

72.2 An exercise on the interpretation of working capital ratios

The figures given in question 72.1 are now supplemented with figures from the published accounts of the prior year.

For each company separately, calculate and compare working capital ratios for the current year and the prior year. Comment on any differences you may find, from one year to the next.

A – producer of dairy foods

			A : ratios	current	prior
A : data	current	prior	current ratio	1.6	1.7
Sales	1 355.2	1 260.6	quick ratio	0.7	0.8
Cost of Sales	1 033.5	928.0	days' sales in stock	68 days	68 days
inventories	192.6	172.7	days' sales in debtors	38 days	36 days
trade receivables	142.8	124.0	days' purchases in creditors	60 days	59 days
total current assets	350.1	323.9	working capital cycle	46 days	45 days
trade payables	173.3	147.9			
total current liabilities	222.3	187.8			
opening stock	172.7	188.5			

Comment

A's working capital position is remarkably unchanged from the prior year, and the very slight increase in the working capital cycle from 59 days to 60 is hardly significant. This may reflect continuous and very effective achievement of targets in working capital management. However, it may reflect simple complacency, with no efforts made to improve a working capital situation which is felt to be tolerable.

B – producer of consumer durables

			B : ratios		
				current	prior
			current ratio	1.2	1.4
			quick ratio	0.9	0.9
			days' sales in stock	55 days	88 days
			days' sales in debtors	73 days	88 days
			days' purchases in creditors	76 days	89 days
			working capital cycle	52 days	86 days

B : data	current	prior
Sales	103 848	100 701
Cost of Sales	79 664	77 270
inventories	12 041	18 606
trade receivables	20 905	24 269
total current assets	44 091	52 827
trade payables	15 320	18 798
total current liabilities	36 304	37 387
opening stock	18 606	19 170

Comment

There has been a radical improvement in B's working capital position between the prior period and the current period. The improvements are so widespread (in stock transit time, debtor collection and creditor payment) and so large that one may presume they are the successful result of deliberate policy. It would be interesting to see the results for the next following period, to see if further improvements were made, or if the firm began to slip back into its old ways.