

**SWISSAM**  
International  
University

# Working capital and Cash

**management**  
START HERE GO ANYWHERE



# Management of Working Capital

**The owners of any company make two major investments of capital in their business:**

- The capital invested in the building, furniture and fittings, kitchen equipment etc.
- The capital (in the form of cash) that they need to invest in stocks (food and drink for resale) and a further amount of cash is necessary to pay wages and running costs whilst awaiting payment from debtors.



# Working Capital

**Working Capital** may be defined as **the necessary investment in stock and cash to cover day-to-day running cost of business.**

It is important to realize that the money tied up in working capital is a **cost** to the business and therefore **must be controlled** and **kept at the minimum.**

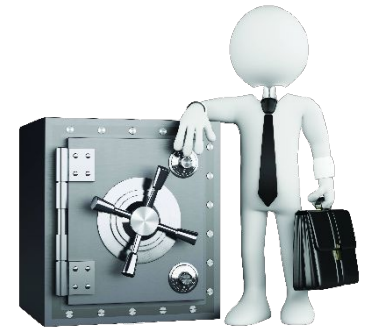
---

# Working Capital

**Working Capital** – the difference between current assets and current liabilities of the company.

The size of working capital depends on

- the type of business,
- the length of working capital cycle.



# Current Assets

**Current assets** consist of

- cash,
- marketable securities,
- notes receivable,
- credit card receivables,
- accounts receivable,
- inventories (for resale),
- supplies, and
- prepaid expenses.



**Current assets** are resources that will be consumed in the production of sales revenue in the next operating period.

---

# Current Liabilities

**Current liabilities** consist of

- accounts payable,
- accrued expenses (wages and salaries payable, interest payable, taxes payable), and
- notes payable.

**Current liabilities** represent operating costs that were incurred on credit and will be paid in the next operating period.



# Working Capital

Hotels and restaurants should minimize the amount of working capital needed to operate the business.

Any surplus cash not required to operate your business should be used for expansion, to fund projects that will generate additional cash flow, or simply be placed in a bank account that draws interest.

How much working capital is needed?



# Working Capital

**The amount of working capital your business needs to operate is a function of several factors:**

- The mix of cash and credit sales
- The method used to process credit card transactions
- The accounts receivable turnover ratio
- The food and beverage turnover ratio
- How quickly vendors and suppliers require their invoices to be paid
- The pace at which the business is growing





# Working Capital

## How to get it low?

- Offer a discount on cash sales
- Turn your inventories over as quickly as possible
- Establish a good credit rating with your suppliers and vendors
- Manage your accounts payable effectively
- Track all transactions



# Working Capital analysis

**Working capital analysis** evaluates changes to working capital over an operating period for the following purposes:

It shows how working capital increased, by identifying the inflows that created the increase.

It shows how working capital decreased, by identifying the outflow that created the decrease.



# Working Capital analysis

**Working capital analysis** evaluates changes to working capital over an operating period for the following purposes:

- It is used to find the net changes to working capital during the completed operating period.
- It provides management with information related to the effectiveness of working capital controls during the operating period.
- It provides prospective lenders with information so they can evaluate their risk in lending funds to the hospitality organizations.



# Management of Working Capital

From the point of view of the impact on the working capital, transactions may be divided into three groups:

- which **increase** working capital
- which **decrease** working capital
- which have **no effect** on working capital



# Inflows – Sources of Working Capital

The following are the major inflows or sources that will **increase working capital**.

***Income from operations.*** In general terms, accrued income is sales revenue less all expenses incurred (including income tax) in producing the sales revenue inflow. Sales revenue is generated by cash sales or on credit through receivables that eventually become cash. Expenses are incurred by immediate payment of cash or on credit through payables. The payables, accounts payable and accrued payables will eventually be paid.

Net income is expected to increase the organization's cash accounts and increase working capital.

---

# Inflows – Sources of Working Capital

The following are the major inflows or sources that will **increase working capital**.

***Accrual net income.*** This is determined after deducting noncash expenses.

Such noncash expenses adjust the book or carrying value of long-term assets through depreciation and/or by recognizing amortization expense.

To convert net income to the increase in working capital, all capitalized expenses must be added back to net income.



# Inflows – Sources of Working Capital

The following are the major inflows or sources that will increase working capital.

***Sale of long-term or other noncurrent assets.*** These include land, building, furniture, equipment, or an investment. Their sale is treated as an inflow, which increases working capital. The sale will create an increase in a current asset, cash, or a current receivable with no corresponding effect to a current liability.



# Inflows – Sources of Working Capital

The following are the major inflows or sources that will **increase working capital**.

***Increase in a long-term liability.*** Creating or increasing a loan, mortgage, debenture, or bond achieves this, and is an inflow that increases working capital. Borrowing additional long-term debt will create an increase in a current asset, cash, or a current receivable with no corresponding effect to a current liability.





# Inflows – Sources of Working Capital

The following are the major inflows or sources that will increase working capital.

***The issuance of stock.*** Equity financing creates an inflow that increases working capital. In a proprietorship or partnership (an unincorporated company), stock is not issued; however, any investment by the owner(s) increases their equity capital accounts. The sale of equity or receipt of an owner's investment will create an increase in a current asset, cash, or a current receivable with no corresponding effect on a current liability.

