



**NIGERIAN INSTITUTE OF
QUANTITY SURVEYORS**

The professional construction cost managers.

WEBINAR SERIES ON ACCOUNTING AND FINANCE FOR NON-FINANCIAL MANAGERS

WORKING CAPITAL MANAGEMENT

BY

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WORKING CAPITAL MANAGEMENT

LEARNING OBJECTIVES AND OUTCOMES

At the end of this session, participants should be able to understand the meaning and application of Working Capital management in and its importance to businesses.

Working Capital Management

Working capital represents the net current assets available for day-to-day operating activities.

Working capital management is a business strategy designed to ensure that a company operates efficiently by monitoring and using its current assets and liabilities to the most effective use.

The primary purpose of working capital management is to enable the company to maintain sufficient cash flow to meet its short-term operating costs and short-term debt obligations.

Working Capital Management

What to Note

Working capital management requires monitoring a company's assets and liabilities to maintain sufficient cash flow to meet its short-term operating costs and short-term debt obligations.

Managing working capital primarily revolves around managing accounts receivable, accounts payable, inventory, and cash.

Working capital management involves tracking various ratios like working capital ratio, the collection ratios, and inventory ratio.

Working Capital Management

What to Note

Working capital management can improve a company's cash flow and quality of earnings by using its resources efficiently.

Working capital management strategies may not materialize due to market fluctuations. It may sacrifice long-term successes for short-term benefits.

Many businesses that appear profitable are forced to cease trading due to an inability to meet short-term obligations when they fall due.

Components of Working Capital Management

Current assets include anything that can be easily converted into cash within 12 months. These are the company's highly liquid assets. Some current assets include cash, accounts receivable, inventory, and short-term investments.

Current liabilities are any obligations due within the following 12 months. These include accruals for operating expenses and current portions of long-term debt payments.

Components of Working Capital Management

Since Working Capital Management entails comparing all current assets to current liabilities the accounts that are critical to track include:

Cash/Treasury Management

This involves managing the company's cash flow by forecasting needs, monitoring cash balances, and optimizing cash inflows and outflows to ensure that the company has enough cash to meet its obligations. Tracking cash balances and cash needs is the core of working capital management.

Also note that cash are held for 3 major reasons: Transactionary, Precautionary and Speculate motives.

Components of Working Capital Management

Receivables

To manage capital, companies must be mindful of their receivables. This is especially important in the short-term as they wait for credit sales to be completed.

This involves managing the company's credit policies, monitoring customer payments, and improving collection practices. At the end of the day, having completed a sale does not matter if the company is unable to collect payment on the sale.

Components of Working Capital Management

Payables

This is one aspect of working capital management that companies can take advantage of because they often have greater control over.

While other aspects of working capital management may be out of the company's hands (i.e. selling goods or collecting receivables), companies often have a say in how they pay suppliers, what the credit terms are, and when cash outlays are made.

Components of Working Capital Management

Inventory

This is about the most risky aspect of managing capital. This is because a company must go to the market and rely on consumer preferences to convert inventory to cash.

If this cannot be completed in a timely manner, the company may be forced to have short-term resource stuck in an illiquid position.

Alternatively, the company may be able to quickly sell the inventory but only with a steep price discount.

Types of Working Capital

There are different types of working capital. The include:

Permanent Working Capital- this is the amount of resources the company will always need to operate its business without interruption.

Regular working capital- this is the part of the permanent working capital that is actually required for day-to-day operations and makes up the "most important" part of permanent working capital.

Types of Working Capital

Reserve working capital- this is another component of permanent working capital. Companies may require an additional amount of working capital on hand for emergencies, seasonal or unpredictable events.

Fluctuating Working Capital- this includes only the variable liabilities that the company has complete control over. They are variable costs such as inventories.

Types of Working Capital

Gross working capital- this is simply the total amount of current assets of a business before considering any short-term liabilities.

Net working capital- this is the difference between current assets and current liabilities.

Working Capital Cycle

The working capital cycle for a business is the length of time it takes to convert the total net working capital (current assets less current liabilities) into cash.

Businesses typically try to manage this cycle by selling inventory quickly, collecting revenue from customers quickly, and paying bills slowly to optimize cash flow.

