UNIVERSITY OF COLOMBO, SRI LANKA

FACULTY OF MANAGEMENT AND FINANCE

Bachelor of Business Administration (Level II – Semester VII) Examination - July 2018

ACT 2203 – Working Capital Management

Two (02) Hours

Answer All (04) Questions

Use of calculators is permitted

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1. i. "A firm should maintain a satisfactory level of working capital rather than a higher or lower level of working capital". Elaborate on this statement.

(05 Marks)

ii. Following details are extracted from the statement of financial position of Wila Ltd.

Liabilities	Rs. '000	Assets	Rs. '000
Non-current liabilities	100,000	Non-current assets	90,000
Current liabilities	50,000	Current assets	60,000
Total	**150,000**	**Total**	**150,000**

Wila Ltd has found that its current assets earn 3%, non-current assets earn 12%, current liabilities cost 2% and non-current liabilities cost 9%.

a. Based on the above information, calculate the net profitability of the Company.
b. The Company is contemplating to lower its net working capital to Rs. 5,000,000 either by shifting Rs. 5,000,000 current assets into non-current assets **or** shifting Rs. 5,000,000 non-current liabilities into current liabilities. Select the most appropriate alternative by analyzing above information.

(10 Marks)

iii. Good Wealth Company has forecasted its fund requirement for the first six months of 2019 to be as follows.

Month	Amount (Rs. millions)
January	130
February	120
March	180
April	170
May	130
June	140

The cost of short term financing and long term financing is 8% and 12% respectively.

You are required to prepare a summary report to the management by comparing cost of financing **and** net working capital under hedging, conservative and mixed approaches.

(10 Marks)

(Total 25 marks)

2. i. "A firm requires to consider various internal and external factors in determining its working capital needs". Explain this statement.

(05 marks)

ii. Gateway is a newly established Company which produces only one product, and has applied for a loan from a bank for financing its working capital requirements. Before granting the loan, the Company has been requested by the bank to prepare an estimation of net working capital. Below details are available for Gateway Company.

- Unit cost structure of the product.

Item	Rs.
Raw materials	60
Direct labour	30
Manufacturing Overheads	40
Selling overheads	10
Total cost	**140**

- The level of activity of 80,000 units of production is maintained for the year.
- Raw materials are purchased on one month credit period, and are in stores for one month period before being issued to production.
- Materials in process on average is one month and two weeks (Assume 100% completion in respect of materials and 50% completion stage in respect of conversion costs).
- Finished goods in stock on average is one month and two weeks.
- Credit allowed to debtors on average is one month and two weeks.
- Average time-lag in payment of wages is one month.
- Average time-lag in manufacturing overheads and selling overheads is three weeks.
- Cash at the bank is expected to be Rs. 300,000.

On behalf of the Company, you are required to prepare a statement showing the working capital requirement.

(20 Marks)

(Total 25 marks)

3. i. Sigma Company sells goods on credit basis. Its current annual sales amount is Rs. 3,500,000. Debtors are allowed one month credit period with no cash discounts. Now, the Company is considering the below two options in financing its debtors.

Option 01

A factor is willing to advance 90% of the total bills raised on credit for a fee of 2% a month, plus a commission of 5% on the total amount of debts. As a result of this arrangement, Sigma Company is likely to save Rs. 150,000 per annum in respect of credit monitoring costs and avoid bad debts of 1% on the credit sales.

Option 02

A bank has offered to make an advance equal to 90% of the total debts at an annual interest rate of 20%. However, the bank will charge 1% on the debts as its processing fee.

As a consultant, what advice would you offer Sigma Company pertaining to above option 01 and 02 (Clearly state your assumptions, if any).

(16 Marks)

ii. Branded Lanka Company requires Rs. 720,000 in cash to meet its transaction needs during the next six month cash planning period. It holds marketable securities of an equal amount. The annual yield on these marketable securities is 20%. The conversion of these securities into cash involves a fixed cost of Rs. 1,000 per transaction.

a. Using Baumol model, compute the amount of marketable securities (economic lot size) converted into cash per order.

(02 Marks)

b. Calculate the total cost for the economic lot size you calculated above.

(04 Marks)

iii. "The planning horizon of a cash budget should be neither too long nor too short". Briefly comment on this statement.

(03 Marks)

(Total 25 marks)

4. i. "ABC system is a widely-used classification technique to identify various items of inventory for the purpose of inventory control. However, it involves certain limitations". Describe this statement.

(05 Marks)

ii. What do you mean by qualitative analysis of credit information?

(03 Marks)

iii. Super Computer Company sells computer parts and currently makes all sales on credit. The Company allows 45 days credit period to its dealers and offers 2% cash discount for the payments within 10 days. 30% of sales will be on cash discount. At present, the Company has annual sales of Rs. 5,600,000 and the bad debt loss is 3% from the total sales.

However, the Company has now decided to restrict its credit standards as follows.

- Decrease credit period up to 30 days
- Reduce the cash discount up to 1.5%

As a result of the new credit standards, credit sales are expected to be Rs. 4,800,000 and 10% of total sales will be on cash discount. The bad debt loss is expected to be 1% from the total sales.

The variable costs are 80% of sales and the fixed costs are Rs. 420,000 and are maintained under two scenarios. Required (pre-tax) return on investment is 20%.

Advise Super Computer Company whether the proposed credit standards are appropriate (Assume that there are 360 days in a year).

(12 Marks)

iv. Strategic PLC is operating in the apparel industry. The Company can buy materials from either Aqua suppliers or Browns suppliers. Following credit terms are offered by Aqua and Browns under the same invoice amount of Rs. 1,800,000.

Supplier	**Credit terms**
Aqua	2/10, net 30 days
Browns	3/10, net 50 days

If the annual borrowing rate is 15%, advise Strategic PLC on the selection of the most appropriate supplier (Assume that there are 360 days in a year).

(05 Marks)

(Total 25 marks)