Working capital (1)

- **Working capital**
  - Is a short term resource that a company needs for carrying out its everyday tasks (routine activities).
  - Deals with current assets and current liabilities.
- **Working capital management -** deals with the management of working capital components:
  - Cash – optimal cash balances, liquidity.
  - Marketable securities – policy.
  - Receivables – size of receivables, credit policy, credit analysis, debt management.
  - Inventories- optimal balance, economic order quantity.
  - Payables – payment terms, use of rebates.

Working capital (2)

- **Gross working capital** – components of current assets i.e. cash, receivables, inventory etc.
  - Gross working capital in Dell:
    - Cash & cash equivalents
    - Short-term investments
    - Accounts receivable, net
    - Short-term financing receivables, net
    - Inventories
    - Other
- **Net working capital** = current assets – current liabilities
  - Current liabilities in Dell:
    - Short-term borrowings
    - Accounts payable
    - Accrued and other
    - Short-term deferred revenue

Working capital (3)

- **Fixed assets** – buildings, machinery, other long term assets important in the long term for assuring the sustainability of company's operations.
- **Differences between current assets and fixed assets**

Indicator	Current asset	Fixed asset
Time factor	Short-term	Long-term
Risk-return trade-off	Very important	Not so important
Dependence on sales	High	Low

Working capital (4)

- **Goals of working capital management:**
  - Set working capital policy – how to solve the risk-return trade-off puzzle.
  - Composition and level of working capital
  - Composition and level of current assets.
- **Traditional view** – current assets must exceed current liabilities.
- **Modern view**
  - Too much working capital is not good, especially, if it includes:
    - assets that generate no value
    - inventory which is obsolete
    - unlikely customer receivables.
  - The focus is on the management of cash conversion cycle.

Working capital (6)

Days supply in inventory = $\frac{\text{Inventory}}{\text{Cost of goods sold}}$ *360

-

Days in accounts payable = $\frac{\text{Accounts payable}}{\text{Cost of goods sold}}$ * 360

+

Days of sales outstanding = $\frac{\text{Accounts receivable}}{\text{Net revenue}}$ *360

=

Cash conversion cycle in days

The shorter it is the less working capital financing is needed.

Working capital (5)

- Problem - excess or inadequate working capital

Disadvantages of excess WC	Disadvantages of inadequate WC
Exist idle funds that yield no profits.	Inability to cover short-term liabilities i.e. difficulties in getting financing.
Unnecessary purchasing and accumulation of inventories (threat of theft, waste and losses increases)	Cannot use discounts, rebates.
Excess debtor/receivables and defective credit policy (higher bad debt rates).	Failure to exploit favourable market conditions and undertake profitable projects.
Difficult to maintain good relations with banks and other financiers (including suppliers).	Inefficiencies arise further reducing the profits.
Lower profitability (return on investment) reduces share price.	Difficulties in utilising all existing fixed assets.
Possibilities for speculative transactions increase (false security).	Difficult to get the expected rate of return on investments.

Working capital (6)

- Working capital requirement determined by:
  - Nature of the business.
  - Size/scale of the business.
  - Length of the production cycle.
  - Seasonal variations.
  - Working capital cycle.
  - Credit policy.
  - Business cycles.
  - Earnings capacity.
  - Dividend policy.

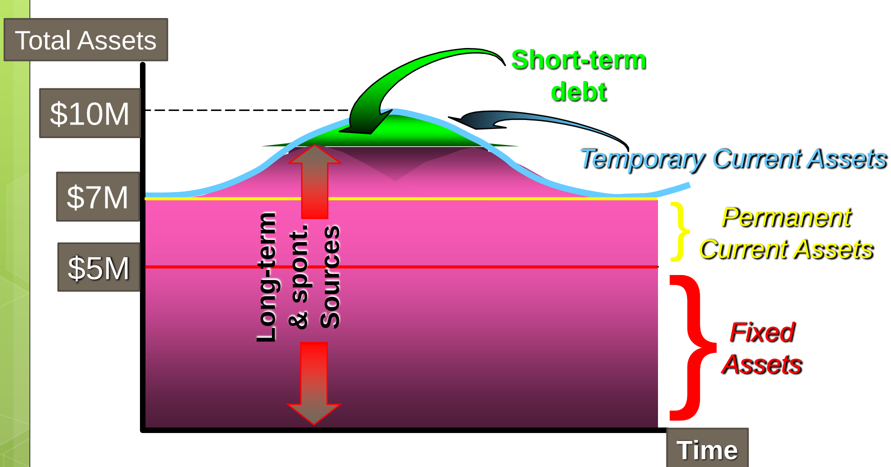
Working capital (7)

- **Financing of working capital (1)**
  - **Assets divided into:**
    - Fixed assets - machinery, buildings etc.
    - Permanent current assets – current assets that are stable during the year.
    - Temporary current assets - fluctuate during the year.
  - **Liabilities and equity dividend into:**
    - Long-term financing – long-term debt + equity.
    - Spontaneous financing – trade credit, other payables & accruals (e.g. Payable to employees, taxes).
    - Short term loans

