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MANAGEMENT OF WORKING CAPITAL AS A PART OF FINANCIAL MANAGMENT

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Summary

The article analyzes the definition and structure of current assets of an enterprise. It sets the optimum structure of assets to ensure the continuous production, getting a high financial results, that will increase the financial stability of the enterprise and increase the profitability of products and production.

Keywords: current assets, enterprise, optimum structure, financial results, financial stability, the profitability of products and production.

Introduction. In conditions of market relations, current assets are particularly important as they are a significant factor in determining the profits of the enterprise. It is also important to know how to manage working capital, develop and implement activities to help reduce the material intensity of products and accelerate working capital turnover. The company effectively managing its and another working capital can achieve good economic situation, as well as well-balanced liquidity and profitability. Hence, the importance of a problem of the organization of the analysis of current assets is unconditional.

The article aims at analyzing the definition and structure of current assets of an enterprise and setting the optimum structure of assets.

The current assets and fixed assets ensure the activity of the enterprise. If there is no current assets – there is no production. Through a high inflation the needs of the

enterprise in current assets are constantly growing through the growth of prices for material resources, planned reserves that a company should generate. Therefore, the enterprise should monitor the presence in the economic turnover the volume of own capital and the rationality of its use for realization of successful production activity.

Theoretical, methodological and practical problems of the organization of economic analysis of current assets in the company were studied in scientific works by S. Vasylenko, I. Kostenko, L. Cannon, G. Smith, L. Beet, F. Butko, O. Wasylyk, A. Danilenko, A. Ivakhnenko, K. Korobov, C. Metz and others.

Research methods. A variety of theoretical and statistical sources of information have been processed for the study of the optimal structure of current assets. Calculations were made of the basic indicators of economic activity such as profitability indicators, indicators of financial stability, liquidity, business activity, that gave a clear set of policy financing of assets.

Results and discussion. In economic literature, there are different approaches to defining the essence of working capital. A.Birman considered cost nature of current assets, namely monetary. He defined current assets like “the assets of the enterprise invested in current production assets and funds of the reference, constitute the company's circulating assets”.

A. Barngolt later gave a definition that current assets are cash funds advanced for the creation of reserves the working capital funds and funds of the reference, low-value items and those that wear out quickly (within their cost, which includes depreciation) required to support a continuous circulation.

Working capital management is an integral part of overall financial management. It includes a number of aspects that makes it an important topic for study. It has also been considered as the life blood and controlling nerve centre of a business. Constant management is required to maintain appropriate levels in the working capital accounts.

The current assets of the enterprise are heterogeneous in its composition, in particular, among those are a tangible items, cash and quite intangible assets.

The current assets of the enterprise have such components:

1) Inventories inventory generally constitutes a major portion of current asset. The profitability of the business to a larger extant depends upon the turnover

of the working capital and this in turn depends upon the turnover of the inventory. The term "inventory", means the aggregate of those items of tangible personal property which are held for sale in the ordinary course of business, are in the process of production of sales, or are to be currently consumed in production of goods or services to be available for sale. The inventory according to the above definition includes the following raw materials, work-in-progress and finished goods.

2) Finished goods. It is very important to maintain a proper level of finished goods in a concern. Danger would be felt on situations of excess or lower inventory. If a firm does not have enough stock of finished goods, it will not be in a position to meet sudden demands of customers. It may sometimes lose sales because the needed stock of finished goods may not immediately be available. It may be economical to hold a reasonable quantity of finished goods. The flexibility afforded by such an inventory makes it possible for a firm to meet sudden or unanticipated demand of customers relatively at lower costs.

3) Trade and other receivables. In most of the business organizations, the bulk of sales would be on credit. This is probably because of the fact that when liberal credit facilities are made available, the sales would increase. In this sense, receivables play an important role in ensuring a higher turnover for the firm concerned. The practice of carrying receivables has a few advantages as the reduction of collection costs over cash collection, reduction in variability of sales, and increase in the level of near term sales.

4) Short-term investments. A business with positive cash balances can either hold them in the bank or invest them for short periods – perhaps by placing them on short-term deposit.

5) Cash and cash equivalents – the actual cash balances that the business has! The final element of working capital required by business concerns is a fund of liquid resources to meet day-to-day expenses. There must be money to meet the weekly payroll and to pay trade accounts which come due[5].

Structure of working capital means the components of the working capital. The basic components of the working capital are current assets and current liabilities. The main elements of current assets are cash and bank balances, receivables, inventories and other quick resources like short term investments.

The management of current assets and current liabilities and the inter relationship that exist between them may be termed as working capital management. It is also known as current assets management because it requires much of the financial manager's time. It is concerned with the problems that arise in attempting to manage the current assets, the current liabilities, and the inter relationship that exist between them. Current liabilities include payables, bank over drafts, outstanding expenses proposed dividends, tax payable and incomes received in advance.

