Financial accounting and working capital management

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Abstract
The importance of timely, accurate and factual display of data in financial accounting forms the basis for a better calculation of the amount of working capital, which is an important indicator for managers. The amount of working capital must be constantly monitored in order to prevent the enterprise from unnecessarily tying up funds that it can use for other purposes. Working capital is funds that need to be permanently maintained in order for an enterprise to be able to provide its production and supply cycle.

Current assets include all assets that an enterprise expects to convert into cash during the year. Current assets thus mean short-term assets that can be in inventories or in the form of cash (cash and bank accounts, receivables, securities). Working capital management includes securing the enterprise's short-term resources to sustain ongoing activities, accumulation of funds and optimize liquidity. The time value of money and the time itself is crucial in managing working capital, because the delay of each day has its value. Effective working capital management requires striking a balance between liquidity and profitability in order to maximise the value of the business. Finding its optimal level may not be an easy task for managers.

Keywords: Financial accounting, working capital, current assets

JEL Classification: M41, M21, D24

1. Introduction
Nowadays, effective working capital management is a necessity. Working capital is inextricably linked to the liquidity of the enterprise and requires active management and control. Timely, faithful and truthfully displayed data in financial accounting are the basis for a better calculation of the amount of working capital. In the present article, we discuss the basic principles of the functioning of working capital and its close connection to cash flows in selected sugar factories in the Slovak Republic.

The optimal level of working capital is one at which an enterprise can carry out its operating activities without restrictions, while not allocating surplus funds to working capital and not causing excess costs. The time elapsing between the moment an enterprise pays its obligations to suppliers until the time of collection of receivables from customers is called the period of turnover of working capital and represents the period during which the enterprise must finance the working capital from its own or external sources. The aim of the enterprise is to reduce the turnover period of working capital as much as possible, thus reducing the amount of funds needed to finance it between the payment of supplier invoices and the collection of the receivable. Working capital should be used with current assets and the nature of an asset is determined by its function (Petriashvili 2017).
Allocations of working capital can be modulated to absorb exogenous shocks to firms’ capital expenditure schedule (see more Chauhan 2020, Ben-Nasr, 2016; Ding et al., 2013; Fazzari and Petersen, 1993). If enterprises are unlikely to generate enough operational cash, they should at least temporarily press the work capital allocation to create incremental cash flows needed for capital expenditure.

Therefore, literature from the past suggests that working capital acts as a tactical tool for creating the value of enterprises. In contrast to the previous literature, Chauhan (2019) found that the relative allocations of enterprises' working capital within the industry remain persistent for several years, suggesting that these allocations are driven primarily by company-specific strategic motives and not by normative concerns about improving interim cash flows.

Working capital management studies fall into two competitive perspectives on working capital investment. In one opinion, higher levels of work capital allow companies to increase sales and get more discounts for early payments (Deloof, 2003) and thus can increase the value of companies (Baños-Caballero et al., 2014). Alternatively, higher levels of working capital require financing and consequently firms face additional financial costs that increase the likelihood of their bankruptcy (Kieschnick et al., 2011). The combination of these positive and negative working capital effects leads to a prediction of the nonlinear relationship between working capital investment and the value of the company.

2. Data and Methods

The main objective of the contribution is to highlight the importance of managing working capital. Given the relatively broad issue, we specify the main objective in the sub-objectives:

1. analysis of working capital in selected sugar factories,
2. the submission of proposals to improve the management of working capital.

The object of the investigation is the area of financial management in two selected sugar factories from Slovakia. The selection was focused on SLOVENSKÉ CUKROVARY, s. r. o., Považský cukor, a. s. Data for individual sugar factories are obtained from publicly available sources – annual reports stored on the website www.registeruz.sk website for the financial year 2020/2021. We are based on financial accounting data, where we focused on the following accounting classes of the framework chart of accounts for entrepreneurs accounting in the double-entry accounting system:

- 1 - Inventory,
- 3 - Accounting for receivables and liabilities,
- 5 – Expenses,
- 6 - Revenues.

In solving the specified issue, we used basic methods of research: analysis, synthesis, comparison and selected indicators for calculating working capital. We calculated working capital (WC) in three of the following ways:

- as an absolute value calculated from balance sheet items:
  \[ WC = \text{Inventory} + \text{Total short term receivables} - \text{Total short term liabilities} \]  

- as a working capital to sales ratio (WCSR), expressed in %:
  \[ \text{WCSR} = \frac{WC}{\text{Net Sales}} \times 100 \]  

\[ WC = \text{Inventory} + \text{Total short term receivables} - \text{Total short term liabilities} \]  

\[ \text{WCSR} = \frac{WC}{\text{Net Sales}} \times 100 \]
as a working capital turnover in days (WCT) calculated from activity indicators:

\[ WCT = IT + RT - LT \]  \hspace{1cm} (3)

Formula for calculating the turnover period of inventories:

\[ \text{Inventory turnover in days (IT)} = \frac{\text{INVENTORY}}{\text{NET SALES}} \times 360 \]  \hspace{1cm} (4)

Formula for calculating the turnover period of receivables (debt collection period):

\[ \text{Receivable turnover in days (RT)} = \frac{\text{Trade receivables}}{\text{NET SALES}} \times 360 \]  \hspace{1cm} (5)

Formula for calculating the turnover period of liabilities (payment period of liabilities):

\[ \text{Liabilities turnover in days (LT)} = \frac{\text{Trade payables}}{(\text{Cost of raw material} + \text{consumables and purchased merchandise} + \text{Service expanse})} \times 360 \]  \hspace{1cm} (6)

Based on calculated activity indicators – the turnover period of liabilities and the turnover period of receivables, at the end of the paper we presented two options for financing working capital using internal or external sources – short-term bank loan.