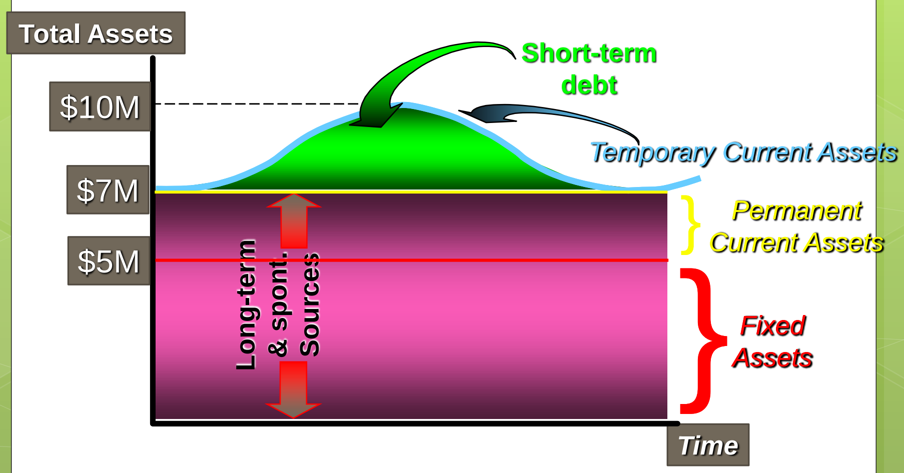
Working capital (8)

- **Financing of working capital (2):**
- Current assets' **financing strategies** (see next slides)
  - Aggressive – higher return, higher risk.
  - Conservative – lower return, lower risk.
  - Moderate - moderate return, moderate risk.

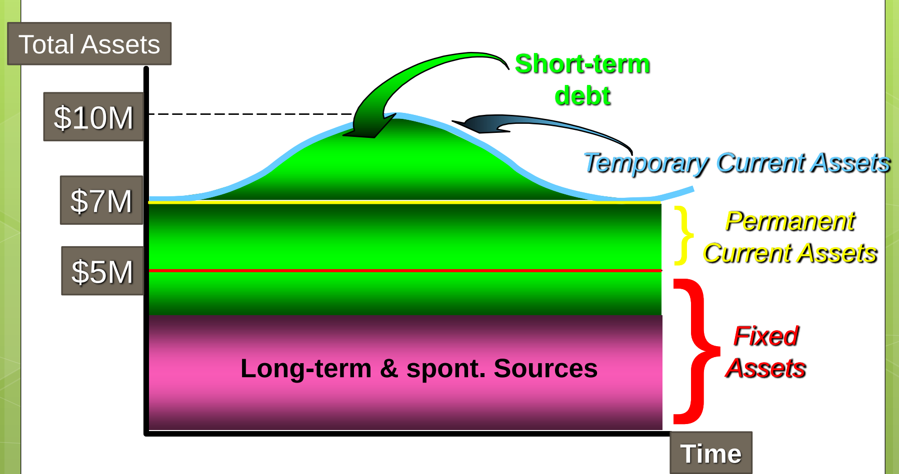
Financing Current Assets: Conservative Approach



Financing Current Assets: Moderate Approach



Financing Current Assets: Aggressive Approach



Case introduction (1)

- Time – May 2013.
- Protagonist – consultant Mary Hope.
- Company – Dell Inc.
  - Established in 1984 by Michael Dell.
  - Activity - desktop personal computers (PC), servers, networking products, storage, mobility products, software and peripherals, and services. See „Business Strategy, Customers and Products".
  - Location – headquarter Round Rock, Texas.
  - Listing - NASDAQ Global Select Market. For share price performance see Figure 1 & 2.
  - Company financials – Appendix 1 to 3.

Case introduction (2)

- Mission - to be the most successful computer company in the world at delivering the best customer experience in markets it serves.
- Market position - 3rd on desktop PC market (12%), 5th on portable PC market (10%). See Figure 5, Appendix 4.
- Competitors - on the PC market are HP (16% market share), Lenovo (15% market share, successor of IBM-s computer production business), followed by Acer and Asus. Main financials of HP an Lenovo in Appendix 5.

Case introduction (3)

- Company processes (purchases, manufacturing, inventory management, sales, financing) described in detail in the text.
- Task:

1. **What are the main weaknesses and strengths of Dell's working capital management?**
2. **Does Dell's current working capital management provide competitive advantages over competitors?**

More recent developments… (1)

- 12 Sept 2013 Dell shareholders approve the proposal that Mr. Dell acquires Dell in Partnership with Silver Lake Partners.
- Shareholders receive $13.75 + special dividend $0.13 per common share.
- Merger transaction closes 29 Oct 2013 and shares are delisted from NASDAQ.
- Why?
  - Dell got sideswiped by the speed of decline in PC sales replaced with smart phones and tablets.
  - Attempt to transform Dell into a provider of computing services to corporations, can be better achieved as a private company.

More recent developments… (2)

- **2016** — Dell and EMC together become **Dell Technologies** - the biggest technology integration in history. Two segments:
  - **Client Solutions** – hardware sales to commercial and consumer customers incl desktops, thin client products and notebooks; as well as services and third-party software and peripherals (monitors, printers and projectors).
  - **Enterprise Solutions Group (ESG)**- servers, networking and storage, as well as services and third-party software and peripherals.

More recent developments… (3)

- Share price of Dell Technologies.