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Business capital for economic well-being

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DESCRIPTION

Business capital is a financial metric which represents operating liquidity available to a business, organization, or other entity, including governmental entities. Beside with fixed assets such as plant and equipment, working capital is considered a part of operating capital (Berryman J, 1983). Gross business capital is equivalent to current assets. Business capital is calculated as current assets minus current liabilities. If current assets are less than current liabilities, an entity has a business capital deficiency, also called a business capital deficit and negative business capital. A company can be endowed with assets and profitability but may descent short of liquidity if its assets cannot be readily changed into cash (Deloof M, 2003). Positive business capital is obligatory to ensure that a firm is able to continue its operations and that it has sufficient funds to placate both maturing short-term debt and upcoming operational expenses. The management of business capital comprises managing inventories, accounts receivable and payable, and cash. Decisions relating to business capital and short-term financing are stated to as business capital management. These contain managing the relationship between a firm's short-term assets and its short-term liabilities (Gill A, et al 2010). The goal of business capital management is to safeguard 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. A managerial accounting strategy focusing on maintaining efficient levels of both components of business capital, current assets, and current liabilities, in respect to each other. Business capital management ensures a company has sufficient cash flow in order to meet its short-term debt obligations and operating expenses. By definition, business capital management entails short-term decisions generally relating to the next one-year period which is reversible. These decisions are hence not taken on the same basis as capital-investment decisions (NPV or related, as above) rather, they will be based on cash flows, or profitability, or both (Ismael B and Muhamed A 2013). Management practices a combination of policies and techniques for the management of business capital. The policies aim at handling the current assets (generally cash and cash equivalents, inventories and debtors) and the short-term financing, such that cash flows and returns are conventional (Kamalavalli AL and Christopher SB 2009).

- Cash management- Identify the cash balance which consents for the business to meet day to day expenses, but reduces cash holding costs.
- Inventory management- Identify the level of inventory which permits for uninterrupted production but reduces the investment in raw materials—and minimizes reordering costs—and hence increases cash flow. Besides this, the lead times in production should be pull down to reduce Work in Process (WIP) and similarly, the Finished Goods should be kept on as low level as possible to avoid overproduction—see Supply chain management; Just In Time (JIT); Economic order quantity (EOQ); Economic quantity
- Debtors management- Identify the appropriate credit policy, i.e. credit terms which will draw customers, such that any impact on cash flows and the cash conversion cycle will be offset by augmented revenue and hence Return on Capital (or vice versa); see Discounts and allowances.
- Short-term financing- Identify the appropriate source of financing, given the cash conversion cycle: the inventory is ideally financed by credit approved by the supplier; however, it may be obligatory to utilize a bank loan (or overdraft), or to "convert debtors to cash" through"factoring".

CONCLUSION

One measure of cash flow is provided by the cash conversion cycle is the net number of days from the outlay of cash for raw material to receiving paymentfrom the customer. As a management tool, this metric makes obvious the inter-relatedness of decisions relating to inventories, accounts receivable and payable, and cash. Because this number effectively parallels to the time that the firm's cash is tied up in operations and unapproachable for other activities, management generally aims at a low net count. In this circumstance, the most useful measure of profitability is return on capital (ROC). The result is shown as a percentage, determined by dividing appropriate income for the 12 months by capital employed; return on equity (ROE) shows this result for the firm's shareholders. Firm value is boosted when, and if, the return on capital, which results from working-capital management, exceeds the cost of capital, which results from capital investment decisions as above. ROC measures are therefore beneficial as a management tool, in that they link short-term policy with long-term decision making. Credit policy of the firm is another factor disturbing business capital management is credit policy of the firm. It comprises buying of raw material and selling of finished goods either in cash or on credit. This distress the whole cash conversioncycle.

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