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An Analysis of Investment Evaluation and Working Capital Procedures

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Abstract: *Within the organization, several personnel may have responsibility for each component, and it is the manager's role to assign them specific, achievable objectives to optimize their working capital holdings. Net working capital is the difference between a company's current assets and its current liabilities. Net working capital refers to the amount of short-term funds that a firm needs in order to function. Working capital management include the management of short-term assets, such as cash, inventory, and accounts receivable, as well as short-term liabilities, such as accounts payable. The investment amount in each account differs from one business to another and varies across different sectors and industries. Additionally, it depends on the nature of the firm and the specific needs of the industry. Many organizations, particularly those in certain industries, are required to make significant investments in inventory due to the nature of their business*

Keywords: Working capital, liquidity, investment

I. INTRODUCTION

Garca-Teruel and Martnez-Solano (2007) and Thalassinos and Curtis (2005) have highlighted the need of managing working capital. This study aimed to present empirical data about the influence of working capital management on the profitability of a selected group of small and medium-sized Spanish firms. The authors have gathered a sample of 8,872 small and medium-sized firms from 1996 to 2002 in order to analyze how working capital management impacts the profitability of SMEs. Their findings suggest that managers might generate revenue by reducing their inventories and accounts receivable. In addition, decreasing the cash conversion cycle enhances the firm's profitability. Their research enhances the existing knowledge by employing rigorous testing to identify and address potential endogeneity problems. The aim was to verify that the relationships identified in the analysis were caused by the impact of the cash conversion cycle on business profitability, rather than the opposite.

Peel and Wilson (1996) examined the allocation of funds and management of short-term assets in small businesses. In their article, the authors presented the findings of an initial study on the working capital and financial management practices of a selected group of small firms in northern England. Overall, the study found that a significant proportion of the small businesses surveyed reported using quantitative capital planning and working capital strategies, and also conducted assessments of several aspects of their working capital. Furthermore, companies that reported using more sophisticated discounted cash flow capital planning methods or had actively reduced inventory levels or the credit period for debtors, on average, implemented more effective working capital management practices.

Problems related to the management of working capital affecting credit

Garca-Teruel and Martnez-Solano (2010) examined the determinants of trade credit provided and received by a sample of 47,197 European small and medium-sized enterprises (SMEs) between 1996 and 2002. Their findings suggest that the factors that influence trade credit in European countries are quite comparable. Enterprises that have greater and more cost-effective access to capital market resources tend to offer their clients more trade credit. Furthermore, the findings support the theory of price discrimination. Furthermore, it was found that businesses augment the amount of credit they offer in order to prevent a decrease in sales. In contrast, suppliers provide more funding to larger firms that have more growth potential and have made significant investments in their current resources. When firms have the option to access alternate sources of finance, they are less inclined to rely on vendor financing due to the substitution effect.

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Optimizing the allocation and utilization of working capital to enhance profitability

Czarnitzki and Hottenrott (2011) examined the correlation between working capital management and profitability of small and medium-sized enterprises in Germany, taking into account unobservable differences and probable endogeneity. The authors investigated the non-linear correlation between these two variables and established that there exists a non-linear (concave) association between the amount of working capital and the profitability of a company. This suggests that small and medium-sized enterprises (SMEs) possess an optimal level of working capital that maximizes their profitability. Furthermore, a thorough investigation of robustness demonstrated that the profitability of firms decreases when they stray from their optimal level.

Management of working capital and liquidity

Successful firms aim to achieve an optimal level of working capital, rather than aiming for the minimum or maximum level. This means finding the most efficient and effective amount of working capital for their operations (Liapis, 2010). Working capital is the result of subtracting current obligations from current assets. When a corporation has an excessive amount of working capital, it will face financing costs for having idle assets that resemble interest. These charges can and should be avoided. Inadequate operating cash can potentially have significant repercussions on a corporation. An absence of essential resources, such as raw materials, could lead to a cessation of manufacturing, perhaps resulting in significant financial setbacks. The primary constituents of working capital include inventories (consisting of raw materials, work-in-progress, and finished goods), receivables, and cash.

In practice, the potential benefits of intelligently optimizing the allocation of capital in inventories, receivables, liabilities, and liquid assets are often ignored or not effectively managed. If a corporation possesses an abundance of inventories or possesses very substantial receivables, it indicates that the company is experiencing financial difficulties.

Involuntary liquidation

Hall and Young (1991) analyzed three sets of 100 small enterprises in the United Kingdom that were forced to close down in 1973, 1978, and 1983. The authors determined that financial reasons accounted for 49.8 percent of the cases of failure. When studying the opinions of official receivers on small firms, it was found that 86.6% of the 247 reasons mentioned were related to financial issues. Peacock has extensively demonstrated the strong correlation between insufficient or absent financial management, which includes fundamental accounting, and the failure of businesses in western countries (1985, 2004).

Decisions on investments and the act of investing

Oftentimes, investment choices regarding fixed assets such as factory buildings, plants, and machinery are made without conducting a systematic analysis. These decisions have enduring consequences for the organization and should be made only after a comprehensive analysis of the market's extent and competition, as well as the utilization of discounted cash flow approaches like internal rate of return. Enhancing working capital not only enhances a company's ability to meet strategic objectives but also serves the primary purpose of boosting capital efficiency. The fact that successful organizations achieve returns on capital investments that are higher than average is not a coincidence; instead, it demonstrates the efficiency of implementing systematic management and control of the working capital cycle.

Inquiries regarding financial support

Currently, the entrepreneur has a wide array of financing options to select from. Currently, there exist alternate options to the conventional loan and personal-funds channels. Some financial organizations already provide Factoring services, which provide funding for credit sales. Consequently, your sales team can now dedicate their efforts just to sales, without having to handle collections.

Many businesses mistakenly utilize short-term loans, such as cash credit or overdraft, to acquire fixed assets. This results in a substantial cost burden. Executives need to have a thorough understanding of the operating cycle and cash cycle of the organization, as well as the need of effectively managing working capital. Management can strategically employ trade credit to optimize the firm's advantages and exercise discretion in extending credit and adjusting terms. Furthermore, it can oversee the payment of outstanding debts and evaluate the financial advantages and disadvantages of maintaining extra inventory.

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II. CONCLUSION

Optimizing capital investments is a crucial factor in improving value-based performance indicators and guaranteeing enough liquidity. In order to enhance capital efficiency and establish a sustainable monitoring system, it is imperative to have a comprehensive capital expenditure management system that encompasses investment, financial, and working capital management. The cash cycle refers to the mean duration during which a corporation settles the payment for its inventory and then obtains cash from the sale of a product. If the company acquires its inventory using cash, this period aligns with its operational cycle. Nevertheless, most businesses acquire their inventory through credit transactions, so reducing the duration between the expenditure of cash and its subsequent return.

Finance managers are responsible for making three crucial decisions: capital budgeting, financial management, and working capital management. Every type of decision has a clear and substantial effect on the company's financial statement and profitability.

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