UNIVERSITY OF COLOMBO, SRI LANKA

FACULTY OF MANAGEMENT AND FINANCE

Bachelor of Business Administration (Level - II, Semester - VII) Examination 2010

ACT 2216 – Working Capital Management

Two (02) Hours

Answer All (04) Questions

Use of calculators is permitted

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1. i. A company has identified that its current assets earn 9%, fixed assets earn 12%, current liabilities cost 6% and long-term funds cost 9%. A summary of the company's balance sheet is given bellow:

Liabilities	**Rs.**	**Assets**	**Rs.**
Capital	50,000	Fixed assets	90,000
Reserves	20,000	Current assets	40,000
Non-current liabilities	30,000		
Current liabilities	30,000		
Total	**130,000**	**Total**	**130,000**

a. Calculate the net profitability of the company. (04 Marks)

b. Company is expecting to reduce its net working capital to Rs.7,000 either by shifting Rs.3,000 of current assets into fixed assets or shifting Rs.3,000 of its non-current liabilities in to current liabilities. Select the most suitable option from the above suggestions. (04 Marks)

c. Can the company implement both above alternatives simultaneously? How would it affect on the net profitability? (04 Marks)

ii. A company has forecasted its fund requirements for the next four months as follows:

Month	Amount in Rs.'000
April	600
May	1,000
June	1,500
July	2,000

The cost of short-term and long-term financing is expected to be 7% and 13% respectively.

a. Calculate the cost of financing using hedging, conservative and moderate approaches. (09 Marks)

b. Compare risk, cost and profit associated with each of the above approaches. (06 Marks)

(Total 27 marks)

2. i. 'Length of operating cycle is the major determinant of working capital needs of a business firm'. Explain. (08 Marks)

ii. A company has the following information and expects to calculate the average amount of working capital which requires them to conduct the business. They expect to add 10% for contingencies.

Raw materials Rs.90; Direct labour Rs.50

Manufacturing and administrative overheads (excluding depreciation) Rs. 40

Depreciation Rs.20; Selling overheads Rs.30

Additional information

a. Budgeted level of activity is 120,000 units of output for the next year.
b. Raw material cost consists of Rs.65 per unit for material A, Rs.15 per unit for material B and Rs.10 per unit for material C.
c. Raw materials are purchased from different suppliers, extending different credit periods such as 2 months for material A, ½ of a month for material B and 1 month for material C. Average time-lag in payment of all overheads is 1 month and ½ of a month for direct labour.

d. Product is in process for a period of ½ month. Production process requires full unit (100%) of material A in the beginning of production; material B is required only to the extent of 50% in the beginning and the remaining is needed at a uniform rate during the process. Direct labour and other overheads are required similarly at a uniform rate throughout the production process.

e. Past trends indicate that the material A is required to be stored for 2 months and other materials for 1 month.

f. Finished goods are in stock for a period of 1 month.

g. It is estimated that one-fourth of total sales are on cash basis and the remaining sales are on credit. The past experience of the firm has been to collect the credit sales in 2 months. Desired cash balance is to be maintained at Rs.1,000,000.

Calculate the average amount of working capital requirement of the company. (14 Marks)

(Total 22 marks)

3. i. Briefly explain the process of determining a credit policy to an organization. (12 Marks)

ii. The turnover of a company is Rs.1,000,000 of which 90% is on credit. Debtors are allowed two months to clear off the dues. A factor is willing to advance 85% of the debtors for a fee of 2% per month plus a commission of 2% on the total amount of debts. The company, as a result of this arrangement, is likely to save Rs.24,000 annual in- house debt management cost and avoid bad debts at 1% on the credit sales. Alternatively, the company can obtain a bank loan equal to 85% of the debts at an interest of 13%. The processing fee of the bank loan is 2% on the debts. You are required to analyze above information and select the most appropriate option between the two alternatives. (12 Marks)

(Total 24 marks)

4. i. Identify the common problems that can be observed in an inventory management system and suggest an inventory control technique each to overcome those problems. (08 Marks)

ii. Prepare a cash budget for July to December from the following information.

a. The estimated sales and expenses are as follows.

Month	**Sales (in '000)**	**Wages and salaries (in '000)**	**Other expenses (in '000)**
May	450	60	52
June	360	55	53
July	260	38	42
August	190	39	49
September	290	46	51
October	300	52	48
November	320	49	49
December	280	48	48

b. 20% of the sales are on cash and balance on credit.

c. The firm has a gross margin of 20% on sales.

d. 70% of the credit sales are collected in the month following the sales month, 20% in the second month following the sales month and 10% in the third month following the sales month.

e. Materials for the sale of each month are purchased one month in advance and payment is made after 2 months.

f. The time-lag in the payment of wages and salaries is one third of a month and for other expenses is one month.

g. Debentures worth Rs. 100,000 will be sold in July.

h. The firm maintains a minimum cash balance of Rs. 50,000. Funds can be borrowed at 15% per annum in the multiples of Rs.5,000 and the interest is paid on monthly basis. In case of an excess cash balance, the firm can invest in marketable securities in the multiples of Rs.5,000 at an interest of 10% per annum and which receives on monthly basis.

i. Cash balance at the end of June is expected to be Rs. 54,000. (19 Marks)

(Total 27 marks)

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