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शक्ति उत्थान आश्रम लखीसराय बिहार

Class 12 commerce   Sub. BST. Date 13.9.2020

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BUSINESS FINANCE

Factors affecting the Requirement of Fixed Capital

1. Nature of Business: The type of business has a bearing upon the fixed capital requirements. For example, a trading concern needs lower investment in fixed assets compared with a manufacturing organisation; since it does not require to purchase plant and machinery etc.

2. Scale of Operations: A larger organisation operating at a higher scale needs bigger plant, more space etc. and therefore, requires higher investment in fixed assets when compared with the small organisation.

3. Choice of Technique: Some organizations are capital intensive whereas others are labour intensive. A capital-intensive organisation requires higher investment in plant and machinery as it relies less on manual labour. The requirement of fixed capital for such organisations would be higher. Labour intensive organizations on the other hand require less investment in fixed assets. Hence, their fixed capital requirement is lower.

4. Technology Upgradation: In certain industries, assets become obsolete sooner. Consequently, their replacements become due faster. Higher investment in fixed assets may, therefore, be required in such cases. For example, computers become obsolete faster and are replaced much sooner than say, furniture. Thus, such organisations which use assets which are prone to obsolescence require higher fixed capital to purchase such assets.

5. Growth Prospects: Higher growth of an organisation generally requires higher investment in fixed assets. Even when such growth is expected, a business may choose to create higher capacity in order to meet the anticipated higher demand quicker. This entails higher investment in fixed assets and consequently higher fixed capital.

6. Diversification: A firm may choose to diversify its operations for various reasons, With diversification, fixed capital requirements increase e.g., a textile company is diversifying and starting a cement manufacturing plant. Obviously, its investment in fixed capital will increase.

7. Financing Alternatives: A developed financial market may provide leasing facilities as an alternative to outright purchase. When an asset is taken on lease, the firm pays lease rentals

and uses it. By doing so, it avoids huge sums required to purchase it. Availability of leasing facilities, thus, may reduce the funds required to be invested in fixed assets, thereby reducing the fixed capital requirements. Such a strategy is specially suitable in high risk lines of business.

8. Level of Collaboration: At times, certain business organisations share each other's facilities. For example, a bank may use another's ATM or some of them may jointly establish a particular facility. This is feasible if the scale of operations of each one of them is not sufficient to make full use of the facility. Such collaboration reduces the level of investment in fixed assets for each one of the participating organisations.

WORKING CAPITAL

A part from the investment in fixed assets every business organisation needs to invest in current assets. This investment facilitates smooth day-to- day operations of the business. Current assets are usually more liquid but contribute less to the profits than fixed assets. Examples of current assets, in order of their liquidity, are as under.

1. Cash in hand/Cash at Bank
2. Marketable securities
3. Bills receivable
4. Debtors
5. Finished goods inventory
6. Work in progress
7. Raw materials
8. Prepaid expenses

These assets, as noted earlier, are expected to get converted into cash or cash equivalents within a period of one year. These provide liquidity to the business. An asset is more liquid if it can be converted into cash quicker and without reduction in value. Insufficient investment in current assets may make it more difficult for an organisation to meet its payment obligations. However, these assets provide little or low return. Hence, a balance needs to be struck between liquidity and profitability. Current liabilities are those payment obligations which, when they arise, are due for payment within one year; such as bills payable, creditors, outstanding expenses, advances received from customers etc. Some part of current assets is usually financed through short-term sources, i.e., current liabilities. The rest is financed through long-term sources and is called net working capital. Thus, NWC = CA – CL i.e. Current Assets - Current Liabilities. Thus, net working capital may be defined as the excess of current assets over current liabilities.