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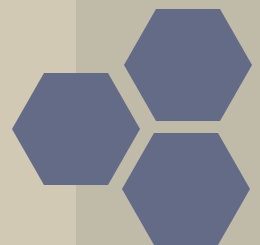
Provided by
ACCA Research Institute

ACCA F9

Financial Management

财务管理

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Part C working capital management IV

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what is working capital

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working capital management

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working capital finance





Working capital finance

1. 企业为什么要保留现金？

- a business needs cash to meet its regular commitments
- precautionary motive 预防动机
- speculative motive 投机动机

2. Cash flow problem出现的原因

- Making losses
- Inflation
- Growth
- Seasonal business
- One-off items of expenditure





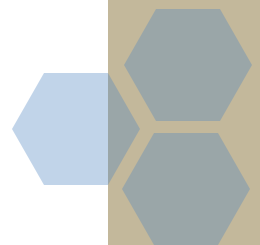
Working capital finance

Cash flow forecast:

a detailed forecast of cash inflows and outflows incorporating both revenue and capital items

Usefulness of cash flow forecast:

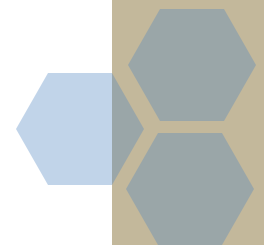
give management an indication of potential problems that could arise and allows them the opportunity to take action to avoid such problems





Working capital finance

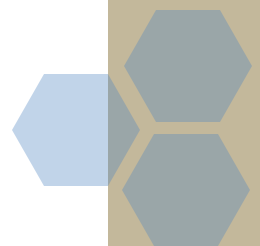
Cash position	Appropriate management action
Short-term surplus	Pay accounts payable early to obtain discount Attempt to increase sales by increasing accounts receivable and inventories Make short-term investments
Short-term deficit	Increase accounts payable by delaying payments to suppliers Reduce accounts receivable by improving collection of overdue payments Arrange a bank overdraft facility, or increase the limit on an existing facility
Long-term surplus	Make long-term investments Expand Diversify Replace/update non-current assets Distribute the surplus to shareholders
Long-term deficit	Raise long-term finance (such as via issue of share capital) Consider shutdown/disinvestment opportunities





如何做现金流预测？

- Not all cash receipts affect statement of profit or loss income
- Not all cash payments affect statement of profit or loss expenditure
- Some costs in the statement of profit or loss such as profit or loss on sale of non-current assets or depreciation are not cash items but are costs derived from accounting conventions
- The timing of cash receipts and payments may not coincide with the recording of statement of profit or loss transactions



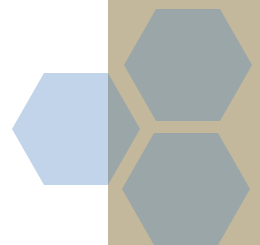


Working capital finance

Example:

You are presented with the following flow forecasted cash flow data for your organisation for the period November 20X1 to June 20X2. It has been extracted from functional flow forecasts that have already been prepared.

	<i>Nov X1</i>	<i>Dec X1</i>	<i>Jan X2</i>	<i>Feb X2</i>	<i>Mar X2</i>	<i>Apr X2</i>	<i>May X2</i>	<i>June X2</i>
	\$	\$	\$	\$	\$	\$	\$	\$
Sales	80,000	100,000	110,000	130,000	140,000	150,000	160,000	180,000
Purchases	40,000	60,000	80,000	90,000	110,000	130,000	140,000	150,000
Wages	10,000	12,000	16,000	20,000	24,000	28,000	32,000	36,000
Overheads	10,000	10,000	15,000	15,000	15,000	20,000	20,000	20,000
Dividends		20,000						40,000
Capital expenditure			30,000			40,000		





Working capital finance

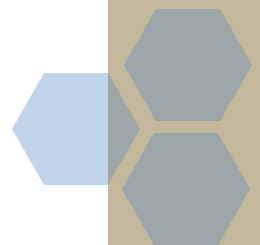
You are also told the following.

- (a) Sales are 40% cash 60% credit. Credit sales are paid two months after the month of sale.
- (b) Purchases are paid the month following purchase.
- (c) 75% of wages are paid in the current month and 25% the following month.
- (d) Overheads are paid the month after they are incurred.
- (e) Dividends are paid three months after they are declared.
- (f) Capital expenditure is paid two months after it is incurred.
- (g) The opening cash balance is \$15,000.

The managing director is pleased with the above figures as they show sales will have increased by more than 100% in the period under review. In order to achieve this he has arranged a bank overdraft with a ceiling of \$50,000 to accommodate the increased inventory levels and wage bill for overtime worked.

Required

- (a) Prepare a cash flow forecast for the six-month period January to June 20X2.
- (b) Comment on your results in the light of the managing director's comments and offer advice.

