

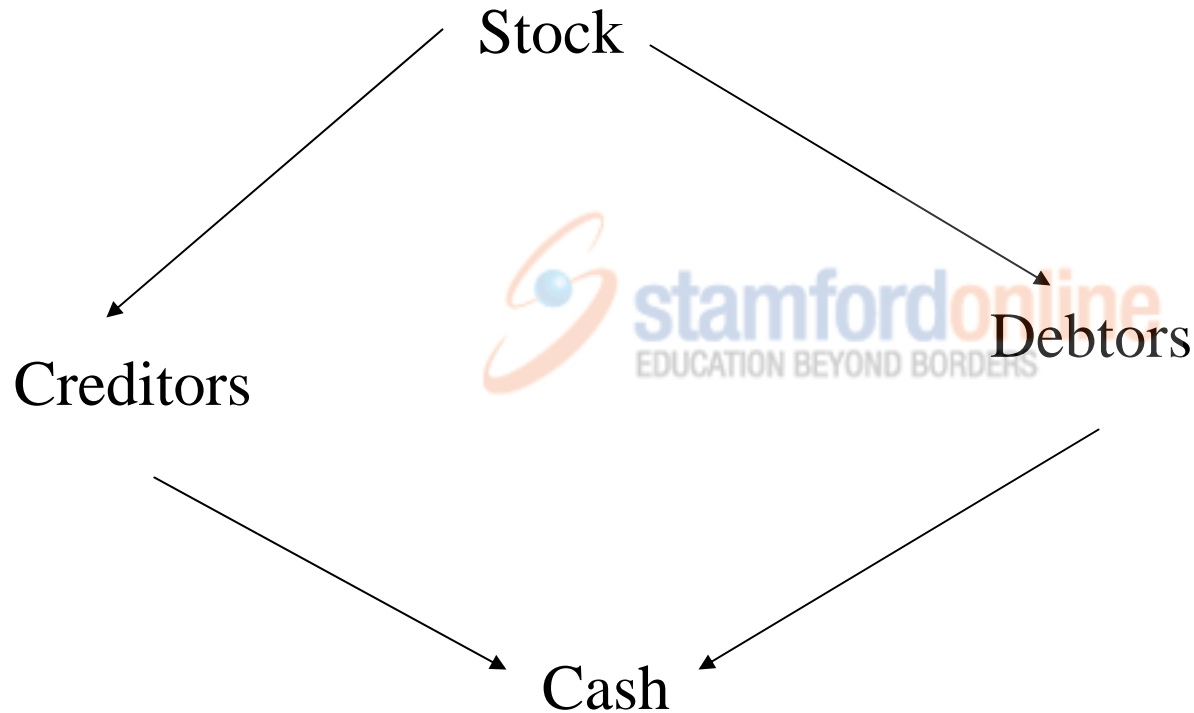
Working Capital Management (Week 10-13)

- The success or failure of a business does depend on the ability of the management to manage the working capital. This is, indeed, the heart of the business which will propel the business operations of all departments to achieve the required objective. Each element of the WC will be a vital link to the final destination.

The nature and purpose of Working Capital (WC)

- Working capital is usually defined as Current assets less current liabilities. Current assets (CA) consists of stock, debtors, bank & cash. Current liabilities consists of creditors, bank overdraft, dividends & corporation tax.

Working Capital cycle (WCC)



The components of the WC varies from industries to industries. For some business, the investment in WC can be very large e.g. a textile company as opposed to a service related industry.

WC represents a net investment in short-term assets. These assets are continually flowing into and out of the business, and are vital for the day to day operations.

The management of WC is an essential part of the business's short-term planning process. It is necessary for management to decide how much of each element should be maintained. The problem will be brought to light when hiccups take place when the components have been casually understood.

Management must be aware of the costs associated with these elements, particularly if stock is in short supply, for example. To this end, the potential benefits must be weighed against the likely costs in order to achieve the optimum investment.

Quiz 1

- What kind of changes in the environment might lead to a decision to alter the level of investment in WC.

- Answer:

Changes in I R

Changes in M d

Changes in S

Changes in the P



Management of Working Capital

- Stock

Management of stock includes some of the following:

- Being able to identify the E.O.Q.
- Set the minimum & maximum re-order levels
- Use budgets to plan
- Need to maintain reliable stock records
- use ratio analysis to evaluate the figures from one period to another
- Consider JIT and MRP solutions
- Ensure proper security controls systems are in place

Control of Debtors

- Use the 5 C's principle
Capital, capacity, character, condition & collateral.
Cost of allowing credit:
 - lost interest
 - lost of purchasing power
 - administration cost
 - cost of assessing customer creditworthiness
 - bad debts
 - cash discounts (if prompt payment)Cost of not giving credit
 - loss of customer goodwill

Management of cash

- The manner in which the “cash” is used will ensure the direction in which the organisation is moving.

Costs of holding insufficient cash:

- Costs of borrowing (if a need arises)
- inability to claim cash discounts
- loss of good opportunities
- loss of supplier goodwill



Steps to Effective cash management:

- receiving cash from debtor's faster than having to pay creditors.
- Optimum 'Cash operating cycle;
- transmit cash promptly
- bank in frequently
- establish a cash management policy
- make use of bank overdraft effectively

Effective use of trade creditors

- Trade credit arises from the fact that most businesses buy their goods and service requirements on credit. Trade creditors are an important source of finance for most business.



Steps:

- establish a policy when it comes to trade creditors
- exploit free credit as far as possible
- use accounting ratios