

Risk Financing

Risk financing primarily concerns with providing funds for covering the financial effect of unexpected losses. Traditional forms of risk financing may include funded retention by way of reserves and risk pooling. Alternative risk financing refers to the use of products and solutions which have grown out of the convergence of the banking and insurance industry. They may include captive insurance companies and catastrophic bonds, and finite risk products such as loss portfolio transfers or adverse development covers.

Cash Conversion Cycle

Cash Conversion Cycle (CCC) measures how long a company will be deprived of cash if it increases its investment in resources for expanding sales. It is therefore a measure of the liquidity risk entailed by growth.



The CCC number effectively corresponds to the time that a company's cash is tied up in operations and unavailable for other activities, and that management would generally prefer a lower net count.

Shortening the CCC can create its own risks: while a business may achieve a negative CCC by collecting from customers before paying suppliers, a policy of strict collections and lax payments may simply be too difficult to sustain in the real world.

Du Pont Analysis

The return on investment (ROI) ratio was developed by Du Pont for its own use, although it is now in use by many companies for evaluating how effectively assets are used. It aims at measuring the combined effects of profit margins and asset turnover. The return on equity (ROE) ratio, on the other hand, is a measure of the rate of return to stockholders.



There are two variants of DuPont analysis, which is the original three-step equation, and an extended five-step equation. The three-step equation looks like this:

$$\text{ROE} = (\text{Net profit margin}) * (\text{Asset Turnover}) * (\text{Equity multiplier})$$

Operating efficiency is measured by profit margin. Asset use efficiency is measured by total asset turnover. Financial leverage is measured by the equity multiplier. The extended DuPont equation breaks down net profit margin further. It shows that increases in leverage don't always indicate an increase in ROE.

Working Capital Management

Working capital, also known as net working capital (NWC) is a financial metric for representing operating liquidity available to a business. The goal is to ensure that the company is able to continue its operations in such a manner that there is sufficient cash flow for satisfying both maturing short-term debt and upcoming operational expenses.



Cash management is all about identifying the cash balance that would allow for the company to meet day to day expenses and at the same time cutting cash holding costs. Inventory management deals with the identification of the level of inventory which allows for uninterrupted production and at the same time cutting the investment in raw materials. Debtors management is about identifying the appropriate credit policy, while short term financing is about identifying the appropriate source of financing given the cash conversion cycle.

Along with fixed assets such as plant and equipments, working capital is considered a part of operating capital. It is calculated as current assets minus current liabilities. If current assets are less than current liabilities, an entity is said to have a working capital deficiency (a.k.a. working capital deficit).

Keep in mind, a company can be endowed with assets and profitability but short of liquidity if its assets cannot readily be converted into cash. Positive working capital is therefore required to ensure that one can continue operations and can satisfy both maturing short-term debt and upcoming operational expenses.

