Dell working capital hbs case

Business

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**** Explain howDell‘ s working capital policy is a competitive advantage for the company? Dell uses a just in time order fulfillment policy and accurate forecasting of sales to minimize inventories. This allowed Dell to hold inventory of finished products far below levels of their competitors (10-20% compared to 50-70% industry level) and furthermore allowed them to quickly implement changes to their product lines as new technologies became available. This quick inventory turnover also allowed Dell to retain more capital.

Finally, this policy enabled Dell to respond immediately to technological progress in components and deliver state of the art new finished products (e. g.

Pc’s holding the newest Pentium microprocessors) while competitors are still selling inventory of products not containing newest technology. When comparing Dell’s 1995 DSI to its competitors you can see the competitive advantage taking shape: Company: DSI (1995): Inventory Savings at competitors DSI: Dell: 320Apple: 54$167. million Compaq: 73$311. 7 millionIBM: 48$121.

6 million * How did Dell fund its 52% growth in 1996? Please be sure to distinguish between internal and external sources of funding, and to discuss the trade-off between the uses of external funds in order to maintain high growth rates. Dell funded its 52% growth in 1996 internally by increasing sales, lowering sales/operating expenses by 1%, which led to an increase in profit margin (net profit/sales) from 4. 3% to 5. %, increasing financing ;

other income by $42 million, while short term investments increased by 22%, accounts payable increased by 15% (“ free” financing from vendors) and Long Term Debt stayed the same. Dell supported this growth externally by issuing an additional $74 million of common stock (the conversion from preferred to common stock is included in this calculation). Using internal sources of funding by becoming more efficient was a preferred route by Dell.

This internal funding had a much lower cost to the company because they streamlined current practices and enhanced the use of short term investments. In general, using external funds, i. e. debt or equity, to finance increasing growth is riskier to the corporation. When issuing debt the company needs to be certain to cover both the repayment of the principal and the interest payments on time (because if they do not this could cause them to have problems securing financing in the future).

When issuing additional shares of stock (equity) the value of existing traded stock is diluted (in proportion) and as such the current ownership might lose control (and may even be voted out by shareholders if dilution is substantial enough). Furthermore, with both debt and equity financing, a fast growing company needs to be aware that payments to either may hamper future expansion because payments that need to be send out in the forms of dividends or interest cannot be retained and invested in future projects. Assuming Dell’s sales will grow at 50% in 1997, how would you recommend that the Company funds this growth? How much capital would need to be reduced and/or profit margin increased if the company were to fund its growth by relying only on internal sources of capital? What steps would you recommend the company take? Assuming the profit margin stays at 5. 1%

and that operating assets (total assets minus short term investments) maintains at 1996 percentage level of approximately 30% of sales, Dell would require $2, 336 million minus $1, 555 million, which equals to $779 million.

The cash flow from profit is 0.

051*5, 296 million*1. 5, which equals approximately $405 million. The cash flow from cumulative liabilities without account payables is $2, 523 million minus (total assets $2, 148 million minus accounts payable $466 million), which equals $841 million. We conclude that since cash flow (which is $841 million plus $405 million, equaling $1, 246 million) exceeds the cash outflow of $779 million, Dell can fully finance its growth internally. How, if at all, would your answers to Question 3 change if Dell also repurchased $500 Million dollars of common stock in 1997 and repaid its long-term debt? Dell would need to further increase its profit margin to have funds available to repurchase $613 million of debt ($500 million of common stock plus $113 million of debt), as such they would most likely need to increase overall sales in conjunction with increase in profit margin.

Additional sources of funding could also come from shortening the CCC further, if possible.