

	Risk avoided	Costs incurred
Inventory	Lack of inventory and loss of customer who cannot wait	Cash tied up in inventory and cost of physically holding inventory
Receivables	Loss of customers who find attractive opportunities elsewhere	Cash tied up in receivables and more possible bad debts
Payables	Reliance on alternative forms financing e.g. bank overdraft	Damage to market reputation and being charged higher prices



Working capital cycle

Working capital tradeoffs

Current assets - current liabilities

Ratios

- Current ratio** = Current assets / current liabilities must be > 2
- Liquid ratio** = Current assets - inventory / current liabilities
- Stock days** = Stock * 365 / cost of sales The less the better
- Debtor days** = Trade receivables * 365 / sales The less the better
- Creditor days** = Trade payables * 365 / cost of sales The more the better
- Sales generation ratio** = Sales revenue / total assets

Working capital

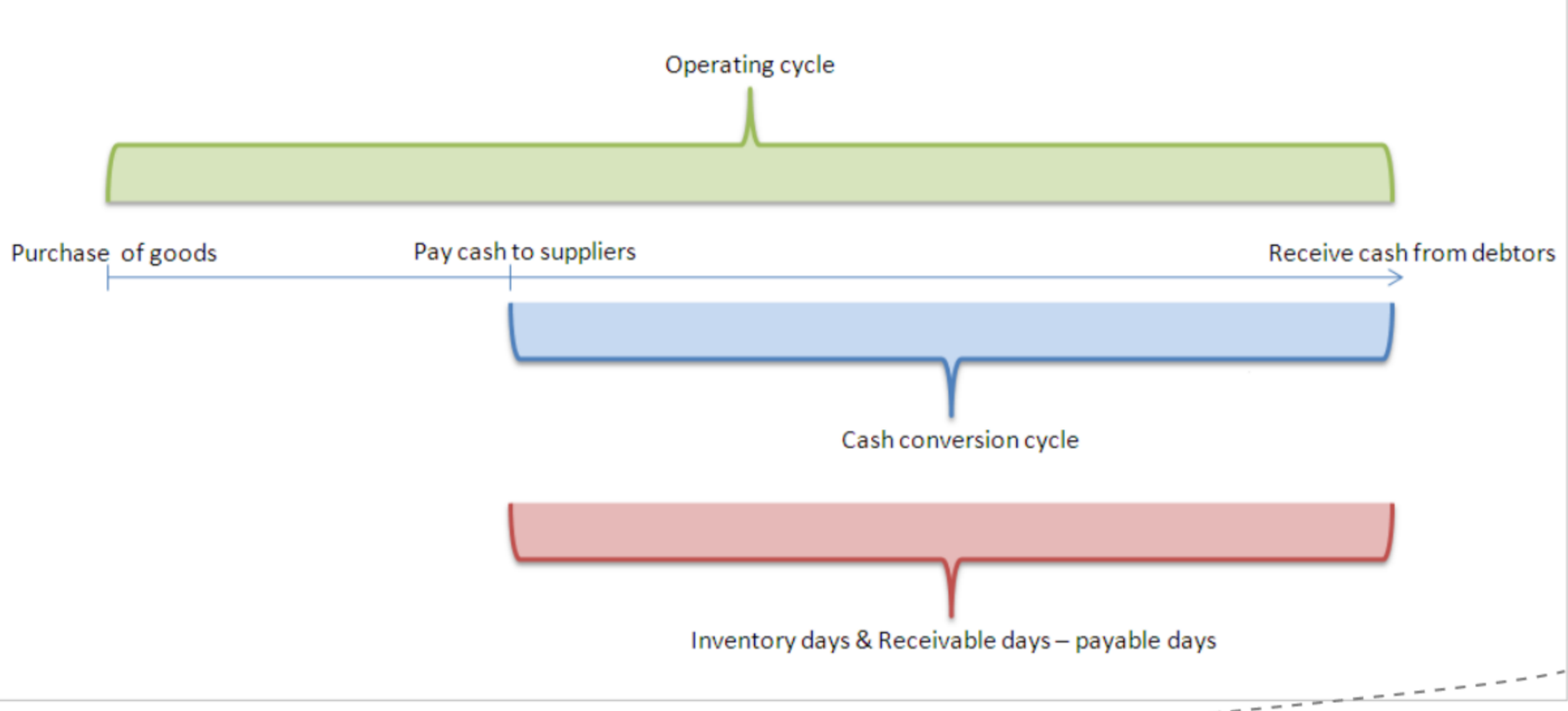
1 Inventory control

- Setting inventory levels Max, Min, Reorder levels --> historic & forecast levels
- Monitoring movements against inventory levels If level goes above max --> cancel orders, if goes below than trigger order etc...
- Taking corrective actions

2 Credit control

- Goal = Minimise bad debts
- 1 Set up credit policy
 - Period of credit
 - Timing & Action
 - Consider competitive environment
- 2 Vetting of new customers
 - Ability to pay (Balance sheets, etc.)
 - Willingness to pay (Look at track record)
- 3 Monitoring of ageing of debts
 - New order would not exceed credit limit
 - No outstanding debts on the account
 - Ageing report (amount, 30 days, 60 day, 90 days, remarks)
- 4 Taking corrective actions
 - In accordance to credit policy
 - Improve collection --> Factoring

Cash conversion cycle



Investment in working capital

- Inventory + trade receivables - payable days = Cash conversion period
- Inventory = 60m * 60 / 365 = 9.9
- Receivable = 100m x 30 / 365 = 8.2
- Creditors = 60m * 30 / 365 = 4.9
- Result = Inventory + Receivable - Creditors = Total working capital 13.2m
- Combination of figures (inventory (60), debts (30), creditors (30)) with forecast (revenue (100), cost of sales (60))

Cash control

- Forecast of sales and cash receipts
- Forecast of cash expenditure
- Monthly net cash flow and cash balance