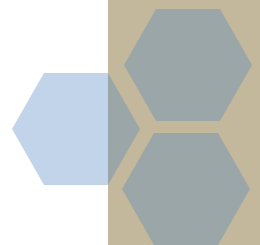




Working capital finance

Methods for easing cash shortage:

- Postponing capital expenditure
- Accelerating cash inflows which would otherwise be expected in a later period
- Reversing past investment decisions by selling assets previously acquired
- Negotiating a reduction in cash outflows, to postpone or reduce payments





Working capital finance

Cash management models :

1) The Baumol model

$$Q = \sqrt{\frac{2CS}{i}}$$

Where S = the amount of cash to be used in each time period

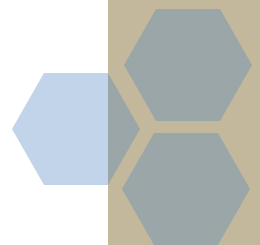
C = the cost per sale of securities

i = the interest cost of holding cash or near cash equivalents

Q = the total amount to be raised to provide for S

Drawbacks of the Baumol model:

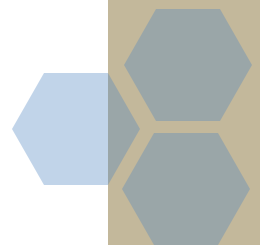
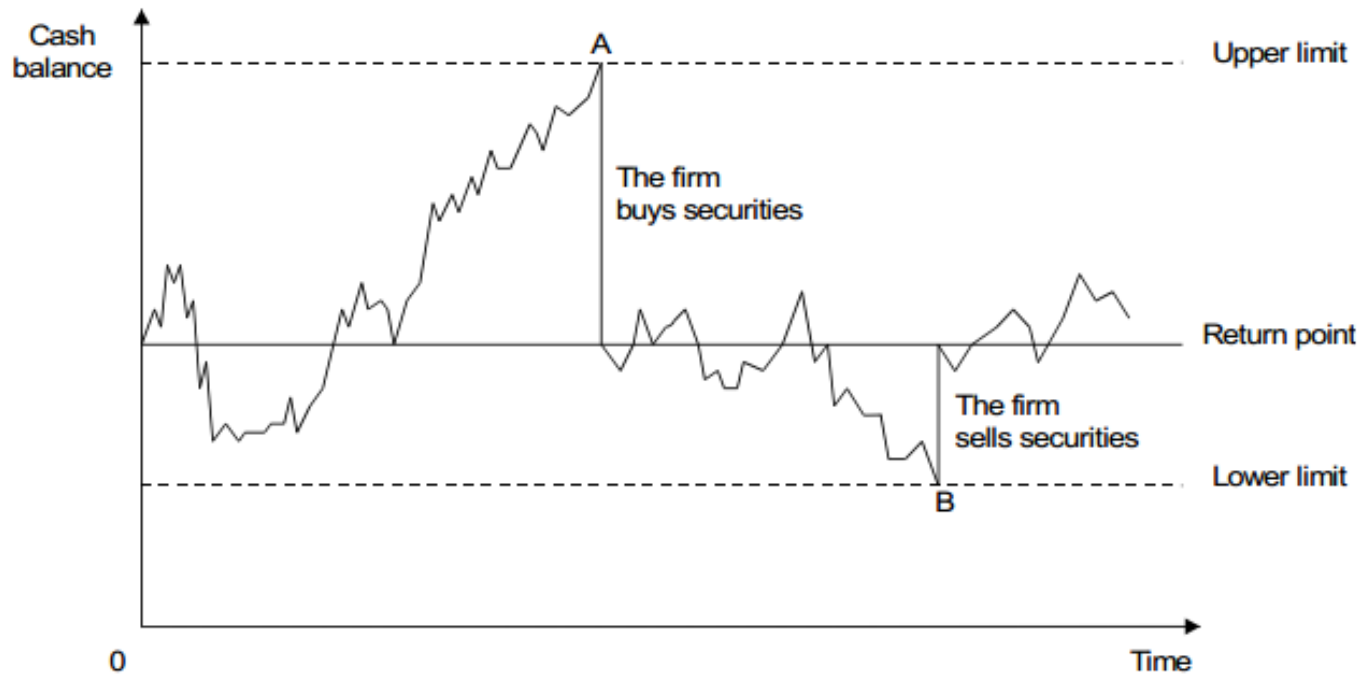
- it is unlikely to be possible to predict amounts required over future periods
- No buffer inventory of cash is allowed for
- There may be other normal costs of holding cash





Working capital finance

Cash management models: 2) The Miller-Orr model





Working capital finance

$$\text{Return point} = \text{Lower limit} + \left(\frac{1}{3} \times \text{spread}\right)$$

The formula for the spread is:

$$\text{Spread} = 3 \left(\frac{3}{4} \times \frac{\text{Transaction cost} \times \text{Variance of cash flows}}{\text{Interest rate}} \right)^{\frac{1}{3}}$$

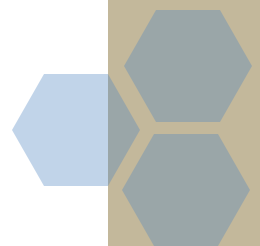
Steps for using Miller-Orr model:

I. Set the lower limit for the cash balance

II. Estimate the variance of cash flows

III. Note the interest rate and the transaction cost for each sale or purchase of securities

IV. Compute the upper limit and the return point from the model and implement the limits strategy.





Thank You!

