Memorandum

To: Stephanie Sanders, CFO, Lawrence Sports and Lan Guan, Instructor for FIN/554

CC: Learning Team A Newsgroup

From: Shivanand R Koppalkar, Andrew Gorman, Scott Schifilliti, Ha Nguyen and Megan Wilson

Date: April 3, 2006

Re: Working Capital Management Simulation Based Memo.

Collection and Payment Policies

As the financial manager of Lawrence Sports the company's cash position is of my highest concern. The circumstances we as Learning Team A have endured with our primary customer Mayo Stores have created difficulty with our working capital management. We have developed options to improve our cash flow and reduce high interest debt.

We must bring our business partners closer to the problem. Meetings have been scheduled with senior members of our supply chain management. The principal owners of Gartner and Murray, our top vendors have been called in to discuss the problem. Neither company was encouraged about moving payment schedules to offset slow payments from our customer; however, they understand the need to take action. As a team we decided to distribute the burden in both directions.

We requested that our customer increase their payment timing and pay a premium for the products we supply to offset the high interests rates. At the same time we have worked out an arrangement with our vendors to obtain a better payment schedule with their suppliers of raw material. Concessions in each direction will provide the payment policy relief Lawrence Sports requires to make it through this difficult time.

At Lawrence Sports we are a company that believes in working with our customers and vendors to create a joint solution that will benefit each organization in the future. Working through this crisis by sharing the responsibility will provide a strong business relationship and increased sales.

Lawrence Sports should make it a point to periodically review collections practices in light of economic shifts as well as changes in the industry, client base, and other business-specific factors. In addition, any time practices that do not seem to be working as well as intended, will be corrected immediately.

Long-Term Relations with Customers and Partners

The long term customer relationships can be maintained by providing excellent products backed by service at reasonable prices. Our relationship can also be maintained by offering discounts, promotions, complementary gifts and product differentiation. Product sold by Lawrence Sports is not available elsewhere; we believe our customers will maintain their loyalty.

It is our recommendation that we review our vendor payment policies to be sure we are in line with the industry standards. If payment agreements are not meeting expectation with industry averages, we may need to renegotiate with vendors to receive additional compensation or concessions. There are special cases when vendors who might perish if payments are delayed--decision should be discussed with the vendor before delaying payment. However, partnerships also have inherent risks that can be damaging to all parties involved. For example, Lawrence Sports may face bankruptcy if the retailer Mayo discontinues carrying Lawrence's products. The heavy reliance on Gartner as their majority provider of raw materials can create a risk that may destroy the relationship.

The financial manager must balance the many issues involved with working capital. Future revenues, collections, bad debts, disbursements, borrowing and loan repayment must be kept under control, while attempting to keep the stakeholders of the company happy. Since the main objective of a corporation is to maximize the value of shareholders' investments naturally they expect the financial manager to make decisions with the shareholders best interest in mind.

The company cash flow can be seriously affected if we do not look to renegotiate the payment agreements previously made with the Mayo and Gartner organizations. Therefore, we should not overestimate the partnership benefits, while ignoring the potential risks associated with the company's cash flow and bank borrowing policies.. The company should be independent from Gartner in order to stay competitive and maintain partnership complacency. The company should expand its market to reduce the effects from externalities and continue to keep a good working relationship with the Mayo organization.

To keep the company's cash flow optimal, financial managers must constantly negotiate price terms and financing with customers and suppliers. They need to try to obtain better collection and payment schedules to help maximize cash flow. An important fact that financial managers must keep in mind is that their decisions affect not only the cash flow of their corporation, but the cash flow of the customers and suppliers as well.

Careful consideration of all alternative options available when working capital problems arise is one way to alleviate possible discontent on the part of business partners. Borrowing is an important option, the organization should avoid over-investing in growth and keep some extra cash in short-term liquid investments such as marketable securities. This is another option that can help a company better prepare for unforeseen emergencies.

Ethical Payment Issue

The Lawrence Sports situation uses their working capital and bank borrowing to finance operations. This is a concern for the organization; they have set goals of increasing the working capital while minimizing bank borrowing. Their plan focuses on explaining the situation faced by the Lawrence organization to both suppliers and their retailer. They expect to renegotiate agreements with each vendor so they do not cause undue harm to anyone in the process. The ideal situation in this scenario called for a tradeoff that needed to be reached between both suppliers and the retailer, both could not be kept happy without affecting the strategies and goals of the Lawrence organization. There had to be new agreements in place that would be acceptable for everyone, Lawrence decided to give Mayo an extra week for payment while changing invoicing options to Gartner. They allowed the payment to be delayed to Murray, as a small vendor they were deemed to be the more understanding of the two suppliers.

A problem arises when trying to maintain business relationships and balancing the organizations working capital and borrowing requirements. This was accomplished in an ethical manner by finding common ground and reaching agreements with all involved. Although this was difficult, at certain points the retailer had to be held to their word for payment in April, so not to create undue burden for Lawrence and its suppliers. This also required the stretching of payments to vendors. It was beyond Lawrence's control, we hope in the future suppliers may be more understanding should payment problems from the retailer arise.

The difference in the possible outcomes of the simulation was the decision to delaying payment to Murray and renegotiate terms with all involved. This allowed the organization to achieve its goals of increasing working capital while decreasing borrowing.

Recommended Strategy for Solving the Challenge

There are many different factors that go into the decisions of how to handle the payment with Mayo, Gartner, and Murray. It is necessary to look at the satisfaction level with each relationship. If unhappy for more than a week Gartner may cut off delivering supplies, which will cause a hardship for Lawrence. Mayo is one of the larger clients and it is important they are satisfied, unfavorable decision making may force Mayo to eliminate Lawrence products in the future. Murray is a small company that will suffer hardships if we do not pay them on time. It is necessary to take this into consideration when making the decision to coordinate the financial inflows and outflows.

Meeting payments on loans that are borrowed must be accomplished in order to make sure there is a consistent inflow of cash. As much as the business relationships are needed to stay strong, the financial situation of the company is a priority. We have a financial responsibility to pay Murray the funds that are due to them, if Gartner does not receive the funds they need they will refuse to deliver their products which will destroy our working relationship.

Short-term negotiation will be more beneficial to Lawrence Sports than increasing loan burden. If a customer is going to default on a payment management will request the senior account manager negotiate a payment plan extension that is beneficial to both parties. Perhaps the customer does not need to default for as long as initially proposed (Ross, Westerfield & Jaffe, 2005). Planning ahead requires Lawrence to consider events that could cause problems in the future such as defective product, deferred payments, or rising costs (Brealey, Myers & Allen, 2005).

Conclusion

Successful negotiations will allow Lawrence to keep the cash flowing without incurring additional bank loan debt. Avoidance of additional bank loan debt will allow Lawrence to eventually develop a positive cash balance and be better prepared for future problems.

References

Anonymous (November 2005), Working Capital Management Simulation, Retrieved April 1, 2006 from the University of Phoenix e-Resource website: https://mycampus.phoenix.edu/secure/resource/vendors/tata/sims/finance/finance_simulation1.html

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