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# ACCA F9

**Financial Management**

**财务管理**

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# Part C working capital management Ⅰ

1. What is working capital
2. Working capital management
3. Working capital finance

# Definition of working capital

| | | |
|---|---|---|
| Current Assets | X | |
| less Current Liabilities | (X) | |
| Net Current Assets | | X |

WORKING CAPITAL MANAGEMENT

Working Capital is the capital available for conducting the day-to-day operations of an organisation

——流动性较高

The two main objectives of working capital management are to ensure it has sufficient liquid resources to continue in business and to increase its profitability.

# Key current assets and liabilities

| Current assets | Current liabilities |
|---|---|
| Cash | Trade accounts payable |
| Inventory of raw materials | Taxation payable |
| Inventory of work in progress | Dividend payments due |
| Inventory of finished goods | Short-term loans |
| Amounts receivable from customers | Long-term loans maturing within one year |
| Marketable securities | Lease rentals due within one year |

# Cash operating cycle

The cash operating cycleis the period of time which elapses between the point at which cash begins to be expended on the production of a product and the collection of cash from a customer.

| | *Months* |
|---|---|
| The average time that raw materials remain in inventory | X |
| Less the time taken to pay suppliers (ie period of credit taken from suppliers) | X |
| Plus the time taken to produce the goods | X |
| Plus the time taken by customers to pay for the goods | X |
| Cash cycle | X |

example P82

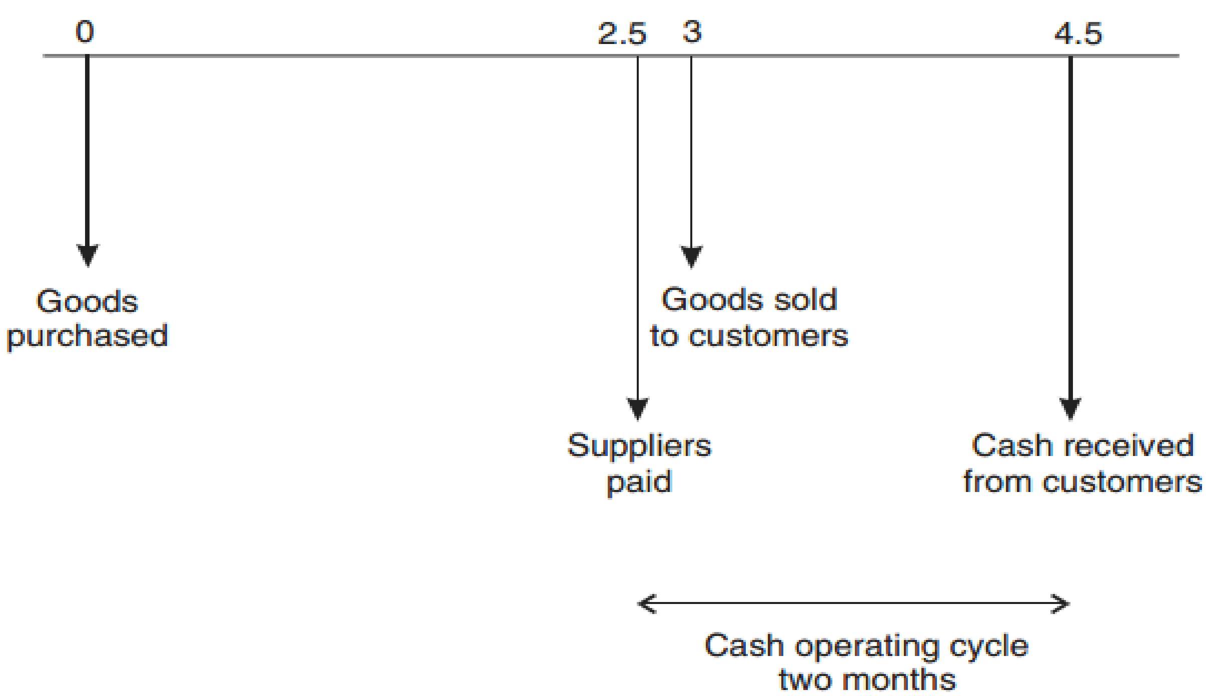
# Examples

## Solution

We can ignore the time that finished goods are in inventory as it is no more than a couple of days.

| | *Months* |
|---|---|
| The average time that raw materials remain in inventory | 1.0 |
| Less the time taken to pay suppliers | (2.5) |
| The time taken to produce the goods | 2.0 |
| The time taken by customers to pay for the goods | 1.5 |
| Cash cycle | 2.0 |

The company's cash operating cycle is 2 months. This can be illustrated diagrammatically as follows.



# Operating cycle

| | Days |
|---|---|
| Raw materials inventory holding period | X |
| Accounts payable payment period | (X) |
| Average production period | X |
| Inventory turnover period (Finished goods) | X |
| Accounts receivable payment period | X |
| Operating cycle | X |

# Liquidity ratios

## Current ratio/ quick (Acid test) ratio

$$\textbf{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}} \qquad \textbf{Quick ratio or acid test ratio} = \frac{\text{Current assets less inventories}}{\text{Current liabilities}}$$

## The accounts receivable payment period

$$\frac{\text{Trade receivables}}{\text{Credit sales revenue}} \times 365 \text{ days}$$

## The inventory turnover period

$$\textbf{Inventory turnover period (Finished goods)} = \frac{\text{Average inventory}}{\text{Cost of sales}} \times 365 \text{ days}$$

## The accounts payable payment period

$$\textbf{Accounts payable payment period} = \frac{\text{Average trade payables}}{\text{Purchases or Cost of sales}} \times 365 \text{ days}$$

## The sales revenue/net working capital ratio

$$\frac{\text{Sales revenue}}{\text{Current assets} - \text{Current liabilities}}$$

# Over-capitalisation and over trading

**Over-capitalisation: excessive working capital may lead to over-capitalisation.**

Indicators:

Excessive inventories

Excessive accounts receivable and cash

Very few accounts payable

Change of liquidity ratios may be an indicator

# Over-capitalisation and over-trading

**Overtrading happens when a business tries to do too much too quickly with too little long-term capital**

Symptoms of overtrading:

- There is a rapid increasein sales revenue
- There is a rapid increase in the volume of current assets and possibly also non-current assets
- There is only a small increase in equity capital
- Some debt ratios and liquidity ratios alter dramatically

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# Thank You!