CBSE Class 12 Business Studies
NCERT Solutions
Chapter 09
Financial Management

Very Short Answer Type

1. What is meant by capital structure?

Ans:
Capital structure refers to the combination of borrowed funds and owners' fund that a firm uses for financing its fund requirements. Herein, borrowed funds comprise of loans, public deposits, debentures, etc. and owners' fund comprise of preference share capital, equity share capital, retained earning etc. Generally, capital structure is simply referred as the combination of debt and equity that a firm uses for financing its funds. It is calculated as the ratio of debt and equity or the proportion of debt in the total capital used by the firm. Algebraically,

$$\text{Capital Structure is } \frac{\text{Debt}}{\text{Equity}} \text{ or, } \frac{\text{Debt}}{\text{Debt} + \text{Equity}}$$

The proportion of the debt and equity used by the firm affects its financial risk and profitability. While on one hand, debt is a cheaper source of finance than equity and lowers the overall cost of capital but on the other hand, higher use of debt, increases the financial risk for the firm. Thus, the decision regarding the capital structure should be taken with utmost care. Capital structure is said to be optimal when the proportion of debt and equity used is such that the earnings per share increases.

2. Sate the two objectives of financial planning.

Ans:

Financial planning means designing a blueprint of the financial operations of the firm. It ensures the smooth functioning of the organisation by the right allocation of resources available at the right time. It helps the firms are able to forecast the requirement of find in the future.

The two objectives of financial planning are:-

a. To ensure the availability of sufficient funds in the company for different purpose such as purchasing long term assets, to meet the day to day expenses, etc. Financial planning also aims at specifying the source of these finances.

b. To ensure that the firm does not raise the resources unnecessarily. Excess funding is as bad as a shortage of funds. An efficient financial planning system ensures that the funds are not raised unnecessarily to avoid unnecessary addition of cost. If there is any surplus money, it should be used e in the best possible manner to avoid any loss for the organisation.

3. Name the concept of financial management which increases the return to equity shareholders due to the presence of fixed financial charges.

Ans:

The concept of financial management which increases the return to equity shareholders due to the presence of fixed financial charges is called Trading on Equity. It refers to the increase in profit earned by the equity shareholders due to the presence of fixed financial charges.

4. Amrit is running a ‘transport service’ and earning good returns by providing this service to industries. Giving reason, state whether the working capital requirement of the firm will be ‘less’ or ‘more’.

Ans:

Working capital is the amount of capital required for meeting the day-to-day operations of the business. In this case, Amrit runs a Transport Service. This business operates on a large scale of operation, with a higher amount of inventory. He would require a large amount to working capital.

5. Ramnath is into the business of assembling and selling of televisions. Recently he has adopted a new policy of purchasing the components on three months credit and selling the complete product in cash. Will it affect the requirement of working capital? Give reason in support of your answer.

   Ans:

Working capital is the amount of capital required for meeting the day-to-day operations of the business. In this case, Ramnath is purchasing the components of television on 3 months of credit, and selling the company's product in cash. His working capital requirement is reduced to the extent of credit availed by him.

Short Answer Type:

1. What is financial risk? Why does it arise?

Ans: Financial risk refers to a situation when a company is not able to meet its fixed financial charges such as interest payment, preference dividend and repayment obligations. In other words, it refers to the probability that the company would not be able to meet its fixed financial obligations. It arises when the proportion of debt in the capital structure increases. This is because it is obligatory for the company to pay the interest charges on debt along with the principle amount. Thus, higher the debt, higher will be its payment obligations and thereby higher would be the chances of default on payment. Hence, higher use of debt leads to higher financial risk for the company.

2. Define current assets? Give four examples of such assets.

Ans: Current asset are those assets which are retained in the business with the purpose to convert them into cash within a short period say, one year. for example- goods are purchased with a purpose to resell and earn profit, debtors exist convert them into cash, i.e., receive the amount from them, bills receivable exist again for receiving cash against it. Some of the examples of current assets are short term investment, debtors, stocks and cash equivalents.

3. What are the main objectives of financial management? Briefly explain

Ans: The financial management is generally concerned with procurement, allocation and control of financial resources of a concern. The objectives can be-

1. To ensure regular and adequate supply of funds to the concern.
2. To ensure adequate returns to the shareholders which will depend upon the earning capacity, market price of the share, expectations of the shareholders.
3. To ensure optimum funds utilization. Once the funds are procured, they should be utilized in maximum possible way at least cost.
4. To ensure safety on investment, i.e, funds should be invested in safe ventures so that adequate rate of return can be achieved.
5. To plan a sound capital structure-There should be sound and fair composition of capital so that a balance is maintained between debt and equity capital.

