CHAPTER 17

WORKING CAPITAL POLICIES

WORKING CAPITAL

NET WORKING CAPITAL

BALANCE SHEET

Asset Side
Liabilities/Equity Side

ASSET & LIABILITY CHARACTERISTICS

Liquidity
Riskiness
Profitability

WORKING CAPITAL POLICY

Conservative
Moderate
Aggressive

CURRENT RATIO VS. NET WORKING CAPITAL

LONG-TERM VS. SHORT TERM FINANCING

MATCHING PRINCIPLE OF WORKING CAPITAL

Permanent Current Assets
Temporary Current Assets
WORKING CAPITAL PRACTICES

MANAGING CASH

Purchasing Power Risk
Why Hold Cash
- Transactions Balance
- Precautionary Balance
- Speculative Balance
- Compensating Balance

CASH BUDGET

SPEEDING UP CASH INFLOWS
SLOWING DOWN CASH OUTFLOWS

Collection Float
- Lockbox

Disbursement Float
- Remote Disbursement
- Payable through draft (PTD)
- Zero balance accounts
- Overdraft agreement

INVESTING TEMPORARY CASH

Low default risk
Low interest rate risk
Low purchasing-power risk
Low liquidity risk
Low foreign-exchange risk
MONEY MARKET SECURITIES

- U.S. Treasury Bills
- U.S. Agency Paper
- Commercial Paper
- Repurchase Agreements
- Money Market Mutual Fund
- Negotiable CD’s
- Banker’s Acceptances

ACCOUNTS RECEIVABLE AND CREDIT POLICY

CREDIT GRANTING STANDARDS

Character
Capacity
Capital
Collateral
Conditions

CREDIT GRANTING TERMS

2/10, net 30
Opportunity Cost

\[
OC = \frac{\text{discount \%}}{1 - \text{discount \%}} \times \frac{365}{\text{Days in discount period}}
\]

MONITORING ACCOUNTS RECEIVABLE

Accounts Receivable Turnover
Average Collection Period
Aging Schedule
INVENTORY MANAGEMENT

Inventory Costs
- Ordering Costs
- Carrying Costs
- Stockout Costs

MINIMIZING INVENTORY COSTS

Total costs = Carrying costs + Ordering costs
Carrying costs = Avg. Size of Inventory \times Annual cost to carry one unit
Ordering costs = Number of order placed per year \times Cost to place one order

ECONOMIC ORDER QUANTITY

\[
EOQ = \sqrt{\frac{2 \times S \times O}{C}}
\]

S = Sale per year in units
O = Cost to place one order
C = Annual cost to carry on unit

MONITORING INVENTORY LEVELS

Inventory Turnover
MANAGING CURRENT LIABILITIES

Trade Credit  
- Stretching Accounts Payable

COMMERCIAL BANK BORROWING

Line of Credit - informal agreement; annual renewal; annual cleanup  
Revolving Credit Agreement - formal agreement; commitment fee; no cleanup

CALCULATING COST OF BANK LOANS

Usable Proceeds  
Discount-Interest Loan  
Discount Interest with Compensating Balance

Effective Annual Rate

\[
\text{EAR} = \frac{\text{Annual Interest}}{\text{Usable Loan Proceeds}}
\]

SECURED LOANS AND FACTORING

Pledging Receivables  
Factoring Receivables  
Inventory Loans  
- Floating Lien  
- Trust Receipt  
- Warehouse Receipt  
- Public Warehousing  
- Field Warehousing