UNIVERSITY OF COLOMBO, SRI LANKA

FACULTY OF MANAGEMENT AND FINANCE

Bachelor of Business Administration (Level – II, Semester – VII) Examination – August, 2016

ACT 2203 – Working Capital Management

Two (02) Hours

Answer All Questions

Use of Calculators is Permitted

---

1. i. Explain, why an efficient working capital management mechanism is essential for an organization to maximize wealth and ensure its long-run survival.

(10 Marks)

ii. "Issues associated with working capital management are frequent and complicated in manufacturing firms than service organizations." Do you agree with this statement? Justify your answer.

(10 Marks)

iii. XYZ Company has forecasted its total fund requirement for the first six months of 2017 as shown below. The cost of short-term and long-term financing is expected to be 8% and 10% per annum, respectively.

Month	Amount (Rs. in millions)
January	100
February	150
March	200
April	150
May	110
June	70

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

(12 Marks)

(Total 32 marks)

2. i. "The length of the operating cycle of a firm is considered as the heart of working capital management." Discuss.

(10 Marks)

ii. The following information has been extracted from the projected statement of profit or loss of the XYZ Company for the year 2017.

		Rs. in '000
Sales		3,200
Cost of sales **(Note: 1)**		(1,800)
Operating profit		1,400
Administrative expenses	180	
Selling expenses	120	(300)
Profit before tax		1,100

Note: 1 Cost of sales	Rs. in '000
Materials	1,150
Wages	350
Depreciation	500
	2,000
Closing stock (10%)	(200)
	1,800

The figures given above are related only to the finished goods and not to work-in-progress. Work-in-progress is 20% of the goods produced which requires full materials and only 40% of other expenses. The company expects to keep 2 months consumption of materials in stock before commencing the production. Average time lag in payment of all expenses of the company is 1 month. Suppliers of materials extend 2.5 months credit period to settle their dues. Sales are 20% on cash and the rest is on 2 months credit basis. Desired cash balance is Rs. 50,000. The company keeps 10% in their working capital for contingencies. Using the above information, compute net working capital requirement of the company for 2017.

(15 Marks)

(Total 25 marks)

3. i. "Different types of 'floats' can be used as a useful tool in both receivables and payables management." Elaborate on this statement. (08 Marks)

ii. XYZ Company has annual sales of Rs.8,000,000 and currently extends 30 days credit period to its dealers. The company assumes that sales can pick up considerably if the existing credit policy is revised. In this respect, the company is in need of determining an appropriate credit policy. The following information is available for consideration:

Alternative credit policy	Average collection period (days)	Annual sales (Rs.)
A	45.	8,600,000
B	60	9,000,000
C	75	9,600,000

Additional information:

a. Variable cost is 80%

b. Fixed cost is Rs. 1,000,000

c. Pre-tax return on investment is 20% per annum

Using the above information, determine which credit policy is most appropriate for this company.

(12 Marks)

(Total 20 marks)

4. i. The annual cash requirement of XYZ Company is Rs.1,000,000. The company has marketable securities in lot sizes of Rs. 100,000, Rs. 200,000 and Rs. 250,000. Cost of converting market securities is Rs. 1,000 per lot. The company earns 5% yield on its securities. The variance of daily changes in cash balances is Rs.160,000. Based on the above information, identify optimal conversion lot size, lower level of cash balance and the upper level of cash balance of the company. (08 Marks)

ii. Prepare a cash budget for January to June, 2017 using the following information:

a. Estimated sales and expenses are as follows:

Month	Sales (Rs.)	Wages and salaries (Rs.)	Other expenses (Rs.)
November, 2016	200,000	30,000	27,000
December, 2016	220,000	30,000	27,000
January, 2017	120,000	24,000	21,000
February, 2017	100,000	24,000	30,000
March, 2017	150,000	24,000	24,000
April, 2017	240,000	30,000	27,000
May, 2017	200,000	27,000	27,000
June, 2017	200,000	27,000	27,000

b. 20% of sales are on cash basis. The firm maintains a 25% of gross profit margin on sales.

c. 50% of credit sales are collected in the month following the sales, 30% in the second month and 20% in the third month following the sales.

d. Goods for sales of each month are purchased one month in advance on two months credit basis.

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

f. Debentures worth Rs. 40,000 will be sold in January, 2017.

g. The firm maintains a minimum cash balance of Rs. 40,000. Funds can be borrowed at 12% interest per annum in the multiples of Rs. 1,000. The interest is to be paid on monthly basis.

h. Cash balance at the end of December, 2016 is expected to be Rs. 60,000.

(15 Marks)

(Total 23 marks)