4. Financial management is based on three broad financial decisions. What are these?

Ans: Financial management refers to the efficient acquisition, allocation and usage of funds
of the company. It deals in three main dimensions of financial decisions namely, Investment decisions, Financial decisions and Dividend decisions.

1. Investment decisions includes investment in fixed assets (called as capital budgeting). Investment in current assets are also a part of investment decisions called as

working capital decisions.

2. Financial decisions - They relate to the raising of finance from various resources which will depend upon decision on type of source, period of financing, cost of financing and the returns thereby.

3. Dividend decision - The finance manager has to take decision with regards to the net profit distribution. Net profits are generally divided into two:

1. Dividend for shareholders- Dividend and the rate of it has to be decided.

2. Retained profits- Amount of retained profits has to be finalized which will depend upon expansion and diversification plans of the enterprise.

5. Sunrises Ltd. dealing in readymade garments, is planning to expand its business operations in order to cater to international market. For this purpose the company needs additional ₹80,00,000 for replacing machines with modern machinery of higher production capacity. The company wishes to raise the required funds by issuing debentures. The debt can be issued at an estimated cost of 10%. The EBIT for the previous year of the company was ₹8,00,000 and total capital investment was ₹1,00,00,000. Suggest whether issue of debenture would be considered a rational decision by the company. Give reason to justify your answer. (Ans. No, Cost of Debt (10%) is more than ROI which is 8%).

Ans:

If the cost of the debt is less than the cost of capital then a company can issue debenture for raising fund.

In the above case, the cost of capital is 10%, for the total capital of ₹ 80,00,000, the cost of capital is ₹ 8,00,000. The EBIT for the previous year of the company was ₹ 8,00,000 and total capital investment was ₹ 1,00,00,000. So the total ROI is

ROI = RETURN ÷ INVESTMENT × 100

ROI= 800000 ÷ 10000000 × 100 = 8 %

It will assume that the company will operates with the same efficiency, the additional investment of ₹ 80,00,000 will have net ROI of 8% which will be ₹ 6,40,000 against the cost of debt ₹ 8,00,000.
In the above case the cost of debt is 10% which is generating ROI of 8%, so it will not be advisable for the company to issue debenture when the cost of debt is higher than the cost of capital.

6. How does working capital affect both the liquidity as well as profitability of a business?

Ans: Working capital of a business refers to the excess of current assets (such as cash in hand, debtors, stock, etc.) over current liabilities. Working capital affects both the liquidity as well as profitability of a business. As the amount of working capital increases, the liquidity of the business increases. However, since current assets offer low return, with the increase in working capital the profitability of the business falls. For example, an increase in the inventory of the business increases its liquidity but since the stock is kept idle, the profitability falls. On the other hand, low working capital, hinders the day to day operations of the business. Thus, the working capital should be such that a balance is maintained between the profitability and liquidity.

7. Aval Ltd. is engaged in the business of export of canvas goods and bags. In the past, the performance of the company had been upto the expectations. In line with the latest demand in the market, the company decided to venture into leather goods for which it required specialised machinery. For this, the Finance Manager Prabhu prepared a financial blueprint of the organisation's future operations to estimate the amount of funds required and the timings with the objective to ensure that enough funds are available at right time. He also collected the relevant data about the profit estimates in the coming years. By doing this, he wanted to be sure about the availability of funds from the internal sources of the business. For the remaining funds, he is trying to find out alternative sources from outside.

a. Identify the financial concept discussed in the above paragraph. Also, state the objectives to be achieved by the use of financial concept so identified. (Financial Planning).
b. 'There is no restriction on payment of dividend by a company'. Comment. (Legal & Contractual Constraints)

Ans:

The financial concept discussed in this is called capital budgeting decision, it is decision-related to capital investment in the company which have long term effect on the profitability of the company.

As the company want to invest in new machinery which will require huge investment, and it will affect the operations of the organisation which will affect the profitability of the organisation.

