MANAGEMENT PROGRAMME

Term-End Examination

December, 2012

02040

MS-41 : WORKING CAPITAL MANAGEMENT

Time : 3 hours *(Weightage 70%)*

Note : Attempt any five questions. All questions carry equal marks. Use of calculators is allowed.

1. Write detailed notes on :
   (a) Risk Return trade off in working capital management.
   (b) Cash flow forecasting.

2. (a) Explain salient features of effective management of payables.
   (b) Critically evaluate Miller - Orr model

3. Easy Limited specializes in the manufacture of a computer component. The component is currently sold for Rs. 1,000 and its variable cost is Rs. 800. During the year ended December 31, 2010 the company sold on an average 400 components per month.

At present, company grants one month's credit to its customers. It is thinking of extending the same to two months on account of which the following are expected :

Increase in sales, 25 percent

Increase in stock, Rs. 2,00,000

Increase in Debtors, Rs. 1,00,000

You are required to advise the company on whether or not to extend credit terms if (a) all customers avail of the extended credit period of two months and (b) existing customers do not avail of the credit terms but only the new customers avail of the same. Assume the entire increase in sales is attributable to the new customers. The company expects a minimum return of 40 per cent on the investments.

4. Prepare cash budget for the period January to June 2012 from the following information :

(a) The estimated sales and expenses are as follows :

Particulars	Nov 2011	Dec. 2011	Jan. 2012	Feb. 2012	March 2012	April 2012	May. 2012	June. 2012
Sales (Rs.)	2,00,1)00	2,20,000	1,20,000	10,00,00	1,50,000	2,40,000	2,00,000	2,00,000
Wages and salaries (Rs)	30,000	30,000	24,000	24,000	24,000	30,000	27,000	27,000
Miscellaneous expenses (Rs)	27,000	27,000	21,000	30,000	24,000	27,000	27,000	27,000

(b) 20 per cent of the sales are on cash basis and balance on credit basis.

(c) The firm has a gross margin of 25 per cent on sales.

(d) 50 per cent of the credit sales are collected in the month following the sales, 30 per cent in the second month and 20 per cent in the third month.

(e) Material for the sale of each month is purchased one month in advance on a credit for two months.

(f) The time - lag in the payment of wages and salaries is one - third of a month and of miscellaneous expenses, one month.

(g) Debentures worth Rs. 40,000 are to be sold in January, 2012.

(h) The firm maintains a minimum cash balance of Rs. 40,000. Funds can be borrowed @ 12 per cent annum in the multiples of Rs. 1,000, the interest being payable on monthly basis.

(i) Cash balance at the end of December 2011 is Rs. 60,000.

5. Alpha Beta Ltd. Sells goods on credit. Its current annual credit sales amount to Rs. 900 lakh. The variable cost ratio is 80 per cent. The credit terms are 2/10, net 30. On the current level of sales, the bad debts are 0.75 percent. The past experience has been that 50 percent of the customers avail of the cash discount, the remaining customers pay on an average 50 days after the date of sale.

The book debts (receivables) of the firm are presently being financed in the ratio of 2 : 1 by a mix of bank borrowings and owned funds which cost per annum 25 per cent and 28 per cent respectively.

As an alternative to the in - house management of receivables, the company is contemplating use of full advance non - recourse factoring deal with the Indbank Factors Ltd. The main elements of such a deal structured by the factor are (i) factor reserve, 15 per cent; (ii) guaranteed payment date, 24 days after the date of purchase; (iii) discount charge, 22 per cent and (iv) commission for other services (payable up front), 4 per cent of the value of receivables.

The finance manager of the company seeks your advice, as a consulatant, on the cost-benefit of the factoring arrangement. What advice would you give ? You can make your own assumptions (specify if any), where necessary.

6. Distinguish between :

(a) Legal Mortgage and Equitable Mortgage

(b) Secured Advance and Guaranteed Advance

(c) Cash Reserve Ratio and Statutory Liquidity Ratio

(d) Discounting of bills and Factoring

7. Explain the relevance liquidity and profitability in the context of working capital management. Discuss the relationship between the two.

8. Highlight, the special features of Commercial Papers issued by companies in India and discuss the guidelines issued by Reserve Bank of India in this regard. How do commercial papers differ from Inter - corporate loans ?