CHAPTER 11
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
- 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
- Money Market Mutual Fund
- Negotiable CD’s

ACCOUNTS RECEIVABLE AND CREDIT POLICY

CREDIT GRANTING STANDARDS

Character
Capacity
Capital
Collateral
Conditions

CREDIT GRANTING TERMS

2/10, net 30
Opportunity Cost

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

MONITORING ACCOUNTS RECEIVABLE

Accounts Receivable Turnover = Credit Sales / Accounts Receivable
Average Collection Period = 365 / Accounts Receivable Turnover
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 x Annual cost to carry one unit
Ordering costs = Number of orders placed per year x 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 one unit

MONITORING INVENTORY LEVELS

Inventory Turnover = Cost of good sold / Inventory
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
- Warehouse Receipt
- Field Warehousing