The objective can be achieved by this are following:-

a. Cash flow :- after this investment, new machinery will reduce the operational cost of the products, which will increase the profitability of the organisation. Cash flow needs to be analysed that how the Investment which affects cash inflow over the period.

b. The rate of return :- as the company want to raise fund both from inside and outside the organisation, it is very important to know that the additional return generated from the investment is more than the cost of capital.

c. The investment criteria involved - as mentioned in the paragraph the company is planning to raise fund both from inside and outside the organisation and both have a different cost associated with it. Debt from outside will have a different interest rate associated with it, whereas internal cash can be used for other activity which may have more or less rate of return which needs to be analysed.

Companies pay part of their earning to the shareholders on a regular basis and it is called dividend. There are multiple factors which affect the pay-out of dividends

Legal constraint :- certain provision of the company's actions put the constraint on the pay-out of dividends and those norms need to be followed while paying dividends.

Contractual constraints- Paying the dividend reduces companies' cash as cash is going outside the company, the company's also raises money in the form of loan from other banks or investors, they can put a restriction of the company to pay dividends, loan agreements need to be analysed.

Long Answer Type:

1. What is working capital? Discuss five important determinants of working capital requirement.

Ans: Every business needs to take the decision regarding the investment in current assets i.e. the working capital. Current assets refer to the assets that are converted into cash or cash equivalents in a short period of time (less than or equal to one year). There are two broad concepts of working capital namely, Gross working capital and Net working capital. Gross working capital (or, simply working capital) refers to the investment done in the current assets. Net working capital, on the other hand, refers to the amount of current assets that is in excess of current liabilities. Herein, current liabilities are those obligatory payments which are due for payment such as bills payable, outstanding expenses, creditors, etc. Net Working Capital is calculated as the difference of current assets over current liabilities. i.e.

NWC = Current Assets - Current Liabilities

The following are five determinants of working capital requirement:

(i) Type of Business: Working capital requirement of a firm depends on its nature of business. An organisation that deals in services or trading will not require much of working capital. This is because such organisations involve small operating cycle and there is no processing done. Herein, the raw materials are the same as the outputs and the sales transaction takes place immediately. In contrast to this, a manufacturing firm involves large operating cycle and the raw materials need to be converted into finished goods before the final sale transaction takes place. Thereby, such firms require large working capital.

(ii) Scale of Operations: Another factor determining the working capital requirement is the scale of operations in which the firm deals. If a firm operates on a big scale, the requirement of the working capital increases. This is because such firms would need to maintain high stock of inventory and debtors. In contrast to this, if the scale of operation is small, the requirement of the working capital will be less.

(iii) Fluctuations in Business Cycle: Different phases of business cycle alter the working capital requirements by a firm. During boom period, the market flourishes and thereby, there is higher sale, higher production, higher stock and debtors. Thus, during this period the need for working capital increases. As against this, in a period of depression there is low demand, lesser production and sale, etc. Thus, the working capital requirement reduces.

(iv) Production Cycle: The time period between the conversion of raw materials into finished goods is referred as production cycle. The span of production cycle is different for different firms depending on which the requirement of working capital is determined. If a firm has a longer span of production cycle, i.e. if there is a long time gap between the receipt of raw materials and their conversion into final finished goods, then there will be a high requirement of working capital due to inventories and related expenses. On the other hand, if the production cycle is short then requirement of working capital will be low.

(v) Growth Prospects: Higher growth and expansion is related to higher production, more sales, more inputs, etc. Thus, companies with higher growth prospects require higher amount of working capital and vice versa.

2. ''Capital structure decision is essentially optimisation of risk-return relationship''. Comment.

