Chapter 05: Section 7

The Fundamentals of Working Capital Management

JAYASEKERA MANAGEMENT CENTRE (PVT) LTD Estd. 1972
Pioneers In Professional Education

Section 07:

Working Capital Management Impact on Firm Survival and Corporate Failure

Overtrading Analysis

JMC ජයසේකර කළමනාකරණ මධ්‍යස්ථානය JAYASEKERA MANAGEMENT CENTRE (PVT) LTD Estd. 1972
Pioneers In Professional Education

1. **Overtrading:** A condition where a business expands too quickly without sufficient long-term capital to support increased working capital requirements.

Overtrading Analysis

JMC ජයසේකර කළමනාකරණ මධ්‍යස්ථානය JAYASEKERA MANAGEMENT CENTRE (PVT) LTD Estd. 1972
Pioneers In Professional Education

Overtrading Warning Indicators – Profitability & Liquidity

Quarter	Sales Revenue (Rs.)	Current Ratio	Net Profit Margin (%)	Cash from Operations (Rs.)
Q1	50,000,000	1.8	8.0	4,000,000
Q2	70,000,000	1.4	6.0	1,500,000
Q3	90,000,000	1.1	4.5	(500,000)
Q4	110,000,000	0.9	3.0	(3,000,000)

Table 7.1.1: Overtrading Warning Indicators – Profitability & Liquidity

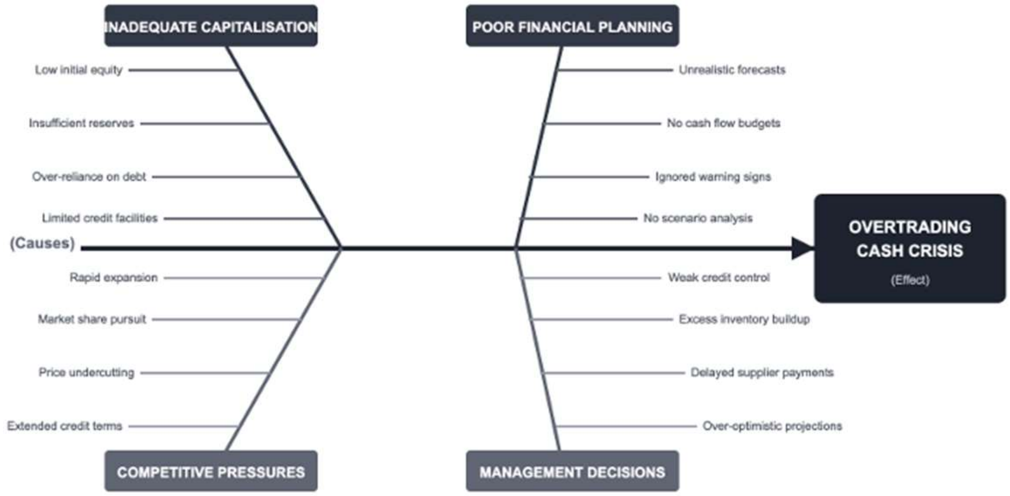
Overtrading Warning Indicators – Leverage & Working Capital

Quarter	Debt-to-Equity Ratio	Inventory Days	Receivables Days
Q1	0.8	30	35
Q2	1.2	38	42
Q3	1.8	48	55
Q4	2.5	62	70

Table 7.1.2: Overtrading Warning Indicators – Leverage & Working Capital

Overtrading Causes and Contributing Factors

JMC ජයසේකර කළමනාකරණ මධ්‍යස්ථානය JAYASEKERA MANAGEMENT CENTRE (PVT) LTD Estd. 1972
Pioneers in Professional Education



Overtrading Remedies and recovery actions

JMC ජයසේකර කළමනාකරණ මධ්‍යස්ථානය JAYASEKERA MANAGEMENT CENTRE (PVT) LTD Estd. 1972
Pioneers in Professional Education

1. Moderate sales growth
2. Optimise Working Capital
3. Secure Additional Financing
4. Improve Operational Efficiency

Corporate Failure Analysis and Prediction

1. **Corporate Failure:** A state where a company cannot meet its obligations to creditors as they fall due

Corporate Failure Indicator Dashboard					
Fiscal Year	Current Ratio	Receivables Days	Payables Days	Operating Cash Flow (Rs. M)	Gross Margin (%)
Year 1	2.1	42	35	25.0	32.0
Year 2	1.7	51	48	15.0	28.5
Year 3	1.3	65	62	5.0	24.0
Year 4	0.9	78	85	(8.0)	18.5
Year 5	0.6	95	110	(22.0)	12.0

Table 7.2.1: Corporate Failure Indicator Dashboard

Recommendations and Intervention Strategies

1. Secure Immediate Liquidity:

- Accelerate collection of all outstanding receivables
- Identify and sell non-core assets quickly
- Negotiate payment standstills or extended terms

2. Implement Operational Restructuring

- Analyse all business lines to identify and exit unprofitable segments
- Implement strict cost controls across all departments
- Re-engineer core processes to eliminate waste and improve productivity metrics

Recommendations and Intervention Strategies

4. Manage Stakeholder Communications

Stakeholder Communication Matrix			
Stakeholder Group	**Primary Concerns**	**Key Messages**	**Communication Frequency**
Lenders	Loan recovery and covenant compliance	Restructuring progress, cash flow forecasts, asset security	Weekly progress reports
Employees	Job security and future prospects	Turnaround plan, retention commitments, role clarity	Fortnightly town halls
Key Suppliers	Payment assurance and continued business	Payment schedule, relationship value, mutual benefits	Direct negotiations as needed
Customers	Service continuity and product availability	Operational stability, commitment to quality, contingency plans	Proactive monthly updates
Shareholders	Investment protection and recovery prospects	Turnaround strategy, timeline, management accountability	Quarterly briefings

Table 7.2.4: Stakeholder Communication Matrix

5. F

- ...petitive advantages
- Identify defensible market niches where the company can compete profitably
- Develop a new business plan with realistic projections demonstrating path to viability

Failure Prediction Models

Altman Z-Score

$$Z = 1.2(X1) + 1.4(X2) + 3.3(X3) + 0.6(X4) + 1.0(X5)$$

X1 (Working Capital/Total Assets)

X2 (Retained Earnings/Total Assets)

X3 (EBIT/Total Assets)

X4 (Market Value of Equity/Total Liabilities)

X5 (Sales/Total Assets)

Failure Prediction Models

JAYASEKERA MANAGEMENT CENTRE (PVT) LTD Estd. 1972
Pioneers In Professional Education

Altman Z-Score