UNIVERSITY OF COLOMBO, SRI LANKA

FACULTY OF MANAGEMENT AND FINANCE

Bachelor of Business Administration (Level – II, Semester – VII) Examination – July, 2017

ACT 2203 – Working Capital Management

Two (02) Hours

Answer All Questions

Use of Calculators is Permitted

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1. i. Explain why a company has to pay a considerable attention to manage its working capital.

(10 Marks)

ii. "Nature of sector a company is operating creates different kinds of working capital management issues". Do you agree with this statement? Justify your answer.

(10 Marks)

iii. ABC Company has forecasted its total funds requirement for the first six months of 2018 as follows. The cost of short-term and long-term financing is expected to be 10% and 12% per annum, respectively.

Month	Amount (Rs. in millions)
January	110
February	130
March	220
April	160
May	120
June	100

Using the above information, calculate cost of financing under hedging, conservative and mixed approaches. Compare the profitability-risk trade-off associated with these approaches.

(10 Marks)

(Total 30 marks)

2. i. Briefly describe the various factors which are taken into account in determining the working capital needs of a firm.

(08 Marks)

ii. The Board of Directors of Build Engineering (Pvt) Ltd requests you to prepare a statement showing the working capital requirement for a level of activity at 156,000 units of production. The following information is available for your calculation:

Particular	Cost per unit (Rs.)
Raw materials	90
Direct labour	40
Overheads	75
Total cost	**205**
Profit	60
Selling price	265

Additional information:

a. Raw materials are in stock, on average one month.
b. Materials are in process, on average two weeks.
c. Finished goods are in stock, on average one month.
d. Credit allowed by suppliers, one month.
e. Time-lag in payment from debtors, two months.
f. Average time-lag in payment of wages, six weeks.
g. Average time-lag in payment of overheads is one month.
h. 20% of the production is sold against cash.
i. Cash in hand is expected to be Rs. 60,000.
j. It is to be assumed that production is carried out evenly throughout the year, and wages and overheads accrue similarly.

(12 Marks)

(Total 20 marks)

3. i. "The major benefits of holding inventory depend on the basic functions of inventory of a particular organization". Elaborate on this statement.

(04 Marks)

ii. Explain why firms are important to maintain a trade-off when credit standards are relaxed or, alternatively, tightened.

(04 Marks)

iii. Super Micro Ltd currently makes all sales on credit and offers no cash discount. The firm's current average collection period is 45 days and sales are Rs. 1,800,000. The variable costs represent the 70% of the selling price whereas total fixed cost is Rs. 360,000. The current bad debt expense is estimated as 1% on total credit sales.

Now the firm is considering following alternative credit terms.

a. Allowing 2% cash discount for customer payments within 10 days.
b. As a result of cash discount offered average collection period is expected to fall up to 30 days.

It is expected that the change in credit terms will result in increase in sales to Rs. 2,070,000 and bad debt expense will decrease to 0.5%. However due to increased sales, increased working capital required will be Rs. 27,000. 50% of the total sales will be on cash discount and the required pre-tax rate on return is 20% on investment.

Should the proposed discount be offered? Advise Super micro Ltd (Assume 360 days in a year).

(12 Marks)

iv. Company Alpha is given an early payment discount as 1/10, net 30 for the invoice amount Rs. 300,000 by the Vendor Beta. Annual borrowing rate is 8%. If company Alpha undertakes the early payment discount borrowing from a bank what will be the net annual savings? (Assume 360 days in a year).

(05 Marks)

(Total 25 marks)

4. i. The following facts relate to Avon Industries Ltd.

   a. Annual credit turnover in the current financial year is Rs. 1,200,000
   b. Average collection period is 75 days
   c. Variable cost ratio is 0.75
   d. Cost of funds is 21% per annum
   e. Annual credit collection expenditure is Rs. 20,000 of which 75% can be avoidable.
   f. Bad debt is 1% of sales.

The Foremost Factors Ltd offers a factoring deal to Avon Industries Ltd. It proposes to charge a commission as percentage of the value of book debts of 2% for recourse factoring and 3.5% for non-recourse factoring. In addition, it would charge 20% per annum as discount on receivables. The guaranteed payment date/collection period is 60 days.

Using the above information, what advice would you give to Avon Industries Ltd to continue with the in-house management of receivables or accept the factoring arrangement. State your assumptions, if any, clearly.

(10 Marks)

ii. Prepare a cash budget for January to June, 2018 from the following information:

a. Projected statement of financial position as at 31.12.2017 as follows;

Equity and other liabilities	**Rs.**	**Assets**	**Rs.**
Equity	100,000	Furniture	20,000
Outstanding liabilities	11,000	Debtors	20,000
		Closing stock	50,500
		Cash	20,500
Total liabilities	**111,000**	**Total assets**	**111,000**

b. Estimated sales and salary expenses are as follows:

Month	Sales (Rs.)	Salary expenses (Rs.)
January, 2018	30,000	3,000
February, 2018	52,000	3,500
March, 2018	50,000	3,500
April, 2018	75,000	4,000
May, 2018	90,000	4,000
June, 2018	35,000	3,000
July, 2018	25,000	3,000

c. The other expenses per month are: rent Rs. 1,000, depreciation Rs. 1,000, commission 1% of sales and miscellaneous expenses Rs. 500.

d. 80% of the sales is on credit basis and 20% for cash. 70% of the credit sales are collected in the first month following sales and the balance in the second month. There are no bad debt losses.

e. Gross profit margin on sales on an average is 30%. Purchases equal to the next month's sales are made every month and they are paid during the month in which they are purchased.

f. The company maintains a minimum cash balance of Rs. 10,000. Cash deficiencies are made up by the bank loans which are repaid at the earliest opportunity available and cash in excess of Rs. 15,000 is invested in securities (interest on bank loans and securities is to be ignored).

g. Outstanding liabilities on the Statement of Financial position remain unchanged and debtors pertain to credit sales of December, 2017.

(15 Marks)

(Total 25 marks)