Ans: Capital Structure refers to the combination of different financial sources used by a company for raising funds. The sources of raising funds can be classified on the basis of ownership into two categories as borrowed funds and owners' fund. Borrowed funds are in the form of loans, debentures, borrowings from banks, public deposits, etc. On the other hand, owners' funds are in the form of reserves, preference share capital, equity share capital, retained earnings, etc. Thus, capital structure refers to the combination of borrowed funds and owners' fund. For simplicity, all borrowed funds are referred as debt and all owners' funds are referred as equity. Thus, capital structure refers to the combination of debt and equity to be used by the company. The capital structure used by the company depends on the risks and returns of the various alternative sources. Both debt and equity involve their respective risk and profitability considerations. While on one hand, debt is a cheaper source of finance but involves greater risk, on the other hand, although equity is comparatively expensive, they are relatively safe. The cost of debt is less because it involves low risk for lenders as they earn an assured amount of return. Thereby, they require a low rate of return which lowers the costs to the firm. In addition to this, the interest on debt is deductible from the taxable income (i.e. interest that is to be paid to the debt security holders is deducted from the total income before paying the tax). Thus, higher return can be achieved through debt at a lower cost. In contrast, raising funds through equity is expensive as it involves certain floatation cost as well. Also, the dividends are paid to the shareholders out of after tax profits. Though debt is cheaper, higher debt raises the financial risk. This is due to the fact that debt involves obligatory payments to the lenders. Any default in payment of the interest can lead to the liquidation of the firm. As against this, there is no such compulsion in case of dividend payment to shareholders. Thus, high debt is related to high risk. Another factor that affects the choice of capital structure is the return offered by various sources. The return offered by each source determines the value of earning per share. A high use of debt increases the earning per share of a company (this situation is called Trading on Equity). This is because as debt increases the difference between Return on Investment and the cost of debt increases and so does the EPS. Thus, there is a high return on debt. However, even though higher debt leads to higher returns but it also increases the risk to the company. Therefore, the decision regarding the capital structure should be taken very carefully, taking into consideration the return and risk involved.

3. "A capital budgeting decision is capable of changing the financial fortunes of a business". Do you agree? Give reasons for your answer?

Ans: Yes, capital budgeting decision is a very essential decision which needs to be taken carefully. It has the capability of changing the financial fortunes of a business. Capital budgeting decision refers to the decisions regarding the allocation of fixed capital to different projects. Such decisions involve investment decisions regarding attainment of new assets, expansion, modernisation and replacement. Such long term investments include purchasing plant and machinery, furniture, land, building, etc. and also expenditure as on launch of a new product, modernisation and advertising, etc. They have long term implications on the
business and are irrevocable except at a huge cost. They affect a business' long term growth, profitability and risk. The following are the factors that highlight the importance of capital budgeting decisions:

(i) Long Term Implications: Investment on capital assets (long term assets) yield return in the future. Thereby, they affect the future prospects of a company. A company's long term growth prospects depend on the capital budgeting decisions taken by it.

(ii) Huge Amount of Funds: Investing in fixed capital involves a large amount of funds. This makes the capital budgeting decisions all the more important as huge amount of funds remain blocked for a longer period of time. These decisions once made are difficult to change. Thus, capital budgeting decisions need to be taken carefully after a detailed study of the total requirement of funds and the sources from which they are to be raised.

(iii) High Risk: Fixed assets involve huge amount of money and thereby, involve huge risk as well. Such decisions are risky as they have an impact on the long term existence of the company. For example, decision about the purchase of new machinery involves a risk in terms of whether the return from the machinery would be greater than the cost incurred on it.

(iv) Irreversible Decisions: These decisions once made are irrevocable. Reversing a capital budgeting decision involves huge cost. This is because once huge investment is made on a project, withdrawing it would mean huge losses.

4. Explain the factors affecting the dividend decision.

Ans: Dividend decision of a company deals with what portion of the profits is to be distributed as dividends between the shareholders and what portion is to be kept as retained earnings. The following are the factors that affect the dividend decision.

1. Legal requirements

There is no legal compulsion on the part of a company to distribute dividend. However, there certain conditions imposed by law regarding the way dividend is distributed. Basically there are three rules relating to dividend payments. They are the net profit rule, the capital impairment rule and insolvency rule.

2. Firm's liquidity position

Dividend payout is also affected by firm's liquidity position. In spite of sufficient retained earnings, the firm may not be able to pay cash dividend if the earnings are not held in cash.

3. Repayment need

A firm uses several forms of debt financing to meet its investment needs. These debt must be repaid at the maturity. If the firm has to retain its profits for the purpose of repaying debt, the dividend payment capacity reduces.

4. Expected rate of return

If a firm has relatively higher expected rate of return on the new investment, the firm prefers to retain the earnings for reinvestment rather than distributing cash dividend.

5. Stability of earning

If a firm has relatively stable earnings, it is more likely to pay relatively larger dividend than a firm with relatively fluctuating earnings.

6. Desire of control

When the needs for additional financing arise, the management of the firm may not prefer to issue additional common stock because of the fear of dilution in control on management. Therefore, a firm prefers to retain more earnings to satisfy additional financing need which reduces dividend payment capacity.

