9.6 Financing and working capital

Name: _____ Class: _____ Date: _____ **Total: 12 marks**

KEY WORDS cash conversion cycle

Objective

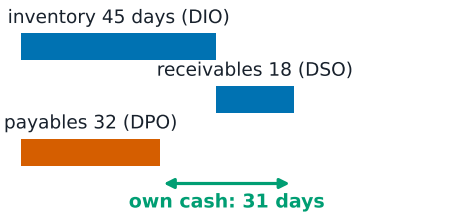
Compute the cash conversion cycle; price the working-capital cost of growth; choose financing with term matching.

1 Key knowledge and worked examples

■ The cycle and the trap

CCC = DIO + DSO − DPO. Growth multiplies it; ratio-worsening doubles it. Match term to life.

The 31-day bridge of own cash



CCC = 45 + 18 - 32 = 31 days of sales tied up

Overtrading, one table

sales	100	**160**
NWC/sales	20%	**25%**
NWC	24,000	**48,000**

NWC DOUBLES (1.6 x 1.25)

sales +60%, not +60% cash

Profit is an opinion; cash is a fact

■ Worked example. The raise

CCC 31 days; sales +60% with NWC/sales 20→25% doubles NWC to 48,000 ✓; rescue levers in speed order.

2 Practice

A stationery wholesaler: inventory 60 days, receivables 35, payables 41; daily cost of sales £2,400; sales £1.1m a year, NWC/sales 18%.

2.1 Compute the CCC and the NWC tied up at 18% of sales. [3]

2.2 Sales grow 50% and NWC/sales rises to 21%. Compute the new NWC and the extra cash required (nearest £100). [3]

2.3 The MD celebrates the profit. In two lines, explain why the overdraft may still grow. [2]

2.4 The expansion vans (8-year life) are to be funded by a 3-year loan at 6.5% or new equity at 13%. In two lines each: the matching verdict, and one speed lever that releases cash regardless. [4]

Solutions

2.1

- $CCC = 60 + 35 - 41 = 54$ days.
- $NWC = 0.18 \times 1{,}100{,}000 = £198{,}000$.

2.2

- New sales = 1.65m; new NWC $= 0.21 \times 1{,}650{,}000 = £346{,}500$.
- Extra cash $= 346{,}500 - 198{,}000 = £148{,}500$ – the 1.5×1.167 multiplier at work.

2.3

- Profit is an opinion: the cycle grew with sales and worsened with terms.
- The cash cycle doubled the tie-up faster than profit replaced it – profitable and insolvent at once.

2.4

- Mismatch: 3-year money funding 8-year assets is refinancing risk – lengthen the debt or write the risk down.
- Equity is permanent and matches, but costs 13% – a pricing choice, not a free pass.
- Speed lever: collect faster or stretch payables honestly – each day of DSO/DPO moves about £3,000 of cash.

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