College of Applied Business (CAB)

Sent-up Examination, February 2015

BBA / Seventh Semester / BFN 204: Working Capital Management

Candidates are required to give their answers in their own words as far as practicable.

Section 'A' **Time: 20 minutes**

Brief answer questions: [10 × 1=10]

Indicate whether the following statements are 'True' or 'False'. Support your answer with reason:

1. Credit Term 3/10 net 20 for credit purchase as on 1 April 2013 should be repaid by 20th April 2013.
2. Bank loans are spontaneous sources of short term financing.
3. Under the aggressive current assets policy, a firm would hold relatively large amount of working capital.
4. Net Working Capital is the amount of current an organization holds.
5. Cash conversion cycle represents the time between sale of goods in credit and receipt of goods sold in credit.
6. The current ratio measures the firm's level of debt it holds.
7. Both long-term sources and short term sources of financing can be used to finance working capital.
8. Transaction motive refers to the need to hold cash in order to take advantage of attractive business situation that occurs in future.
9. The decision to grant credit depends on whether the customer represents a one-time sale or possible repeat business.
10. A firm places the order of 400 units EOQ size, which has a safety stock level of 50 units. The average inventory size is 550 units.

Section 'B' **Time: 30 minutes**

Short answer questions:(Attempt any two questions.) [2 × 5=10]

11. A Company has Rs. 3 per year carrying cost of each unit of inventory, an annual usage of Rs. 75,000 units and an ordering cost of Rs. 100 per order. The purchase price of the inventory is Rs. 12 per unit. Assume 360 days a year. [1+1+1+2]
    a. Calculate the economic order quantity.
    b. What is the total annual cost of EOQ including acquisition cost?
    c. If the lead time is 14 days, find the reorder level.
    d. If a discount of Rs. 0.15 per unit is offered to the company when it purchases a lot of 2,000 units, should the discount be accepted?
12. Guras Pvt. Ltd. turns its inventory 8 times each year, has an Average Payment Period of 35 days, and has an average collection period of 50 days. The firm's total annual outlays for operating cycle investments are Rs. 3.5 million. Assuming a 360 day year.
    a. Calculate the firm's operating cycle and cash conversion cycle. [3]
    b. Assuming the firm pays 14% for financing, by how much would it increase its annual profits by favorable changing its current cash conversion cycle by 20 days? [2]

13. Suppose a firm makes purchases of Rs. 3.6 million per year under terms 2/10 net 30 and takes discounts. [2+2+1]
    a. If the firm did not take discounts but it did pay on the due date, what would be its average payables and effective annual costs of non-free trade credit?
    b. If the company could stretch its payables for 40 days what would be the nominal annual percentage cost and effective percentage cost.
    c. Is there any cost of trade if the firm pays on 10th day?

14. The present sales of ABC Company is Rs. 200 million. The company wants to try a liberal credit policy to increase its sales. Currently the firm has a collection period of 35 days. It believes the probable increase to be as follows:

	Credit Policy			
	1st	2nd	3rd	4th
Increase in sales from previous level (in mil)	20	10	15	5
Average Collection Period for incremental sales (Days)	40	65	95	140

The prices of its products average Rs. 25 per unit, and variable costs average Rs. 20 per unit. No bad debt losses are expected. If the company has a pre-tax opportunity cost of funds of 15%, which credit policy should be pursued? Why? (Assume 360 days a year) [5]

15. What are the various alternative working capital financing policy a firm can pursue? Explain them with the help of appropriate diagram. [5]

Section 'C' **Time: 80 minutes**

Comprehensive answer questions. [2 × 10=20]

16. The New Horizon Company is attempting to establish a current asset policy. Fixed assets are Rs. 5,500,000 and the firm plans to maintain 55% debt ratio. The interest rate is 10% on short term debt and 15% on long term debt. Three alternative current asset policies under consideration are: 45, 55, 65% of projected sales. The company expects to earn 16% before interest and taxes on sales of Rs 12 million. Company's marginal tax rate is 50%.
Calculate the expected return on equity under each alternative. [7]
Explain the relationship between the debt ratio and profitability. [3]

17. Prepare a Cash Budget for the Asian Manufacturing Company for three months of May, June and July. The company has a policy of maintaining a minimum cash balance of Rs. 50,000. The company's cash balance as on 30 April is Rs. 30,000.

Month	**Amount**	**Month**	**Amount**
January	75,500	May	150,000
February	75,000	June	125,000
March	90,000	July	250,000
April	90,000	August	150,000

Consider the following additional information:

a. Cash Sales are 60% of the total sales. The remaining sales are collected equally during the following months.
b. Cost of goods manufactured is 75% of sales, 80% of this cost is paid after one month and the balance is paid after two months of the cost insurance.
c. Fixed operating expenses are Rs. 15,000 per month. Variable operating expenses are 10% of the sales each month.
d. Half yearly interest on 12% Rs. 450,000debentures is paid during July.
e. Rs. 60,000 is expected to be invested in fixed assets during July.
f. An advance tax of Rs. 15,000 is paid in July.

You are also required to determine whether or not borrowing will be necessary during the period and if yes, when and how much.