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Lawrence Sports is a manufacturing and distribution company of sporting goods. They make and distribute equipment and protective gear for baseball, football, basketball and volleyball. Lawrence Sports purchases its materials from Gartner Products and Murray Leather Works. They also distribute 95 percent of its products to Mayo Stores and have revenues of $20 million.

Currently, the company is facing several situations that offer opportunities as well as problems that need to be evaluated. Lawrence Sports' working capital policy will include the following:

- Cash balance requirements including cash reserves needed for long term opportunities that may arise.
- A credit policy that balances Lawrence Sports' desire to minimize accounts receivable and maximize revenue.
- A supplier negotiation strategy for terms of payment that balances the costs to Lawrence Sports and their cash requirements.
- A short-term financing strategy to ensure availability of an adequate line of credit while minimizing the cost of that credit.
- Metrics that will be used to monitor performance against the policy.

Working Capital Policy

Working capital is calculated as current assets minus current liabilities (Wikipedia, 2007). Working capital is also known as operating capital. A most important value, it represents the amount of day-by-day operating liquidity available to a business. A company can be endowed with assets and profitability, but short of liquidity if these assets cannot readily be converted into cash.

Any change in the working capital has an effect on the cash flow into or away from a business (Wikipedia, 2007). A positive change in working capital means that the business has pumped in cash for inventory. Consequently, an increase in working capital has a negative effect on cash flow. However, a negative change in working capital will mean lower funds to pay off short term liabilities which will have bad repercussions to the future of the company. So, working capital is the most sensitive part of a business.

Lawrence Sports' purpose of cash budgeting is to have cash in hand to pay its suppliers and liquidity to meet contingencies and opportunities. On the other hand the use of cash budgeting is to have Mayo pay its dues early or have bank financing on day –to-day basis.

The weakness in Lawrence Sports' policy is that it is receiving payment late but paying its payables immediately. Lawrence Sports needs to pay its suppliers late and receive payments from its customers early. Lawrence Sports is in a difficult position because it has only one customer who is exercising purchasing power and is paying late and is having only two suppliers who are exercising supplier power and are requiring immediate payment. Purchasing power is a consumer's ability to buy goods and services as distinguished from the amount of money a consumer has (American Marketing Association, 2007).

Cash Balance Requirements

The current ratio is a comparison of a firm's current assets to its current liabilities (Wikipedia, 2007b). The current ratio is an indication of a firm's market liquidity and ability to meet short-term debt obligations. Acceptable current ratios vary from industry to industry, but a current ratio between 1 and 1.5 is considered standard. If a company's current assets are in this range, then it is generally considered to have good short-term financial strength. The liquidity ratio measures the extent to which a corporation or other entity can quickly liquidate assets and cover short-term liabilities, and therefore is of interest to short-term creditors (InvestorWords, 2007). The current ratio of Lawrence Sports must be two (2) and the liquidity ratio must be one (1). This is a requirement that Lawrence Sports needs to have to meet its immediate current liabilities. For, this Lawrence Sports needs to renegotiate its terms with Mayo. Mayo will have to pay cash immediately within one week. On the other hand the suppliers Gartner and Murray will have to be paid at least one month after delivery. This is possible only if Lawrence Sports develops power to negotiate. In other words Lawrence Sports has to increase the number of customers and increase the number of suppliers.

Credit Policy

Lawrence Sports should at the most give one weeks time for accounts receivable. If Mayo cannot meet these terms, Lawrence Sports should seek other customers that are willing to pay within a week. Lawrence Sports should refrain from giving more credit to its customers.

Supplier Negotiation

Supplier negotiation can be successful if there are a larger number of suppliers. Gartner and Murray must realize that if they insist on immediate payment, Lawrence Sports may use other sources for its supplies. Taking bank loans to finance working capital is harmful in two important ways. It increases the costs and second Lawrence Sports has already reached the ceiling for borrowing money.

Short-term Financing Strategy

The best short term financing strategy is to negotiate immediate payment with buyers and delayed payments from suppliers. A strategy that is often employed by firms is stretching accounts payable (Farquhar College of Arts and Sciences). This is accomplished by paying bills as late as possible without damaging its credit rating. Such a strategy can reduce the cost of giving up the cash discount. This strategy may be attractive to many firms, but it could raise an ethical issue as the firm is violating the terms of the agreement it entered into when it purchased the merchandise.

Metrics

Factoring is a form of commercial finance whereby a business sells its accounts receivable at a discount (Wikipedia, 2007c). Effectively, the business is no longer dependent on the conversion of accounts receivable to cash from the actual payment from their customers, which takes place on typical 30 to 90 day terms. Over a period of 180 days Lawrence Sports should stop taking any bank finance or factoring. In addition it should achieve its profitability targets within a year. The metric will be the percentage of profitability goal achieved at the end of one year. Lawrence Sports should also develop at least three (3) new customers within 180 days who are willing to pay within a week of delivery and they should also develop at least four new sources of suppliers who are willing to wait for one month before they get payment.

Ethical Implications

Lawrence Sports has responsibility towards its final customers for supplying good quality products at reasonable rates. The proposed policy is ethical because with it Lawrence Sports will be able to meet this responsibility. Lawrence Sports has a responsibility towards the society to supply good quality products at reasonable prices, pay its creditors according to terms, pay its employees and earn profits. With the new policy, all these requirements are fulfilled.

Conclusion

A firm's working capital policy has two components: policies regarding the appropriate level of current assets and policies regarding the use of short-term financing (University of North Alabama). The goal of working capital management is to ensure that the firm is able to continue its operations and that it has sufficient cash flow to satisfy both maturing short-term debt and upcoming operational expenses (Wikipedia, 2007d).

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