The management of an enterprise should try to take maximum utilization of its components at the minimum possible cast. This is highly dependent on the structure of working capital.

It involves the administration of short term assets like cash, marketable securities, accounts receivables and inventories. Technically it is an integral part of the financial management, and it attempts to manage and control the current assets and the current liabilities in order to maximize the profitability and ensure proper liquidity in the business. Liquidity and profitability are two important and major aspects of business life. No firm can survive if it has no liquidity. A fin may even exist without making profits but cannot survive without liquidity.

Characteristically, current assets represents more than half the total assets of a business firm. Since they represent such a large investment this investment tends to be relatively volatile, and hence worthy of the financial manager's careful attention.

Effective management of working capital of the company includes a formation of an optimal structure. The structure of working capital is characterized by the ratio of their individual elements in the total volume of working capital, which is expressed as a percentage. This structure may be very different, it depends on the industry to which the enterprise belongs, but in the whole industry 2/3 of working capital is current assets and 1/3 - funds of the reference[7].

Current assets and current liabilities should be compared over periods of time. It is good if the current assets have increased significantly over longer periods of time. This means that the company generates cash. Working capital needs may reflect cyclical swings or long-run growth in business volume. Seasonal peaks in demand, for example for department store merchandise at Christmas time, necessitate large outlays on current assets during preceding months. Fluctuations in business activity

may affect demands for the physical volume of current assets, and fluctuations in commodity prices may affect demands for the dollar volume of current assets over a period of several consecutive years. Finally, an absolute growth or decline in the enterprise, or a technical change in the manner of doing business, may permanently affect requirements for working capital. These capital requirements are financed not only by short-term debt (bank loans and trade payables) but also by funds retained from operations and proceeds from the sale of equities and long-term debt. If the current liabilities of the company are growing at a fast pace, then there might be some problem with the company. However, this is not always bad since the company may incur higher liabilities since it needs money to finance some of its goals.

As would be expected, however, most increases in current assets occur during periods of recovery and prosperity. When business is improving and sales forecasts are upward, concerns tend to in-crease their stocks of raw materials, goods in process and finished goods. In manufacturing, more goods are in process of production. Higher prices add to the financial requirements for working capital. At the same time more and more finished goods are sold and debts of customers pile up. Finally, along with increases in sales and production come increases in wages and other out-of-pocket costs and more cash is needed in the till to keep the enterprise functioning smoothly.

Current assets may, however, be a source as well as a use of funds. In times of recession and depression such assets are often liquidated to provide funds for other corporate purposes. With decreasing sales, weakening expectations of future sales, and anticipations of a continued decline in the prices of raw materials, enterprises cut down on their raw material commitments and attempt to liquidate existing stocks of goods. Price declines accentuate the decline in the dollar volume of inventory. Customers' debts are collected and the decreased level of current sales produces fewer outstanding receivables. At this lower level of business, concerns operate on smaller volumes of cash. Just as additions to current assets during business expansions add impetus to that expansion, liquidations of such assets during contractions accentuate that contraction.

The financial manager should determine the optimum level of current assets so that the wealth of the share holders be maximized. In fact, optimum level for each

typo of current assets should be fixed. A firm needs fixed and current assets to support a particular level of output. However, to support the same level of output, the firms may have different levels of current assets. As the firm's output and sales increases, the need for current assets also increases, but not in direct proportion to output, it increases at a decreasing rate, because of the economies of large scale operations.

The level of current assets can be measured by relating it to fixed assets. Assuming a constant level of fixed assets, a higher current asset/fixed assets ratio indicates a conservative current assets policy and a lover current assets/fixed assets means an aggressive current assets policy. Other things remaining constant, conservative policy implies greater liquidity and lower risk. While an aggressive policy indicate a higher risk and poor liquidity. The current assets policy of the moat firms may fall between these two extremes[6].

How does one really know if managers are maximizing stockholder wealth through working capital management? Tests of this stewardship take a number of forms in the literature. Fazzari and Peterson inspect working capital as a cushion for smoothing fixed investment (and avoiding capital markets). They contend that a "strong balance sheet" (high positive WC) can help protect against recession at the macro level (or weakened balance sheets can make recessions more pronounced). Finally, Graham and Harvey, in summarizing survey evidence, "…find that informal criteria such as financial flexibility and credit ratings are the most important debt policy factors" and cash flow volatility is important. It seems that managers must coordinate working capital and debt policy to protect shareholder wealth[1].