7. Access to the capital market

If a firm has easy access to capital markets in raising additional financing, it does not require more retained earnings. So a firm's dividend payment capacity becomes high.

8. Shareholder's individual tax situation

For a closely held company, stockholders prefer relatively lower cash dividend because of higher tax to be paid on dividend income. The stockholders in higher personal tax bracket prefer capital gain rather than dividend gains.

5. Explain the term ''Trading on Equity''. Why, when and how it can be used by a company?

Ans: Trading on equity refers to a practice of raising the proportion of debt in the capital structure such that the earnings per share increases. A company resorts to Trading on Equity when the rate of return on investment is greater than the rate of interest on the borrowed fund. That is, the company resorts to Trading on Equity in situation of favourable financial leverage. As the difference between the return on investment and the rate of interest on debt increases, the earnings per share increase.

The use of Trading on Equity is explained in detail with the help of the following example. Suppose there are two situations for a company. In situation I it raises a fund of Rs 5,00,000 through equity capital and in situation II, it raises the same amount through two sources- Rs 2,00,000 through equity capital and the remaining Rs3,00,000 through borrowings. Also suppose the tax rate is 30% and the interest on borrowings is 10%. The earnings per share (EPS) in the two situations is calculated as follows.

	Situation I	**Situation II**
Earnings before interest and tax (EBIT)	**1,00,000**	**1,00,000**
Interest		**30,000**
Earnings Before Tax (EBT)	**1,00,000**	**70,000**
Tax	**30,000**	**21,000**
Earnings After Tax (EAT)	**70,000**	**79,000**
No. Of equity shares	**50,000**	**20,000**
EPS= $\frac{\text{EAT}}{\text{Number of equity share}}$	$\frac{70,000}{50,000} = 1.4$	$\frac{79,000}{20,000} = 3.95$

Clearly, in the second situation the EPS is greater than in the first situation. In the second situation the company takes advantage of the Trading on Equity and raises the EPS. Here, the return on investment calculated as

$$\left(\frac{\text{Earnings Before Tax (EBT)}}{\text{Total Investment}} = \frac{1,00,000}{5,00,000}\right) \text{ is } 20\%$$

while the interest on the borrowings is 10%. Thus, the Trading on Equity is profitable. However, it should be noted that Trading on Equity is profitable and should be used only when the return on investment is greater than the interest on borrowed funds. In case the return on investment is less than the rate of interest to be paid, the Trading on Equity should be avoided.

Suppose instead of Rs 1,00,000 the company earns just Rs 25,000. In such a case the EPS are calculated as follows.

	Situation I	Situation II
Earnings before interest and tax (EBIT)	**40,000**	**40,000**
Interest		**10,000**
Earnings Before Tax (EBT)	**25,000**	**10,000**
Tax	**30,000**	**3,000**
Earnings After Tax (EAT)	**70,000**	**7,000**
No. Of equity shares	**50,000**	**20,000**
$\text{EPS}=\dfrac{\text{EAT}}{\text{Number of equity shares}}$	$\dfrac{70{,}000}{50{,}000}=1.4$	$\dfrac{79,\ 000}{20{,}000}=3.95$

Clearly in this case, the EPS in Situation II falls. Here the return on investment is only

8% $\left(\dfrac{\text{Earnings Before Tax (EBT)}}{\text{Total Investment}}=\dfrac{40{,}000}{5{,}00{,}000}\right)$ while the interest on the borrowings is 10%.

Thus, in this situation the Trading on Equity is not favourable and should be discouraged. Hence, it can be said that a firm can use Trading on Equity if it is earning high profits and can increase the EPS by raising more funds through borrowings.

6. ‘S’ Limited is manufacturing steel at its plant in India. It is enjoying a buoyant demand for its products as economic growth is about 7–8 per cent and the demand for steel is growing. It is planning to set up a new steel plant to cash on the increased demand. It is estimated that it will require about ₹5000 crores to set up and about ₹500 crores of working capital to start the new plant.

a. Describe the role and objectives of financial management for this company.

b. Explain the importance of having a financial plan for this company. Give an imaginary plan to support your answer.

c. What are the factors which will affect the capital structure of this company?

d. Keeping in mind that it is a highly capital-intensive sector, what factors will affect the fixed and working capital. Give reasons in support of your answer.

