



# THE BASIC CRITERIA FOR MAKING FINANCIAL DECISIONS ON THE FINANCEMENT OF THE WORKING CAPITAL IN SMALL BUSINESS ENTERPRISES

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## ABSTRACT

*The article provides the scientific basis for the formation and management of working capital in the small business enterprises and provides relevant scientific conclusions.*

**KEYWORDS:** *working capital, current capital, real sector development, receivables, product sales*

## DISCUSSION

Small business and private entrepreneurship are very crucial factors in the economic development, in the improvement of the income, as well the employment level of the population.

Small business provides about 60% of the country's GDP, a third of industrial output, 98% of agricultural output and half of the investments. About 70-90 percent of exports corresponds to small businesses in many regions of our country. In the first six months of this year, the number of business entities increased by 60,000. In addition, the main issues are the adequacy of working capital in the implementation of financial tactics of the enterprises, its planning mechanism, regulation and financing, analysis of the effectiveness of their use.

If the enterprise is not involved in short-term business operations for the purchase of material resources and sale of ready products, execution of long-term financial decisions will not be successful.

Depending on the specific purpose of financial management, working capital can be classified as follows:

- ❖ In line with the liquidity level;

- ❖ In line with the functional role in production;
- ❖ In line with the risk level of capital investments;
- ❖ In line with the funding sources.

In the economic conditions of the enterprise associated with a number of negative factors, it is important to set goals such as "ability to finance" in the management of working capital. Stating differently, the entity must be willing and able to recover losses related to working capital.

The enterprise may become uncompetitive because of its debt, lose its ability to finance, and cause extensive growth of working capital.

The amount of working capital is determined not only by the needs of the production process, but also by random factors. Hence, it is recommended to determine the types of working capital, such as constant working capital and fluctuating working capital.

There are two main interpretations of the concept of "constant working capital" in the theory of financial management. According to the first interpretation, working capital is a constantly needed



part of receivable accounts and production reserves throughout the entire operating period. This is, for example, the amount of current assets that an entity has at its disposal on an average time parameter.

According to the second interpretation, constant working capital is the minimum amount required to carry out production activities.

This approach means that an enterprise needs certain minimum working capital to carry out its activities, for example, the balance of funds in a current account, which is some analogue of reserve capital. In subsequent descriptions of the data, we follow the second interpretation.

The fluctuating working capital category reflects additional current assets that are needed during the busiest period of the process or as an insurance reserve. For example, the need for additional production inventories may be related to supporting the maintenance of high levels of sales during the current seasonal trading season. At the same time, the volume of receivables will increase with the development of sales. Additional cash is needed to supply raw materials and supplies, as well as to pay for pre-employment activities prior to the high-level entrepreneurial period.

The purpose of working capital management was to determine the amount and composition of working capital, their sources of coverage and the determination of the ratios between them, which is sufficient to ensure the long-term production and efficient financial performance of the enterprise.

The goal formed is strategically important. It is also important to maintain working capital in an amount that optimizes current business management. In this regard, the liquidity of the enterprise, including its ability to repay short-term payables, was a description of its most important financial and economic condition. Adequate level of liquidity for any enterprise is one of the most important features of business stability. Loss of liquidity is associated not only with additional costs, but also with periodic interruptions in the production process.

In the condition of the level of working capital is low, production activity is not provided at the level of demand. As a result, there is a possibility of liquidity loss, periodic interruptions in work and low profit margins. In the optimal period of working capital, income is at its maximum.

As a result of further increase in the amount of working capital, the enterprise will have a temporarily vacant, immovable current capital, as well as additional costs associated with financing. As a result, the amount of profit is reduced.

Hence, a balance should be ensured among the working capital management strategy and tactics, the risk of liquidity loss and operational efficiency. This solves two important issues.

### 1. *Providing solvency*

This condition does not occur if the entity is unable to pay its accounts receivable, fulfill its obligations, and possibly declare bankruptcy. An enterprise that does not have a sufficient level of working capital may be at risk of insolvency.

### 2. *Providing a reasonable composition and profitability of assets*

It is known that different levels of different current assets affect profits in different ways. For example, high levels of production and inventories require correspondingly high current costs. At the same time, a wide range of ready products can then pave the way for increased sales and revenue growth.

Every decision regarding the maintenance of a moderate level of cash, receivables and inventories must be taken into account in terms of the profitability of these types of assets and the optimal structure of working capital.

The possibility of a decrease in the level of liquidity or a decrease in efficiency due to the volume and composition of working capital can lead to the following situations:

#### 1. **Lack of capital.**

When an unforeseen expense arises and a potentially effective investment is made, the entity must have the funds to carry out the current activity. Lack of funds in a timely manner can lead to the suspension of the production process, increase the probability of non-fulfillment of obligations or the loss of additional profits.

#### 2. **Lack of self credit.**

This risk is closely associated with the fact that when goods are sold on credit, buyers can pay them for several days or months, resulting in receivables in the enterprise.

On the point of view of financial management, receivables have twofold specifications. On the one hand, the "moderate" growth of receivables is related to the increase in future income and the increase in liquidity. On the other hand, an enterprise cannot "bear" any amount of receivables. This is because excessive receivables are the mobilization of personal working capital. Debt exceeding a certain limit can lead to a decrease in liquidity and even a cessation of production. Such a situation with high mutual payments is typical of countries with economies in transition.

#### 3. **Lack of production resources.**

The enterprise must have sufficient raw materials and supplies to ensure an efficient production process, and the finished products must be sufficient to fulfill all orders. Insufficient inventory is associated with additional costs or the risk of production downtime.

#### 4. **Excess of working capital.**

Because the value of working capital is directly related to financing costs, the retention of excess assets reduces revenue. There are various



reasons for the emergence of surplus assets: non-transferable and stagnant goods. There are some other specific reasons as well.

Circumstances associated with the risk of insufficient working capital financing include:

#### 1. High level of creditor indebtedness.

When an entity acquires inventories on credit, a creditor's indebtedness arises in connection with certain maturities.

Perhaps the company has purchased large amounts of inventory in the near future that it does not need or at an expensive price. As a result, at a time when the amount of credit and the amount of unused reserves is too large, the enterprise will not have the funds to repay the debts. This, in turn, leads to non-fulfillment of obligations.

#### 2. The imbalance between sources of short-term and long-term debt.

Although long-term resources are usually more expensive, in some cases, they can generate significant returns when liquidity growth is less. For many business managers, the efficient use of different sources of money is a relatively new challenge.

#### 3. The large share of long-term debts in the volume of liabilities.

Long-term debts play an important role in the technical and technological re-equipment of enterprises. However, the high share of long-term debt in the volume of liabilities leads to an increase in the amount of costs associated with covering them.

It should be noted that very short-term lending increases the risk of liquidity loss, while exceeding the norm of long-term resources reduces the risk of profitability. Of course, such a situation can change under certain conditions under the influence of inflation, devaluation, preferential lending conditions and other factors.

In the theory of financial management, various criteria of effective financial management have been developed. The main ones are as follows:

#### 1. Reducing existing debt.

This approach reduces the likelihood of liquidity loss. However, such a strategy requires the use of long-term resources and private funds to finance a large portion of working capital.

#### 2. Minimizing the total expenses to be financed.

In this case, short-term debts are taken as a source of asset recovery. This resource is considered the cheapest. Developing the mechanism of working capital management is one of the key factors in increasing the economic efficiency of production.

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