MANAGEMENT PROGRAMME

Term-End Examination

December, 2006

MS-41 : WORKING CAPITAL MANAGEMENT

Time : 3 hours | *Maximum Marks : 100*
(Weightage 70%)

Note : *Attempt any **five** questions. All questions carry equal marks.*

1. (a) "The most important challenge for a finance manager in Working Capital Management is to find an optimum mix and level of current assets and current liabilities." Elucidate the statement.

   (b) Define Float as used in Cash Management. State how a finance manager can manage float to enhance profitability without sacrificing liquidity of a firm.

2. Explain in brief the following and bring out the differences between them :

   (i) Aggressive and Conservative Financing Strategy for Working Capital

   (ii) Certificate of Deposits and Commercial Paper

   (iii) Precautionary and Speculative Motives of holding cash

   (iv) Spot Rate and Forward Rate

3. (a) Rajiv Stampings are in the business of manufacturing and supplying stampings to various fan manufacturing firms in India. It faces a lead time demand distribution which is given below. It has estimated carrying cost 20% p.a. of price, which is Rs. 1,500 per thousand. Shortage cost is also estimated at Rs. 75 per thousand per period of time.

Lead time demand (in thousands)	30	40	50	60	70
Probability	0·15	0·25	0·20	0·30	0·10

Determine the optimum reorder level.

(b) Rainbow Paints Limited manufactures decorative paints. One of their processing plants has a requirement of a particular chemical which is 80 kg per week. The cost of ordering is Rs. 300 per order, holding cost is Rs. 4·00 per kg per week, and no shortages are permitted. Vendor A will supply the chemical at Rs. 11·00 per kg. Vendor B quotes the following price schedule (where X is the order quantity)

Kgs	**Price per kg.**
$0 \leq X < 200$	Rs. 11·50
$200 \leq X < 400$	Rs. 11·20
$400 \leq X < 1{,}000$	Rs. 10·80
$1{,}000 \leq X$	Rs. 10·30

Determine which source of buying the chemical will be more preferred and what will be the minimum cost order size ?

4. Mr. X has joined recently the Accounting and Finance Department of Peacock Glass Pvt. Ltd. One of the tasks given to him is to arrange necessary funds for the working capital requirement of the company. For this purpose, he has to estimate the working capital requirement of the company and accordingly, he has collected the following **annual data** from the various books of account :

Particulars	**Amount (Rs.) in lakhs**
Sales (at 90 days credit)	540·00
Material Consumed (Suppliers extend two months credit)	15·00
Wages Paid (on the last day of the month)	12·50
Manufacturing expenses outstanding at the end of the year 31-03-2006 (Such expenses are paid one month in arrears)	2·50
Total Administrative Expenses, paid one month in arrears.	4·00
Sales Promotion Expenses paid quarterly in advance	1·00

The Company sells its products on gross profit of 20% of selling price. It keeps one month's stock of each of raw material and finished goods, and a cash balance to the extent of 50% of current liabilities.

Assuming a safety margin of 10% and no work-in-progress, determine the working capital requirement of the company. Ignore tax.

5. How are the advances given by banks classified on the basis of the security ? Explain the modes of creating charge over borrower's assets.

6. (a) Explain the purpose and the philosophy behind the following models :

(i) Baumol Model

(ii) Miller-Orr Model

(b) Sprint Enterprises is in the business of selling a product with highly fluctuating demand. As a result, its demand for cash to meet its working capital requirement is random with an expectation of Rs. 15 millions for a year with a standard deviation of 0·27 million. The recent experience of Sprint Enterprises has been that it costs Rs. 300 to convert marketable securities to cash and vice-versa. The average rate of return on marketable securities is estimated to be about 8%.

You are required to determine the Upper Control Limit and the Return Point using Miller-Orr Model.

7. Catalysts Enterprises Limited has been formed to take over a running business in January 2006. For this, the company has decided to raise Rs. 55 lakhs by issuing shares to the promoters, and the balance of capital required in the first six months is to be financed by a financial institution against an issue of Rs. 5 lakhs 8% Debentures (interest payable annually). Initial outlay consists of :

* Freehold Premises	Rs. 25 lakhs
* Plant and Machinery	Rs. 10 lakhs
* Stock	Rs. 6 lakhs
* Vehicle and other assets	Rs. 5 lakhs

Payments on the above items are to be made in the month of January 2006. Sales during the first six months ending on June 30, 2006 are estimated as follows :

* January 2006	Rs. 14 lakhs
* February 2006	Rs. 14 lakhs
* March 2006	Rs. 18·50 lakhs
* April 2006	Rs. 25 lakhs
* May 2006	Rs. 26·50 lakhs
* June 2006	Rs. 28 lakhs

Other Information :

(i) Preliminary Expenses : Rs. 50,000 (payable in February 2006)

(ii) General Expenses : Rs. 50,000 (payable at the end of each month)

(iii) Debtors are collected with a lag of 2 months and creditors are paid after a month.

(iv) Monthly Wages and Salaries (payable on the first day of the next month) : Rs. 80,000 for the first three months and Rs. 95,000 thereafter.

(v) Gross Profit rate is expected to be 20% on sales.

(vi) The shares and debentures are to be issued on January 1, 2006.

Assuming that the inventory level throughout is to be the same as outlay on them, prepare a cash budget for a period of six months from January 1, 2006 to June 30, 2006.

8. Write short notes on any ***four*** of the following :

(i) Tools to determine the creditworthiness of a customer

(ii) STIFP (Short Term Integrated Funds Planning) Process

(iii) Receivables Variance Analysis — a tool for Receivables Management

(iv) Letter of Credit and Bank Guarantee

(v) Cash Budget Method to assess the working capital requirement of a firm

(vi) Bierman-McAdams Model — a tool of managing marketable securities