Working capital cycle=

Inventory Days + Receivable Days – payable Days

Working Capital Cycle

Inventory days = The average number of days it takes to sell inventory

Receivable days = The average number of days it takes to receive money from debtors

Payable days = The average number of days it takes to pay creditors

e.g. given:

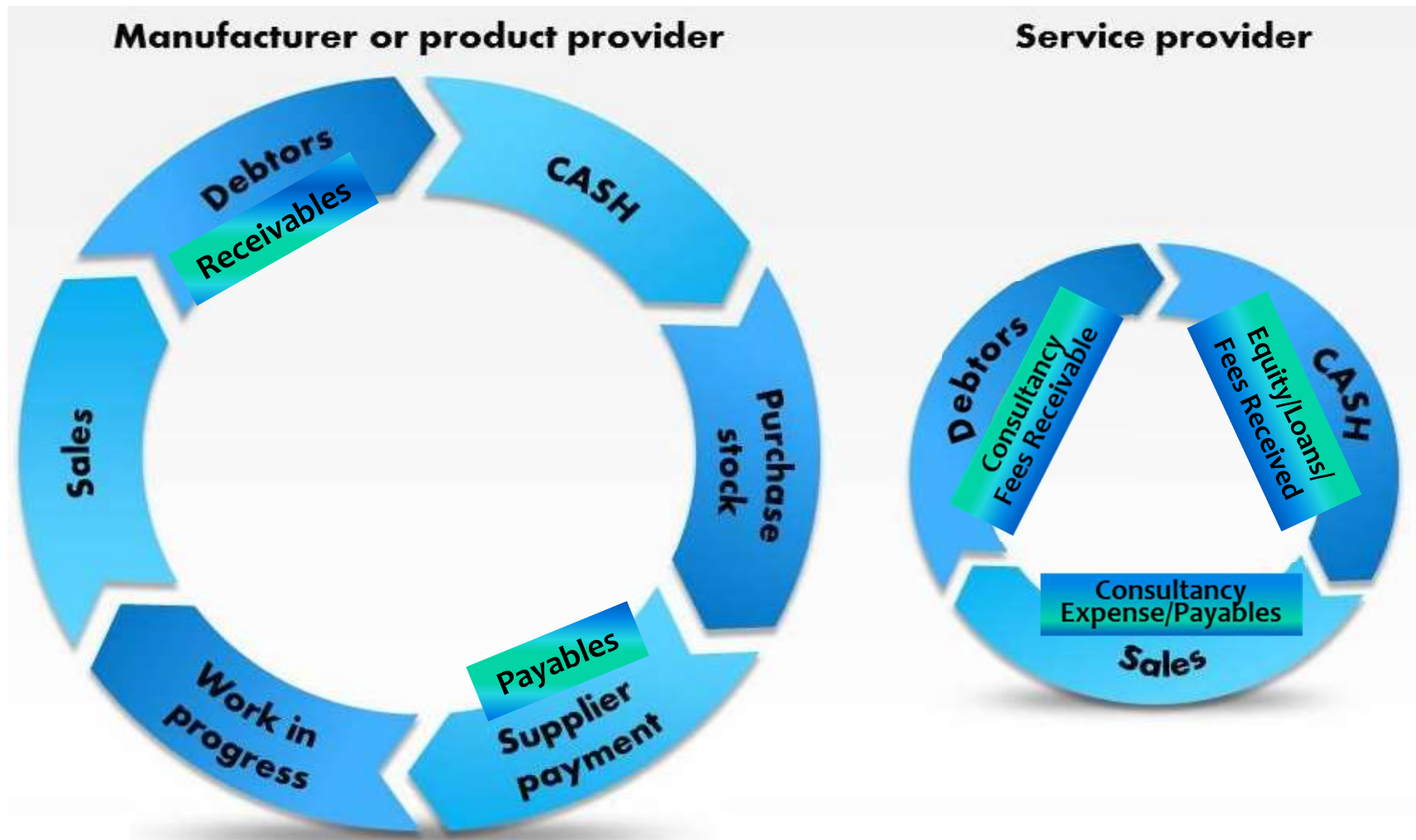
Inventory days = 85 ; Receivable days = 20 Payable days = 90
Working Capital Cycle = $85 + 20 - 90 = 15$ days

The company has a positive Working Capital Cycle. It has to wait for 15 days to receive payment or make cash available.

On the other hand, a Negative Working Capital Cycle is when a business collects money at a faster rate than the time required to pay its bills.

Working Capital Cycle

Simple Diagram of Working Capital Cycle



Working Capital Cycle

WAYS TO IMPROVE YOUR WORKING CAPITAL CYCLE

- Reducing your receivable days, i.e. debtors to pay you faster.
- Stretching your payable days so you can have favourable payment terms.
- Manage your inventory days by avoiding stockpiling and getting your products to move faster.
- Ensure that your receivable days are not greater than your payable days, i.e. get paid by your debtors before you need to pay your suppliers.

Conclusion

When a company does not have enough working capital to cover its obligations, *financial insolvency can result and lead to legal troubles, liquidation of assets, and potential bankruptcy.*

It is therefore safe to conclude that working capital management is a corporate strategy designed to ensure a company is operating as efficiently as possible by increasing visibility into its assets and liabilities.

The successful management of working capital is essential to remaining in business.

THANK YOU FOR YOUR ATTENTION



Do You Have Any Questions?



We would be happy to help.

SYNDICATE SESSION

Group discussions / Interactions

Define and Discuss Working Capital Management.