Chapter 16
Short-Term Financial Planning

Sources and Uses of Cash

• Sources of Cash
  – Obtaining financing:
    • Increase in long-term debt
    • Increase in equity
    • Increase in current liabilities
  – Selling assets
    • Decrease in current assets
    • Decrease in fixed assets

• Uses of Cash
  – Paying creditors or stockholders
    • Decrease in long-term debt
    • Decrease in equity
    • Decrease in current liabilities
  – Buying assets
    • Increase in current assets
    • Increase in fixed assets

The Operating Cycle

• The time it takes to receive inventory, sell it and collect on the receivables generated from the sale
• Operating cycle = inventory period + accounts receivable period
  – Inventory period = time inventory sits on the shelf
  – Accounts receivable period = time it takes to collect on receivables

The Cash Cycle

• The time between payment for inventory and receipt from the sale of inventory
• Cash cycle = operating cycle – accounts payable period
  – Accounts payable period = time between receipt of inventory and payment for it
• The cash cycle measures how long we need to finance inventory and receivables

Carrying versus Shortage Costs

• Carrying costs
  – Opportunity cost of owning current assets versus long-term assets that pay higher returns
  – Cost of storing larger amounts of inventory
• Shortage costs
  – Order costs – the cost of ordering additional inventory or transferring cash
  – Stock-out costs – the cost of lost sales due to lack of inventory, including lost customers

Temporary versus Permanent Assets

• Are current assets temporary or permanent?
  – Both!
• Permanent current assets refer to the level of current assets that the company retains regardless of any seasonality in sales
• Temporary current assets refer to the additional current assets that are added when sales are expected to increase on a seasonal basis
Cash Budget

• Primary tool in short-run financial planning
  – Identify short-term needs and potential opportunities
  – Identify when short-term financing may be required

• How it works
  – Identify sales and cash collections
  – Identify various cash outflows
  – Subtract outflows from inflows and determine investing and financing needs

Short-Term Borrowing

• Unsecured loans
  – Line of credit – prearranged agreement with a bank that allows the firm to borrow up to a certain amount on a short-term basis
  – Committed – formal legal arrangement that may require a commitment fee and generally has a floating interest rate
  – Non-committed – informal agreement with a bank that is similar to credit card debt for individuals
  – Revolving credit – non-committed agreement with a longer time between evaluations

• Secured loans – loan secured by receivables or inventory or both