



RAMA UNIVERSITY

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FACULTY OF COMMERCE AND MANAGEMENT

COURSE: MBA III SEM..

SUBJECT: WORKING CAPITAL MANAGEMENT

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LECTURE-14



FORECAST OF WORKING CAPITAL REQUIREMENT

There are so many popular methods for forecasting the working capital requirements which are as follows.

- (i) Cash Forecasting Method
- (ii) Balance Sheet Method
- (iii) Profit and Loss Adjustment Method
- (iv) Percentage of Sales Method
- (v) Operational Cycle Method
- (vi) Regression Analysis Method.

(i) Cash Forecasting Method. Under this method, the working capital is to be determined on the basis of the closing balance of the cash, after considering the receipts and payments made during that period

(ii) Balance Sheet Method. According to this method, a forecast is made of the various assets and liabilities of the concern. The difference between two is taken which will indicate either cash surplus or cash deficiency.

(iii) Profit and Loss Adjustment Method. Under this method, the forecasted Profits or Losses are to be adjusted on cash basis.

(iv) Percentage of Sales Method. Under this method, working capital is determined as a percentage of forecasted sales. It must be decided on the basis of past observations. This method is simple and easy to understand.

(v) Operational Cycle Method. Under this method, working capital is determined according to the operating cycle concept. In a manufacturing organisation the working capital cycle starts from the purchase of raw material and ends with the conversion of cash. It involves purchase of raw materials, work in progress, finished goods, sales, debtors and conversion of cash. This cycle will continue again and again. Each of the cycle stage is expressed in terms of number of days of relevant activity and requires a level of investment. The amount required for these stage wise investments will be the total amount of the working capital of the organisation.

Following formula is used to express the framework of the operating cycle :

$$T = (r - c) + w + f + b$$

T = Stands for the total period of operating cycle in number of days.

r = Stands for the number of days of raw material and stores consumption requirements held in raw materials and stores

c = Number of days of credit allowed by creditors

W = Stands for the number of days of cost of production held in work in progress.

f = Finished stock storage period

or

T = Duration of operating cycle in number of days

r = Raw materials and storage period

c = Creditors payment period

w = Work in process period

f = Finished stock storage period

b = Debtors collection period