

WORKING CAPITAL – BANKING VIEW

As per the recommendations of Tandon Committee, the corporate should be discouraged from accumulating too much of stocks of current assets and should move towards very lean inventories and receivable levels. The committee even suggested the maximum levels of Raw Material, Stock-in-process and Finished Goods which a corporate operating in an industry should be allowed to accumulate these levels were termed as inventory and receivable norms. Depending on the size of credit required, the funding of these current assets (working capital needs) of the corporate could be met by one of the following methods:

First Method of Lending

Banks can work out the working capital gap, i.e. total current assets less current liabilities other than bank borrowings (called Maximum Permissible Bank Finance or MPBF) and finance a maximum of 75 per cent of the gap; the balance to come out of long-term funds, i.e., owned funds and term borrowings. This approach was considered suitable only for very small borrowers i.e. where the requirements of credit were less than Rs.10 lacs

Second Method of Lending

Under this method, it was thought that the borrower should provide for a minimum of 25% of total current assets out of long-term funds i.e., owned funds plus term borrowings. A certain level of credit for purchases and other current liabilities will be available to fund the build up of current assets and the bank will provide the balance (MPBF). Consequently, total current liabilities inclusive of bank borrowings could not exceed 75% of current assets. RBI stipulated that the working capital needs of all borrowers enjoying fund based credit facilities of more than Rs. 10 lacs should be appraised (calculated) under this method.

The committee suggested norms

Ceilings for inventory and receivables, which could be considered for bank finance. The 15 industries included cotton and synthetic textiles, paper, cement, pharmaceuticals and engineering. Thus, for instance, the norms proposed for the pharmaceutical industry were:

Raw materials	:	2.75 months' consumption
Stocks in process	:	½ month's cost of production
Finished goods	:	2 months' cost of sales
Receivables	:	1.25 months' sales

for determining the maximum permissible bank finance (MPBF), the methods suggested were:

Method I	:	0.75 (CA - CL)
Method II	:	0.75 CA - CL
Method III	:	0.75 (CA - CCA) - CL

Here CA stands for CURRENT ASSETS corresponding to the suggested norms or past levels if lower, CL represents CURRENT LIABILITIES excluding bank lending and CCA stands for the 'Core Current Assets', i.e., permanent current assets. Method I and, following the CHORE COMMITTEE recommendations, Method II have been used by banks in assessing working capital needs of businesses, for the last several years. In October 1993, the RBI infused operational autonomy by permitting banks to determine appropriate levels of inventory and receivables, based on production, processing cycle, etc. These lending norms were made applicable to all borrowers enjoying an aggregate (FUND-BASED) working capital limit of Rs.1 crore and above from the banking system. However, the requirement of the CURRENT RATIO at 1.33 was retained.