While the connections between short-term asset/liability management and long-term investment cannot be denied, good working capital maintenance also relates to other long-term managerial strategies. For John, just as working capital management links to capital budgeting, it also shares ties to financial structure and dividend policy. In her investigation of the relationship between financial distress and liquidity, John distinguishes between hard contracts (fixed interest on bonds) and soft contracts (dividends), stating, "A firm is in financial stress…when the liquid assets of the firm are not sufficient to meet the current liquidity requirements of its hard contracts". The mechanisms for dealing with this "mismatch" (increasing

liquidity by selling assets or decreasing hardness through debt renegotiation) represent the costs of financial distress. She hypothesizes (and finds support for the contention that) "…the proportion of total assets invested by a firm in liquid assets…will be increasing in its costs of financial distress". She also finds that "collateral value" (as measured by the ratio of inventory and property, plant, and equipment to total assets) reduces the need for liquidity. Thus much of the "value-added" by good working capital management is to prevent the illiquidity that leads to financial stress.

In their efforts to balance the need for liquidity with investment demands, dividend expectations, and financing cost minimization, financial managers face choices among short- and long-term financing sources as well as internal funding. Beranek, Comwell, and Choi support the view that "firms tend to match long-term sources of financing with long-lived assets, and short-term debt with short-lived assets…[and they] favor financing capital expenditures with short-term debt, either permanently or temporarily". In addition, the principle of managerial capitalism also finds support—that managers prefer internal financing, because it saves transactions and SEC compliance costs, avoids timing problems, costs less than selling new shares, permits low normal dividends, and helps existing owners retain control. In sum:"Apparently firms, on average, significantly draw down net working capital before turning to the capital markets to finance capital expenditures". This suggests that, apart from the fact that this approach insulates managers from the scrutiny of the marketplace, it does seem to offer some promise of stockholder wealth maximization[2].

Another aspect of this tactic that might serve to further stockholder wealth, maturity matching, is investigated by Stohs and Mauer. They contend that, since working capital includes the financing of current assets, the debt maturity structure is related. This study finds that "larger, less risky firms with longer-term asset maturities use longer-term debt… [and] …firms with high or very low bond ratings use shorter-term debt". The authors offer a good discussion of the wisdom of matching the maturity of liabilities to assets: "If debt has a shorter maturity than assets, there may not be enough cash on hand to repay the principal when it is due. Alternatively, if debt has a longer maturity, then cash flows from assets cease, while

debt payments remain due. Maturity matching can reduce these risks. this study supports the idea that decisions related to working capital are important to wealth creation.

The following articles highlight three specific instances where managers can interfere with wealth creation: (1) using excess working capital to make unwise acquisitions, (2) adopting an overly aggressive working capital policy, and (3) mishandling trade receivables when times get tough. Harford addresses the first of these shortcomings, finding that firms with excess cash attempt more acquisitions and that these are value decreasing: "Cash-rich bidders destroy seven cents in value for every dollar of cash reserves held. …the evidence supports the agency costs of free cash flow explanation for acquisitions by cash-rich firms"[3].

Conclusions. Working capital is a financial metric that represents the operational liquidity of a business, organization, or other entity. Along with fixed assets, such as property, plant, and equipment, working capital is considered a part of operating capital. Positive working capital is required to ensure that a firm is able to continue its operations and has sufficient funds to satisfy both maturing short-term debt and upcoming operational expenses. A company can be endowed with assets and profitability but short on liquidity if its assets cannot be converted into cash.

Decisions relating to working capital and short term financing are referred to as working capital management. These involve managing the relationship between a firm's short-term assets and its short-term liabilities. The goal of working capital management is to ensure that the firm is able to continue its operations and that it has sufficient cash flow to satisfy both maturing short-term debt and upcoming operational expenses. Working capital management entails short-term decisions, usually relating to the next one-year period and are based in part on cash flows and/or profitability.

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Анотація

Кульбач Ю.О. Управління оборотними активами як частина фінансового менеджменту

Ковальчук О.С. Управління оборотними активами як частина фінансового менеджменту

У статті аналізується визначення і склад оборотних коштів. Вона встановлює оптимальну структуру активів для забезпечення безперервного виробництва, отримання високого фінансового результату, що дасть змогу збільшити фінансову стійкість підприємства та підвищити рентабельність продукції та виробництва.

Ключові слова: оборотні активи, підприємство, оптимальна структура, фінансовий результат, фінансово стійкість, рентабельність продукції і продажу.

Аннотация

Кульбач Ю.О. Управление оборотными средствами как часть финансового менеджмента

Ковальчук О.С. Управление оборотными средствами как часть финансового менеджмента

В статье проанализировано определение и состав оборотных средств предприятия. Она определяет оптимальную структуру активов для обеспечения безостановочного производства, получения высокого финансового результата, что даст возможность увеличить финансовую стойкость предприятия, рентабельность продукции и продаж.

Ключевые слова: оборотные средства, предприятие, оптимальная структура, финансовый результат, финансовая стойкость, рентабельность продукции и продаж.