Ans:

1. The role of financial management in this company is to ascertain:-

1. The amount and structure of fixed assets :- A decision to invest more in a particular type of fixed asset would increase its share in the overall composition of fixed assets. For instance, a financial management decision to invest more in fixed assets would directly increase the size of the fixed assets held by the business.

2. The composition of funds used :- The composition of funds used by a company refers to the short-term and long-term financing sources used by that company. It is determined by the company's decisions regarding liquidity and profitability. For instance, a company aiming at higher liquidity would rely more on long-term financing and vice versa.

3. The proportion of debt, equity, etc. in long-term financing :- What proportion of the long-term finance is to be raised by the way of debt or equity is a financial decision, which in itself is a part of financial management.

4. The quantum and composition of current assets :- The amount of current assets (i.e. working capital) that the organisation holds depends on the financial decisions pertaining to the amount of fixed assets to be held. A decision to increase the quantum of fixed assets directly increases the working capital requirements of the business and vice versa.

The basic objective of the financial management in this company would be to **maximise the shareholders' wealth**. The company must opt for those financial decisions that prove gainful from the point of view of the shareholders (i.e. increase in the market value of the shares). The market value of shares increase when the benefits from a financial decision exceed the cost involved in taking them.

2. The following points highlight the importance of financial planning for the company.

i. Financial plan would enable the company to forecast the future in a better manner. For instance, it would be able to forecast the sales return that it would be able to earn through the expansion.
ii. Proper planning would help to avoid any shortage or surplus of funds, thereby ensuring optimum utilisation of funds.
iii. Planning would help in better coordination of the

production and sales activities.
iv. Financial planning would help in avoiding wastages of time, effort and money.
v. With a clear definition of targets and policies, financial planning helps in evaluating current performance in a better way.

Financial Plan

It is given that the company requires Rs 5000 crore fixed capital and Rs 500 crore working capital. Of this the company can collect 50 % through issue of shares and the remaining 50% can be collected through borrowed funds.

3. The following are the factors affecting the choice of capital structure.

1. Cash flow :- The company should opt for debt capital only in case of strong cash flow position. This is because debt cash is required to pay the principle as well as the interest on the debt.

2. Debt-service coverage ratio (DSCR) :- This ratio shows the cash payment obligations of a company as against the availability of cash. In case of high DSCR, the company can opt for debt.

3. Equity cost :- Cost of equity is directly related to the financial risk faced by the company. With higher financial risk, shareholders expectations of return increases. This in turn implies that the cost of equity rises. With high cost of equity it becomes difficult for the company to opt for equity.

4. Condition of stock market :- It is easy to opt for equity capital in case of good stock market conditions. On the other hand, in case of poor stock market conditions it becomes difficult to opt for equity capital.

5. Interest coverage Ratio :- This ratio refers to the number of times 'earnings before interest and tax' is able to meet the interest rate obligations. Higher interest coverage ratio implies lower risk for the company, thereby the company can opt for higher portion of debt in the capital structure.

6. Floatation cost :- Higher the floatation cost of a particular source (in terms of broker's commission, underwriting commission), lower is its component in the capital structure. For instance, if the floatation cost involved in equity is high, its component in the capital structure would be low.

7. Rate of interest on debt :- High rate of interest on debt implies higher cost of debt, thereby, it becomes difficult to opt for debt in the capital structure.

4. The factors that will affect the fixed capital requirements of the company are as follows:

1. Type of business :- The amount of fixed capital required by a company depends, to a large extent, on the type of business that it deals in. Since 'S' Limited is a manufacturing firm (having a large operating cycle), thus it requires large fixed capital.

2. Scale of operations :- The scale of operations of the company is high implying that a larger amount needs to be invested in plants, land, building, etc. Thus, it requires large fixed capital.

3. Growth prospects :- Since the company is growing and expanding, thus it requires higher amount of fixed capital.

The factors that will affect the working capital requirements of the company are as follows:

1. Type of business :- The company would require large working capital as it is a manufacturing firm and involves a large operating cycle. That is, in this company the raw materials need to be converted into finished goods before they are finally sold. Therefore, it requires large working capital.

2. Scale of operations :- Since the company is operating on a large scale, thus it requires large working capital. This is because it need to maintain high stock of inventory and debtors.

3. Growth Prospects :- The company would require higher amount of working capital as it has higher growth prospects.

4. Seasonal factors related to operation :- The company would require high working capital as the demand for its product (i.e steel) is growing.