

## IMT- 07

### WORKING CAPITAL MANAGEMENT

#### Notes:

- Write answers in your own words as far as possible and refrain from copying from the text books/handouts.
- Answers of I<sup>st</sup> Set (Part-A), II<sup>nd</sup> Set (Part-B), III<sup>rd</sup> Set (Part – C) and Set-IV<sup>th</sup> (Case Study) must be sent together.
- Submit the assignments in IMT CDL H.O. along with the assignments Question Papers for evaluation .
- Only hand written assignments shall be accepted.

#### A. First Set of Assignments

5 Questions, each question carries 1.5 marks.

#### B. Second Set of Assignments

5 Questions, each question carries 1.5 marks.

#### C. Third Set of Assignments

5 Questions, each question carries 1.5 marks. Confine your answers to 150 to 200 Words.

#### D. Forth Set of Assignments

Two Case Studies : 7.5 Marks. Each case study carries 3.75 marks.

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#### SECTION - A

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- The varying ratio between fixed assets and current assets has an impact on profitability/liquidity of a firm. Discuss
- Enumerate the advantages of trade credit.
- Write short notes on:
  - Call money market in India
  - Commercial Papers
- The ABC Ltd sells goods on credit. Its current annual credit sales amounts to Rs 900 lakh. The variable cost is 80%. The credit terms are 2/10, net 30. On the current level for sales the bad debts are 0.75. The past experience has been that 50% of the customers avail of the cash discount , the remaining being financed in the ratio of 2:1 by a mix of bank borrowings and owned funds which costs 25% and 28% per annum respectively. As an alternative to the in house management of receivables, ABC LTD. is contemplating use of full advance non- recourse factoring with the Indbank factors Ltd. The main elements of the deal are:
  - Factor reserve 15%
  - Guaranteed payment date 24 days after the purchase
  - Discount charge 22%
  - Commission of other services 4% of the receivables
 Analyze the proposal.
- Following information is available in respect of a trading firm:
  - On an average, debtors are collected after 45 days; inventories have an average holding period of 75 days and creditor's payment period on an average is 30 days.
  - The firm spends a total of Rs 120 lakh annually at a constant rate.
  - It can earn 10% on investments.

From the above information compute:

- Cash cycle and cash turnover
- Minimum amount of cash required to meet the payment obligations
- Savings by reducing the average inventory holding period by 30 days.

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## SECTION - B

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1. Explain with an example how cash requirements in a particular period are assessed.
2. What are the different forms of bank credit? Explain different modes in which collateral is placed.
3. From the following information you are required to calculate the Economic Order Quantity and the total annual inventory cost.
  - Annual Demand:- 2400 units
  - Unit Price: Rs 2.40
  - Ordering cost per order: Rs 4.00
  - Storage Cost: 2% per annum
  - Interest Rate: 10% per annum
  - Lead time: half month
4. The objective of working capital is not attainable unless factors influencing working capital management are confirmed. Discuss
5. A company deal in consumer durables, having an annual turnover of Rs 80 lakh, 75% of which are credit sales effected through a large number of dealers while the balance sales are made through showrooms on cash basis. Normal credit allowed is 30 days. The company proposes to expand its business substantially and there is a good demand as well. However the marketing manager finds that the dealers have difficulty in holding more stocks due to financial problems. He therefore proposes a change in the credit policy as follows:

Rs in lakhs		
Proposal	Credit Period	Anticipated Credit Sales
A	60 days	70
B	90 days	75

The product yields an average contribution of 25% on sales. Fixed costs amount to Rs 5 lakh per annum. The company expects a pre tax return of 20% on capital employed. The finance manager after a review of the proposal has recommended increasing the provision for bad debts from the current 0.5% to 1% for proposal A and to 1.5% for proposal B.

Evaluate the merits of the new proposal and recommend the best policy.

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## SECTION - C

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1. A company has a collection of Rs 5,00,000 per day. Mailing and processing delays account for 6 days. If a lock box system is introduced, the delay is reduced to 3 days but the annual cost of the lock box system comes to Rs 50,000.
  - How much cash is released on account of the shortening of mailing and processing delay?
  - What will be the annual benefit on account of lock box system if the released amount is invested at 10% p.a?
2. Write a note on the JIT in inventory system.
3. Explain the norms suggested by Tandon Committee for providing bank credit.
4. Differentiate between
  - Payment float and receivable float
  - Budgeting and forecasting
5. From the following information, draw a plan of ABC selective control:

Product	Units	Per Unit Price
1	7000	5
2	24000	3
3	1500	10
4	600	22
5	38000	1.5
6	40000	.5
7	60000	.2
8	3000	3.5
9	300	8
10	29000	.4
11	11500	7.1
12	4100	6.2

### CASE STUDY - 1

A proforma cost sheet of a company provides the following particulars:

	Amount(Rs)
Raw Material	80
Direct Labour	30
Overheads	60
Total Cost	<b>170</b>
Profit	30
Selling price	<b>200</b>

The following particulars are available:

Raw material in stock, on average one month; material in process, on average half a month; finished goods in stock, on average one month. Credit allowed by suppliers is one month, credit allowed to debtors is two months, lag in payment of wages is one and a half weeks, lag in payment of overhead expenses is one month; one fourth of the output is sold against cash; cash at bank is expected to be Rs 25000. You are required to prepare a statement showing the working capital needed to finance a level of activity of 1,04,000 units of production. Assume that production is carried out during the year evenly.

### CASE STUDY - 2

Prepare the cash budget for July-December from the following information. The estimated sales, expenses etc are given below:

Particulars	Months						
	June	July	Aug	Sep	Oct	Nov	Dec
Sale	35	40	40	50	50	60	65
Purchase	14	16	17	20	20	25	28
Wages & Salaries	12	14	14	18	18	20	22
Misc. Expenditure	5	6	6	6	7	7	7
Interest Received	2	-	-	2	-	-	2
Shares issued	-	-	20	-	-	-	-

Additional Information:

1. 20% of the sales are on cash and the balance on credit.
2. 1% of the credit sales are returned by the customers, 2% of debts are uncollectible, 50% of the good account receivables are collected in the month of the sales and the rest during next month.
3. The time lag in payment of miscellaneous expenses and purchases is one month. Wages and salaries are paid fortnightly with a time lag of 15 days.
4. The company keeps minimum cash balance of Rs 5 lakh. Cash in excess of Rs 7 lakhs is invested in Government securities in the multiples of Rs 1 lakh. Shortfalls in the minimum cash balance are made good by borrowings from the banks. Ignore interest received and paid.