3. Results and Discussion

Structure working capital in selected sugar factories for the financial year 2020/2021 is shown in Figure 1. Považský cukor a.s. has the highest value of working capital in the amount of 34,142 thousand EUR (TEUR). The amount of trade liabilities for both companies monitored oscillates around 5,900 TEUR. The amount of inventories represents the highest share of working capital in both companies surveyed. In Považský cukor a.s. it amounts to 27,154 TEUR.

![Figure 1: Working capital in selected sugar factories for the financial year 2020/2021 in TEUR](Source: author's calculations, data from www.registeruz.sk)

Figure 2 is devoted to the working capital to sales ratio, values are expressed in %. The financial years 2018-2021 are compared in selected companies. Both companies surveyed
show a trend of growth in the share of working capital in sales. The biggest difference was recorded in 2020.

The highest share of the operating capital in sales is held by SLOVENSKÉ CUKROVARY s.r.o., where the share amount reaches up to 50% in the observed year 2020 and 2021. In the last year we see an increase in this share also by Považský cukor a.s., which reached 42%.

Figure 2: Working capital to sales ratio in selected sugar factories for the financial years 2018-2021 expressed in %

*Source: author's calculations, data from www.registeruz.sk*

The comparison of selected sugar factories in terms of working capital turnover is documented in Figure 3. The longest period of turnover of working capital is in the company SLOVAK SUGAR FACTORIES, s. r. o. 173 days. The working capital of this company amounted to 26,386 TEUR, which represents a 50% share of sales. In the reference period from 2018 to 2021, it is standard to maintain a working capital ratio of 44% (obtained by calculating using the median function in the reference period 2018-2021). The company's management should explore the possibility of reducing this share to 44%, bringing working capital from 26,386 TEUR to 21,109 TEUR thereby freeing up cash.
In order to assess whether an enterprise operates with optimal working capital, it is possible to compare the level of working capital with other competing enterprises. A more detailed analysis assesses the amount of inventories, trade receivables and trade payables. The adequacy of receivables and liabilities can be assessed on the basis of activity indicators—turnover period of receivables, turnover periods of liabilities, between which there should not be much difference.

At the time of the turnover of liabilities, we can note the high value in Považský cukor a.s., which reaches 60 days.

The turnover period of receivables is significantly higher in SLOVENSKÉ CUKROVARY, s. r. o. compared to the turnover period of liabilities. This is a positive for the creditors of this enterprise and is a good prerequisite for the payment of liabilities.

The increasing turnaround period of liabilities indicates that the enterprise is late in making payments to suppliers, which could be seen as a sign of poor efficiency in the management of working capital.

The increasing turnaround period of receivables may also indicate that the enterprise does not manage its working capital very efficiently. It takes longer to collect payments from customers, as a result of which the enterprise may not have enough cash to finance its short-term liabilities from business relationships.

Companies should compare the achieved levels of working capital with previous years. Should values fall outside normal, managers should look for causes and take corrective action. Importance should be placed on the behaviour of working capital in the growth and decline of sales and how it affects cashflow itself. Each company should have predefined target levels of working capital, expressed as a turnover period or a share in % of sales. Track each component of working capital, which is inventories, receivables and liabilities.
4. Conclusion

In today's pandemic situation, it is very important to address the area of labour capital management, especially if the collection time of receivables increases. The ideal state of economic activity of an enterprise is when the duration of the production cycle, i.e. the period of inventory turnover and the period of turnover of receivables, is less than the turnover period of liabilities. This means that the enterprise gets its money earlier, has already paid suppliers for the material intended for this production. Otherwise, it is necessary to cover the missing time with another source of capital.

One option is internal resources, which are, for example, deposits of the owners of the enterprise. Other options are the use of external resources, such as the form of a short-term bank loan. Such a loan must be earmarked. In relation to the issue addressed, we list two options for the purposeful drawing of a short-term bank loan:

1. overdraft to finance trade payables,
2. a loan for current funds, which is intended to finance trade receivables and to purchase inventories.

In both cases, it is important that managers are able to make the right decision. The management of the enterprise must ensure sufficient financial resources to cover the working capital. It is therefore necessary that they be based in particular on timely and faithful financial accounting data. Which they use to calculate economic activity, such as the turnover period of liabilities, the turnover period of receivables and the turnover period of inventories.

Obtaining a short-term bank loan to finance trade payables would allow enterprises with a higher turnover period than the debt turnover period to increase liquidity. By paying supplier invoices in a timely manner, the turnover period of liabilities decreases and the enterprise becomes more trustworthy for creditors, specifically suppliers, on the basis of which it can obtain more favourable purchase conditions.

A short-term bank loan to finance trade receivables would allow enterprises that have a higher turnover period than the turnover period of liabilities (in our analysis SLOVENSKÉ CUKROVARY, s. r. o. and Považský cukor a.s.) similarly as in the previous case to increase liquidity.

Both methods of special-purpose drawing of short-term bank loans represent an operational solution to cover both planned and unplanned short-term operating needs.

In conclusion, we note that monitoring the amount of working capital and the turnover period of working capital is an important management tool through which managers can better manage cash flows. In the submitted contribution, we present the possibilities of calculating working capital, its analysis and practical application. Based on the generalization of the results obtained, we recommend that managers monitor the amount of working capital and the turnover period of working capital. The two indicators are linked to liquidity and indebtedness, which are among the financial indicators for assessing the competitiveness of enterprises.

References


