supply of goods, minimum stock of finished goods is to be maintained. Stock of finished goods should also be maintained for sudden demands from customers and for seasonal sales.

Therefore, **the primary objectives of holding raw materials are:**

- (i) To separate purchase and production activities and for holding finished goods there should be a separate production and sales activities;
- (ii) To obtain quantity discount against bulk purchases, and
- (iii) To avoid interruption in production.

At the same time, work-in- progress inventory is necessary since production is not instantaneous and finished goods should also be maintained for: (i) serving customer on a continuous basis; (ii) meeting the fluctuating demands.