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Budgeting and Controlling – Part 8

Components of the Finance Plan: Working Capital

The previous articles of the series Budgeting and Controlling dealt with the principle structure of a finance plan (BTV Aktuell 4/2000) and the description of the first sector of the finance plan, cash flow (BTV Aktuell 1/2001).

In this article the second sector of the finance plan Working Capital will be reviewed in more detail.

Whereas in the determination of cash flow the result (profit or loss) of the profit plan is corrected by expense or income of the profit plan that contributed to determining the profit plan but demonstrate no cash flow out of or into the enterprise, working capital covers the short-term changes that affect solvency of an enterprise. Examples are changes in stock, receivables or liabilities.

The following are the main points which result in an alteration in working capital: Positive values improve liquidity , negative values deteriorate liquidity.

Working Capital:

- Increase of stock
+ Decrease of stock
- Increase of receivables
+ Decrease of receivables
+ Increase of liabilities
- Decrease of liabilities
- Increase of other current assets
+ Decrease of other current assets
+ Increase of other liabilities
- Decrease of other liabilities

= Working Capital

The sector Working Capital is of considerable importance for the planning of liquidity of an enterprise because the operating business activities of the enterprise affect the changes in working capital.

In this way, increasing sales result, when constant time is allowed for payment for the customers, in an increase in receivables. If this also leads to increasing purchases and stock, liquidity in the warehouse sector of an enterprise gets worse because of higher stock. An increase of liabilities improves liquidity in the same way as decrease of receivables. Furthermore, the effects of received payments on account and deposits paid must be taken into consideration.

Together with cash flow, long-term sector and shareholder sector, working capital results in planned liquidity deficit or liquidity surplus of an enterprise.

The series Budgeting and Controlling will be continued with the two further sectors of a finance plan: long-term sector and shareholder sector.

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