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ANALYSIS OF NET WORKING CAPITAL – A BASIC TOOL IN BUSINESS FINANCING

ANALIZA FONDULUI DE RULMENT – INSTRUMENT DE BAZA IN FINANTAREA AFACERII

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The paper aimed to analyse Net Working Capital, considered to be a basic tool in business financing. The data collected for the period 2005-2007 from Balance Sheet and Profit and Loss Account of an agricultural company dealing with cereal production were used to determine specific ratios .Net Working Capital Statement reached a critical point in the year 2005.The managerial decisions have improved the financial performances. In 2006 and 2007 , the company was able to face short-term debt and upcoming operational expenses, because Working Capital had a positive value and its specific ratios registered corresponding level : Current Assets exceeded Current Liabilities ; the relationship between Net Sales , Tangible Net Worth and Long –term Liabilities and Net Working Capital showed an improved financial statement .

Key words: *analysis , Net Working Capital, business financing*

INTRODUCTION

Working capital is considered to be a useful tool in business financing because it measures the conditions of financial balance resulting from the ratio between the liquidity of short-term assets and the exigibility of short-term liabilities [9] . Therefore , it is an indicator of Operating Liquidity to a business . The higher the net working capital, the lower the short-term debts for financing working capital. As it is calculated Current Assets minus Current Liabilities, if current assets are less than current liabilities, the company registers a lack of working capital [7,8]. It is important for any company as their assets to be readily converted into cash. In order to continue its activity , a firm requires a positive working capital . It needs

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enough funds to satisfy both maturing short-term debts and upcoming operational expenses. The management of working capital involves managing inventories, accounts receivable and payable, and cash [5,6] .In this context, the paper presents some considerations upon Net Working Capital Management in an agricultural company where current assets (stocks of raw materials, work in progress , finished goods , trade debtors and cash balances) are normally very high and current liabilities (trade creditors, accruals, short-term loans) as well.

MATERIAL AND METHODS

In order to set up this paper , the basic data have been collected from Balance and Profit and Loss Account ended at December 2005, 2006 and 2007 , belonging to an agricultural company dealing with cereal production in the Southern Romania . The specific indicators related to Net Working Capital have been determined using the following formulas : (a)Net Working Capital = Current Assets – Current Liabilities, (b)Current Ratio = Current Assets /Current Liabilities; (c) Working Capital Turnover Ratio = Net Sales / Net Working Capital ;(d) Current Debt to Net Worth Ratio = Current Liabilities /Tangible Net Worth ; (e) Funded Debt to Net Working Capital Ratio = Long-term Debt /Net Working Capital ; (f) Working Capital to Total Assets = Net Working Capital/ Total Assets **.**

RESULTS AND DISCUSSIONS

Net working Capital was determined by Current Assets including : stocks of raw materials, work in progress , finished goods, trade debtors, prepayments and cash and equivalents and other current assets and Current Liabilities , consisting of : trade creditors and short-term borrowings. The Net Working Capital has a negative value , Euro -3,002 in the year 2005 showing that the company is unable to meet its short-term liabilities with its current assets (cash, accounts receivable and inventory). In the year 2006, Net Working Capital registered Euro 41,265 , because of the increased Current Assets which exceeded Current Liabilities. This shows that the company was able to pay off its short-term liabilities in that year. Also, in the year 2007, the firm was able to pay off its short term debt because Net Working Capital was Euro 71,981. Therefore, from a year to

another , the Working Capital Statement was better and better. The evolution of Net Working Capital and its specific ratios is presented in Table 1.

Table 1 . Evolution of Net Working Capital and its specific Ratios during the period 2005-2007

Specification	2005	2006	2007
Current Assets	71,300	108,758	158,215
Current Liabilities	74,302	67,493	86,234
Net Sales	205,333	259,747	167,634
Tangible Net Worth	220,753	260,098	303,894
Long-term Liabilities	6,106	4,843	3,653
Total Assets	294,338	325,112	393,553
Net working Capital	- 3,002	+41,265	+71,981
Current Ratio	0.96	1.61	1.83
Net Sales / Net Working Capital Ratio	- 68.39	6.29	2.32
Current Debt to Net Worth Ratio	0.34	0.25	0.29
Long-term Liabilities/ Net Working Capital	- 2.03	0.11	0.05
Net Working Capital/Total Assets	-0.01	0.13	0.18

Current Ratio increased from the year 2005 to the year 2007. So, in the year 2005, it recorded 0.96 , because Current Liabilities exceeded Current Assets. In the next year, 2006, the ratio was 1.61 and then in the year 2007 it was 1.83 , showing the continuous increase of Current Assets against to Current Liabilities, a positive aspect. As a result, in the year 2007, Current Ratio was 1.9 times higher than in the year 2005. This ratio reveals the business ability to meet the company current obligations (suppliers of credit etc) . As a test of solvency , it has balanced the current assets against current liabilities.

Working Capital Turnover Ratio registered various values from a year to another. In the year 2005, it recorded a negative value, - 68.39 , because Net Sales were below Working Capital . In the coming years, the ratio value has become a positive one, 6.29 in the year 2006 and ,

respectively 2.32 in the year 2007. This ratio indicates that there are no signals of overtrading and the business does not require additional funds to support its financial structure.

Current Debt to Net Worth Ratio registered satisfactory values : 0.34 in the year 2005, 0.25 in the year 2006 and 0.29 in the year 2007. This ratio shows that the business had no debt that exceeded the invested capital. It showed that a small proportion of funds are provided by current creditors to the business operations . The ratio value did not exceeded 60 % which is considered a critical threshold for a small company .

Funded Debt to Net Working Capital Ratio recorded a negative value in the year 2005 : -2.03 , but in the coming years the situation was better : 0.11 in the year 2006 and 0.05 in the year 2007. This indicates that long-term liabilities did not exceed Working Capital which is a positive aspect.

Working Capital to Total Assets was -0.01 in the year 2005, 0.13 in the year 2006 and 0.18 in the year 2007 . As a liquidity ratio it reflects the proportion of net liquid assets relative to total capitalization . It is the most valuable indicator of a looming business disaster . In the year 2005, the negative value , resulting from a negative Working Capital reflected that the company was facing serious problems . It is a very important indicator, because many business owners wish to be warned earlier about their company's downward spiral. Therefore, it helps the business man to predict bankruptcy before it is too late to take corrective actions and the creditors to reduce potential losses.

CONCLUSIONS

1. Decision making in agricultural companies has to take into account not only the increase of vegetal or animal production , but also the additional costs related to higher stocks, work in progress , in a word , additional current assets .

2.Net Working Capital is a useful indicator in financial management because it reflects how much cash has the business to meet its obligation . Positive working capital is required to ensure that a firm is able to continue its operations and that it has sufficient funds to satisfy both maturing short-term debts and upcoming operational expenses. The management of

working capital involves managing inventories, accounts receivable and payable, and cash

3. In case of this agricultural company producing cereals , the Working Capital Statement was at a critical point in the year 2005 . But the corresponding managerial decisions taken in time have lead to the improvement of financial performances in the coming years . Therefore , in the years 2006 and 2007 , the company was enough strong to face short-tern debt and upcoming operational expenses .

4. The Working Capital had a positive value and its specific ratios registered corresponding levels in the years 2006 and 2007 . Current Assets exceeded Current Liabilities and also between Net Sales , Tangible Net Worth and Long –term Liabilities and Net Working Capital a corresponding ratio was established showing the business capability to improve its financial statement in time .

5. This positive aspect is available not only for the company managers but also for creditors who are conscious that the company will be able to pay off its debts and potential losses could be avoided.

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