---

# Outflows – Uses of Working Capital

The following are the major outflows or uses that will **decrease working capital**.

***Loss from operations.*** Just as accrual net income is an increase in working capital, an accrual net loss is a decrease in working capital. When a loss occurs, operating expenses have exceeded sales revenue, which decreases working capital. Just as net income has to be adjusted for noncash expenditures (depreciation, write-downs, or amortization), the net loss is similarly adjusted. The net loss may be reduced by any noncash expense shown on the income statement.

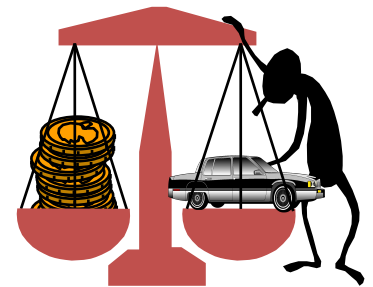
---

# Outflows – Uses of Working Capital

The following are the major outflows or uses that will decrease working capital.

## ***Purchase of a long-term or other noncurrent asset.***

This would include land, building, furniture, equipment, or other investment that is an outflow that decreases working capital. The cost of another noncurrent asset, such as the prepayment of a long-term franchise fee, is also an outflow that decreases working capital.



# Outflows – Uses of Working Capital

The following are the major outflows or uses that will decrease working capital.

***Payment of long-term liabilities.*** Any payment reducing the principal amount owed on a long-term (noncurrent) liability is an outflow that decreases working capital.



# Outflows – Uses of Working Capital

The following are the major outflows or uses that will decrease working capital.

***Redemption of stock.*** Any previously issued stock repurchased by the issuing company is called *treasury stock*, an outflow that decreases working capital.

***Payment of cash dividends.*** Previously declared, these are payable obligations, payment of which is an outflow that decreases working capital.

In a nonincorporated company, a partnership, or proprietorship, any cash or other current asset withdrawals made by the owner(s) are reductions of their capital investment and are treated as an outflow, decrease of working capital.

---

# Management of Working Capital

Transactions which have **no effect** on working capital:

- ✓ The purchase of fixed assets financed by a long-term loan
- ✓ The payment to supplier
- ✓ The purchase goods on credit



# Controlling Working Capital

Management must control the amount of cash tied up in working capital.

The amount of working capital needed by a business normally depends on three things:

- the level of trade,
- the length of working capital cycle,
- the level of stock required.



# Working Capital Cycle

**Working Capital Cycle** is the length of time a business has to wait between **expending** its cash on materials and labour etc. in order to sell goods or services and **receiving** payment from its customers.

The hospitality industry has traditionally a relatively short working capital cycle.





# Controlling the key items

**Stock:** regular stock-taking, reviewing the system of stock receipt and quality of suppliers (the more dependable the supplier the less need for large stocks. Regular analysis of fast and slow moving items.

**Debtors:** age analysis and two-week reminder system, offer of discounts.

**Creditors:** reduction of the number of suppliers and negotiate terms.



# Cash Management

- Cash is the one asset that is convertible into any other type of asset.
- It is liquid, often easily accessible to employees, and attractive to everyone that comes in contact with it.
- Cash is not limited to currency; it includes checks, money orders, and marketable securities.
- As a hospitality manager, your job is to control cash. You should know how much cash you need to operate your business, plan your cash disbursements carefully, and prepare accurate cash forecasts at all times.



# Cash Management

Whether or not the hotel takes in enough cash in a day to cover all these transactions, cash must be available for when it is required.

This **cash must be tracked and taken into account** just as carefully as any other service industry manages its cash. Hotels need to be even more careful because the methods in which money comes in and goes out don't match, so there's no fast and obvious way to reconcile accounts. Without good tracking of all the money flowing into and out of the hotel, including in cash, it's impossible to tell how the business accounts stand from one day to the next.

---

# Ratio analysis using the Statement of Cash Flows



# Ratio analysis using the CFS

**The cash flow from operating activities to current liabilities** ratio is a measure of liquidity and is calculated as follows:

**Cash flow from operating activities to current liabilities**  
= Cash flow from operating activities /  
Average current liabilities



# Ratio analysis using the CFS

**The cash flow from operating activities to total liabilities** ratio considers cash flow from operating activities over a period of time such as a year rather than debt of a specific date. This low ratio would indicate that the operation has a very high debt and creditors may be concerned about the security of their loans.

**Cash flow from operating activities to total liabilities =**  
Cash flow from operating activities /  
Average total liabilities



# Ratio analysis using the CFS

**The cash flow from operating activities to interest is a solvency ratio and is calculated as follows:**

$$\text{Cash flow from operating activities to interest} = \frac{(\text{Cash flow from operating activities} + \text{Interest expense})}{\text{Interest expense}}$$



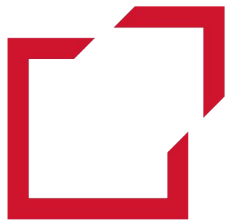
# Ratio analysis using the CFS

**The cash flow from operating activities margin is a profitability ratio and is calculated as follows:**

**Cash flow from operating activities margin =**  
Cash flow from operating activities /  
Sales revenue







**SWISSAM**  
International  
University

**THANK YOU  
FOR YOUR  
ATTENTION!**

**ANY QUESTIONS?**

START HERE. GO ANYWHERE

