

Working Capital Estimation and Financing

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Particulars	Calculations			Amount	Amount
	LOA	Rate	Duration		
Current Assets:				0	
Stock of raw material	2500	100	2	500000	
Stock of WIP	2500	115	1	287500	
Stock of Finished goods	2500	130	1	325000	
Debtors	2500	200	2	1000000	
Cash in hand				50000	
cash at bank				0	
Other current assets if any				0	
	A				2162500
Current Liabilities:					
Creditors	2500	100	1	250000	
Outstanding wages				0	
Outstanding manufacturing overheads				0	
Outstanding selling overheads				0	
Other Outstanding expenses if any				0	
Other current liability if any				0	
	B				250000
A-B= Working Capital requirement					1912500

Your Invest+ Bank OD + STL+DEBT +Dep FUND =
1912500

Tandon committee recommendations

- In 1974, a study group under the Chairmanship of Mr. P. L. Tandon was constituted for framing guidelines for commercial banks for follow-up & supervision of bank credit for ensuring proper end-use of funds.
- The group submitted its report in August 1975, which came to be popularly known as Tandon Committee Report on Working Capital.
- Its main recommendations related to norms for inventory and receivables, the approach to lending, style of credit, follow ups & information system.
- It was a landmark in the history of bank lending in India. With acceptance of major recommendations by Reserve Bank of India, a new era of lending began in India.

Tandon committee recommendations

- Breaking away from traditional methods of **security oriented lending**, the committee enjoined upon the banks to move towards **need based lending**.
- The committee pointed out that the best security of bank loan is a well functioning business enterprise, not the collateral.

Major recommendations of the Tandon committee were as follows:

- Assessment of need based credit of the borrower on **a rational basis** on the basis of their business plans.
- Bank credit would only be **supplementary to the borrower's** resources and not replace them, i.e. banks would not finance one hundred percent of borrower's working capital requirement.
- Bank should ensure **proper end use of bank credit** by keeping a closer watch on the borrower's business, and impose financial discipline on them.
- Working capital finance would be available to the borrowers on the basis of industry wise norms (prescribe first by the Tandon Committee and then by Reserve Bank of India) for holding different current assets, viz.
 - Raw materials including stores and others items used in manufacturing process.
 - Stock in Process.
 - Finished goods.
 - Accounts receivables.
- Credit would be made available to the borrowers in different components like cash credit; bills purchased and discounted working capital, term loan, etc., depending upon nature of holding of various current assets.
- In order to facilitate a close watch under operation of borrowers, bank would require them to submit at regular intervals, **data regarding their business and financial operations**, for both the past and the future periods.

Methods of Lending

- The lending framework proposed by Tandon Committee dominated commercial bank lending in India for more than 20 years and it continues to do so despite withdrawal of mandatory provision of Reserve Bank of India in 1997.
- As indicated before, the essence of Tandon Committee's recommendations was to **finance only portion of borrowers working capital needs not the whole of it.**
- It was thought that gradually, the **borrower should depend less on banks to fund its working capital needs.**
- From this point of view the committee three graduated methods of lending, which came to be known as **maximum permissible bank finance** system or in short MPBF system

Three methods of calculating MPBF

- **Method 1: MPBF = 75% of Net working capital**
 $75\% (\text{Current Assets} - \text{Current Liabilities})$
 $75\%(\text{CA}-\text{CL})$
- **Method 2: MPBF = 75% of Current Assets – Current liability**
 $[75\% (\text{Current Assets})] - \text{Current Liability}$
 $(75\% \text{ CA}) - \text{CL}$
- **Method 3: MPBF = 75% of (Current Assets- Core Current Asset) – Current liability**
 $(75\% \text{ CA} - \text{CCA}) - \text{CL}$

Other Parts

- Please refer to entire theory and sums of SEM III MA Working capital management

References

- <https://www.mbaknol.com/business-finance/tandon-committee-report-on-working-capital-norms-and-recommendations/>

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