THE MANAGING CASHFLOW POCKETBOOK

By Anne Hawkins and Clive Turner

Drawings by Phil Hailstone

“Managers do not understand the difference between profit and cash. This book explains the issues involved clearly and simply. It is an essential guide for the non-financially trained manager.”
Nick Bacon, Director, Lloyds TSB Development Capital Ltd

“An invaluable guide to the most critical of business issues - easy to read and full of helpful ideas.” **J. B. McCarthy, Financial Director, Triton plc**

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INTRODUCTION

In most businesses efficient management of Working Capital is the key to successful cash management.

What is Working Capital?

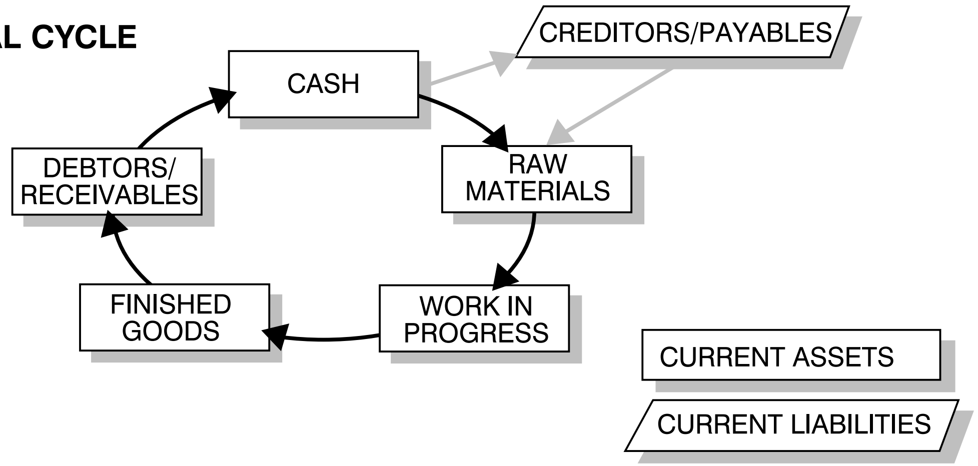
- Businesses raise Long-term money (Source of Funds) in order to invest it in the business (Use of Funds)

- Investment is required to provide:
  - Facilities/Processes (Accountant's jargon: Fixed Assets)
  - Products/Services (Accountant's jargon: Working Capital)

These terms and the Working Capital cycle are explained in *The Balance Sheet Pocketbook.*

WHAT IS WORKING CAPITAL?

WORKING CAPITAL CYCLE



1 Working Capital = Current Assets *less* Current Liabilities
- the amount the business has invested in products/services (stock + debtors + cash) less the value of goods and services owed to suppliers (creditors)

2 Stock = Raw Material + Work in Progress + Finished Goods

HOW MUCH WORKING CAPITAL IS REQUIRED?

This is a function of:

- The size of the business
- Credit given and taken
- Lead time through the manufacturing process
- Range of products/services offered

How much Working Capital does your business **need**?

How much Working Capital does it **have**?

HOW MUCH SHOULD I HAVE?

You should have as little Working Capital as possible, consistent with maximising business profitability!

The objectives are to complete the Working Capital Cycle:

1 As fast as possible

Why? - minimise the investment and hence improve the return
- reduce risk (see pages 62-3)

2 As frequently as possible

Why? - completing the cycle generates profit and cash

HOW MUCH WORKING CAPITAL?

REDUCING RISK

- There is only one part of the Current Asset cycle that accountants like - **CASH;** everything else represents risk
- When you use cash to buy Raw Material:
  - what if there is a modification?
  - what if the customer cancels?
  - does the material have a shelf life?
  - could you sell the material back or to someone else?
- When you convert Raw Material to Work in Progress and Finished Goods:
  - ditto
- Even when you despatch the goods:
  - what if the customer does not pay?

HOW MUCH WORKING CAPITAL?

REDUCING RISK

- The degree of risk is affected by the type of product and whether it is customer-specific

  However

  There is no benefit whatsoever to the business until the Working Capital Cycle has been completed and cash received from the customer

- Hence to persuade the accountant to part with cash and embark on the cycle, you must convince him/her that the return is worth the risk
- By reducing the time taken to complete the cycle, the risk can be reduced

MEASURING PERFORMANCE

RATIOS

- Ratios are used to express Working Capital management performance
- These ratios express each component of the cycle in terms of time (a number of days)
- Improvements in Working Capital management can then be seen by a reduction in the number of days required to complete the cycle
- Working Capital Days

Working Capital Days	equals	no. days Raw Material
	plus	no. days Work in Progress
	plus	no. days Finished Goods
	plus	no. days Debtors
	less	no. days Creditors

About the Authors

Anne Hawkins, BA, ACMA is a Management Accountant with a first class honours degree in Business Studies. Anne has progressed from this strong knowledge base to gain senior management accounting experience within consumer and industrial product industries. As a Training Consultant she develops and presents finance programmes to Directors and Managers from all sections of industry.

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