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Preface

Working capital management is the management of the firm's short-term assets and liabilities, individually and in aggregate. Of all the functional areas of business financial decision making, the one that occupies the largest amount of the time and effort for practicing financial managers is the management of current assets and liabilities. Survey evidence shows that 60 percent of a financial manager's time is spent on decisions related to working capital management.¹ Credit management, cash management, inventory management, and accounts payable management are all part of the management of working capital. There are many more people employed in these endeavors than in other occupations concerned with the financial management of firms. Despite this prevalence in the workplace, however, the management of working capital has traditionally been neglected in academic programs and in academic research. This text is an attempt to partially remedy this neglect by providing a reference from which complete courses in the management of current assets and liabilities can be taught.

INTENDED AUDIENCE

This text is intended for senior undergraduates majoring in finance and for M.B.A. students concentrating in finance. It can be used as a primary text in a one-semester course in working capital management, or selected portions of it can be used as supplementary material for a course in corporate finance.²

¹See Lawrence J. Gitman and Charles E. Maxwell, "Financial Activities of Major U. S. Firms: Survey and Analysis of Fortune's 1000," *Financial Management*, (Winter 1985), p. 60.

²Suggestions for tailoring this text to various audiences and uses may be found in the instructor's manual.

It can also be profitably used by finance practitioners wishing to update their knowledge of working capital management. Readers should possess a basic knowledge of business finance, algebra, basic calculus, probability and statistics, and common mathematical techniques such as integer programming. We assume that students have access to and can utilize a microcomputer, a spreadsheet package, and an integer programming package.³ Access to and facility with a simulation package is useful but not necessary.

ORIENTATION AND FEATURES

This text is an improvement over other texts in working capital management in several respects. First, this text presents a balanced coverage of the various aspects of the topic. The management of cash, accounts receivable, inventory, and short-term liabilities all receive significant and approximately equal attention. Other texts have a more uneven coverage of the important topics in working capital management.

Second, we have strongly emphasized analysis and decision-making techniques that are in keeping with the principles of modern corporate finance. We have opted for emphasis on the state of the art as we see it; cash flows and shareholder wealth maximization are the benchmarks of our discussion. Students and instructors who are comfortable with such concepts as net present value and risk-adjusted discount rates will find this text to their liking. We avoid becoming involved with the minutiae of accounting techniques wherever possible.

Third, the analysis of risk is emphasized as an integral part of decision making. We will see that the very existence of working capital accounts is made necessary, in part, by risk. Consequently, risk considerations are a major part of working capital decisions. Discussions of numerous risk-pricing and hedging strategies are included in this text. For example, we present mechanisms for hedging the risk of cash shortages, the use of interest rate futures and options in hedging interest rate risk, and the use of currency futures and forwards to hedge exchange rate risk.

Fourth, while extensive examples of calculation methodologies occur frequently throughout, we have included cases as well as problem sets for each chapter within the text.⁴ This is in keeping with the level of expected

³Within this text we have tried to keep the discussion of these packages as generic as possible. At West Virginia University we use the popular Lotus® 1-2-3® and LINDO® packages; we anticipate that many other universities are similarly equipped. However, for students who are fortunate enough to have access to a spreadsheet package with integer programming capacity, or to a spreadsheet package and an add-on program which utilizes spreadsheet files as integer programming inputs, familiarity with a separate integer programming package is not necessary.

⁴The cases within this text may be addressed at various levels; suggestions for use are given in the instructor's manual.

knowledge and expertise that we assume of our audience. Cases require not only a facility for the mathematical analysis techniques associated with a particular situation, but also the ability to identify problems, to make decisions based on incomplete data, and to deal with nonquantified considerations. These are important skills for the practicing business manager. All the cases in this volume have been extensively class tested.

Fifth, the text is heavily oriented toward the microcomputer. We believe that the use of a computer is vital to the student's understanding of financial techniques and prepares him or her for the conditions under which he or she will function in the business world. Examples of spreadsheet analysis occur in virtually every chapter, and data for the student's use in solving the cases are presented in spreadsheet format on a diskette.

Sixth, we have put extensive effort into the development of the instructor's manual and the instructor's diskette. We recognize that these aids are critical to the effective teaching of a nonintroductory course. It is useful for instructors to examine these aids before making decisions regarding text adoption.

Seventh, we have included a chapter on the management of working capital in an international setting. The increasingly worldwide nature of business relationships makes discussion of the special risks and issues in such dealings an important topic. Chapter 13, "Working Capital Management in International Settings," introduces the student to these risks and issues in the management of short-term international assets and liabilities.

Finally, we have included a review of survey evidence on the current practice of working capital management for each of the major topics in the text. There is a substantial amount of survey evidence on some of these topics, and a review of survey findings helps put the material presented in the text into perspective.

With these features and orientation, we have created a text that can be used on a stand-alone basis for courses in the management of working capital. Our aim was to eliminate the necessity for instructors to assign extensive lists of outside readings or additional case problems. By providing a course package consisting of an up-to-date text, challenging cases, a student diskette, an instructor's diskette, and an extensive instructor's manual, we hope to facilitate the teaching of working capital management.

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FCS