

BBA / Seventh Semester / BNK 203: Working Capital Management

Candidates are required to answer the questions in their own words as far as practicable.

Group "A"

Brief Answer Questions:

[10 × 2 = 20]

1. State the meaning of working capital.
2. Write the meaning of cash conversion cycle.
3. Mention any two motives for holding cash.
4. A firm's credit term is 2/10 net 30. Write the meaning of 2, 10 and net 30 of credit term.
5. Define inventory ordering cost.
6. Mention the any four functions of credit manager.
7. Outline any four factors to be considered in working capital financing.
8. How do you calculate net float? Illustrate.
9. The PQR Company is ordering economic order quantity of 1,200 units. The firm maintain the safety stock of 500 units. Calculate maximum inventory and average inventory of the company.
10. XYZ firm has a cash balance of Rs 150,000, debtors of Rs 100,000, inventory of Rs 100,000, and current liabilities of Rs 250,000. Calculate the gross working capital and net working capital of the firm.

Group "B"

Short Answer Questions: (Attempt any SIX Questions)

[6 × 5 = 30]

11. Discuss the factors affecting the size of working capital.
12. How does working capital affect profitability of the firm?
13. Explain the elements of credit policy of a firm.
14. Champion Manufacturing turns over its inventory 8 times each year, has an average payment period of 35 days, and has an average collection period of 60 days. The firm's total annual outlays for operating cycle investments are Rs 3.5 million. Assume a 360-day year.
 - a. Calculate the firm's operating and cash conversion cycle.
 - b. Calculate the firm's daily cash operating expenditure. How much in resources must be invested to support its cash conversion cycle?
 - c. If the firm pays 14 percent for these resources, by how much would it increase its annual profits by favorably changing its current cash conversion cycle by 20 days?

15. The Silver Corporation has a fixed cost associated with buying and selling marketable securities of Rs 100. The interest rate is currently 0.02 percent per day, and Silver has estimated that the standard deviation of its daily net cash flows is Rs 90. Management has set a lower limit of Rs 1,000 on cash holdings. Calculate the target cash balance and upper limit using the Miller Orr Model. What should company do when cash balance increases to upper limit?
16. The Biratnagar field office of the Mathema Corporation has sold a quantity of silver ingots for Rs 2.5 million. Mathema wants to transfer this amount to its concentration bank in Kathmandu as economically as possible. Two means of transfer are being considered. (1) A mail depository transfer check (DTC) which costs Rs 2,000 and takes three days. (2) A wire transfer, which costs Rs 5,000 and for which funds are immediately available in Kathmandu.
- Mathema earns 12 percent annual interest on funds in its concentration bank. Which transfer method should Mathema use to minimize the total cost of the transfer?
 - At what rupee transfer amount would Mathema be indifferent to the two transfer procedures?
17. Siddhartha Tools industry purchases 100,000 unit annually. Ordering cost is Rs 1,000 per order and carrying cost is Rs 2 per unit per year. Currently the company is purchasing at Economic Order Quantity (EOQ). Suppose, supplier offers the firm a quantity discount of Re 0.50 per unit, if the company purchase in order size of 20,000 units at a time. Would company accept the offer?

Group "C"

Long Answer Questions: (Attempt any THREE Questions)

[3 × 10 = 30]

- Describe the concept of working capital. Also discuss the importance of working capital management in manufacturing and trading firm.
- How long-term financing and short-term financing are used in conservative, aggressive and matching approach of working capital financing? Explain.
- Prepare a cash budget for the Bhulke Manufacturing Company indicating receipts and disbursements for May, June, and July. The firm wishes to maintain a minimum cash balance of Rs 20,000 at all times. Determine whether or not borrowing will be necessary during the period, and if it is, when and how much. As of April 30, the firm had a balance of Rs 20,000 in cash.

Actual sales		Forecasted sales	
January	Rs 70,000	May	Rs 90,000
February	60,000	June	100,000
March	80,000	July	110,000
April	80,000	August	120,000

Accounts receivable: 50 percent of total sales are for cash. The remaining 50 percent will be collected equally during the following two months (the firm incurs a negligible bad-debt loss).

Cost of goods manufactured: 70 percent of sales; 90 percent of this cost is paid during the first month after incurrence, the remaining 10 percent is paid the following month.

Sales and administrative expenses: Rs 10,000 per month plus 10 percent of sales. All of these expenses are paid during the month of incurrence.

Interest payments: Semiannual interest of Rs 18,000 is paid during July. An annual Rs 50,000 sinking fund payment is also made at that time.

Dividends: A Rs 10,000 dividend payment will be declared and made in July.

Capital expenditures: Rs 40,000 will be invested in plant and equipment in June

Taxes: Income tax payments of Rs 1,000 will be made in July.

21. Superlight Company estimates that due to the seasonal nature of its business, it will require an additional Rs 200,000 of cash for the month of July. Superlight has four options available to provide the needed funds. It can

- Establish a one-year line of credit for Rs 200,000 with a commercial bank. The commitment fee will be 0.5 percent, and the interest charge on the used funds will be 15 percent per annum. The minimum time the funds can be used is 30 days.
- Forego the July trade discount of 2/10, net 40 on Rs 200,000 of accounts payable.
- Issue Rs 200,000 of 30-day commercial paper at a 13.8 percent per annum interest rate.
- Issue Rs 200,000 of 60-day commercial paper at a 14 percent per annum interest rate. Since the funds are required for only 30 days, the excess funds (Rs 200,000) can be invested in 13 percent per annum marketable securities for the month of August. The total transaction fee on purchasing and selling the marketable securities is 0.5 percent of the fair value.

Required:

- a. Which financial arrangement results in the lowest cost?
- b. Is the source with the lowest expected cost necessarily the source to select? Why or why not?

Group "D"

Comprehensive Answer / Case / Situation Analysis Questions:

[20]

22. Read the following information carefully and answer the questions that follow:

Ravi Thami, financial vice president of Shikhar Chemical Corporation, recently received a report from the company's marketing department recommending that Shikhar's credit policy be eased. Specifically, the report recommended that the credit terms be changed from 2/10, net 30 to 3/20, net 45. According to the report, such a change would cause sales to increase from Rs 18 million to Rs 24 million.

Currently, 60 percent of Shikhar's paying customers pay on Day 10 and take the discount, 40 percent pay on Day 30. Only 2 percent of sales currently end up as bad debt losses. If the new credit policy is adopted, Thami thinks that 70 percent of paying customers would take the discount, 30 percent would pay on Day 45. However, bad debt losses would rise from 2 percent to 3 percent.

Variable operating costs currently are 75 percent of sales, the cost of funds used to carry receivables is 10 percent, and Shikhar's marginal tax rate is 40 percent. None of these factors would change as a result of a credit policy change.

To help decide whether to adopt the new policy, Thami has asked you to answer the following questions:

- a. Calculate Shikhar's Days sales outstanding before and after change in credit terms.
- b. What is the rupee amount of bad debt losses, discounts, cost of carrying receivables under the current and the proposed credit policies?
- c. What is the expected incremental profit associated with the proposed change in credit policy? Based on the analysis thus far, should the change be made?
- d. How does relaxation in credit standard affect expected sales, bad debt loss, and opportunity cost? Answer in words only.

