

MANAGEMENT PROGRAMME**Term-End Examination****June, 2007****MS-41 : WORKING CAPITAL
MANAGEMENT***Time : 3 hours**Maximum Marks : 100
(Weightage 70%)*

Note : Attempt any **five** questions. All questions carry 20 marks each.

1. "One of the challenges before a finance manager is to ensure proper trade-off between risk and return in every financial decision. Since Working Capital Decisions are financial decisions, he has to ensure desired level of risk - return trade-off in them as well." You are required to discuss and show how a finance manager ensures a proper risk - return trade-off in financial decision. Support your answer with suitable examples.

2. Distinguish between the following :

- (a) Operating Cycle and Cash Conversion Cycle
- (b) Bridge Loans and Composite Loans
- (c) Discounting and Factoring
- (d) Business Analysis and Financial Analysis
- (e) ABC Analysis and VED Analysis

3. (a) M/s Golden Furniture Pvt. Limited is in the trading of furniture items. The firm follows Economic Order Quantity Policy for its 20 odd items in which it trades. For an item that is coded as FM-205, the following data about stock out situation in one inventory cycle is collected from the historical data of the firm.

No. of Stock out units in one inventory cycle	0	50	100	250	400	500
Probability	0.70	0.15	0.07	0.04	0.03	0.01

From the past records, it is estimated that stock out cost per unit is Rs. 50 and the carrying cost per unit per period is Rs. 25.

From the given data, you are required to find out optimum level of buffer stock for M/s Golden Furniture Pvt. Limited.

- (b) Lotus Flower Amenities Limited had a bad financial performance in the last financial year. In the current financial year, the company wants to introduce some drastic strategic changes and one of the changes under contemplation is to extend the credit period. At present the company has credit period of 30 days and it is planning to increase to 50 days. It is expected that this will increase average credit period from 40 days to 60 days and bad debts from the present level of 1% to 2.5%. Total credit sales would increase from 30,000 units to 50,000 units. The average cost per unit of the product is Rs. 16 and the selling price is Rs. 20 per unit. The opportunity cost of the funds for the company is 20%.

You are required to suggest whether it would be beneficial for the company to increase its credit period from the present 30 days to 50 days.

4. PYN Associates are planning to get working capital loan from their banker to meet their working capital requirement. For this, they want to know their working capital requirement and you have been asked to estimate the same from the following information :

	Amount (Rs. in lakhs)	Amount (Rs. in lakhs)
Sales (at 60 days credit and 20% of it is cash sales)		210.00
Material Consumed (Suppliers extend 1.5 months credit and all material is procured on credit basis)	84.00	
Wages Paid (on the last day of the month)	50.00	
Manufacturing Expenses (Such expenses are paid one month in arrears)	12.50	
Depreciation	23.50	
	170.00	
Less : Stock of Finished Goods (10% not yet sold)	17.00	
Cost of Goods Sold		153.00

Gross Profit	57-00
Total Administrative Expenses, paid one month in arrears	14-00
Sales Promotion Expenses paid one month in arrears	13-00
Net Profit	30-00

The data given above does not include work in progress; goods equal to 15% of the year's physical production in units are work in progress on an average, requiring 100% of material and 40% of all other expenses. The company has a policy of maintaining 2 months' consumption of material in stock and a desired level of Rs. 4 lakh of cash.

Assuming a safety margin of 10%, determine the working capital requirement of the company. Ignore tax.

5. (a) Explain the various methods that the firms use to recognise and manage the uncertainty associated with cash flow variations ?
- (b) What are different options available before the firm in improving collection efficiency of cash-in-transit ?
6. (a) "Working Capital is like *blood pressure* – too high of it is fatal, too low of it is collapse." Do you agree with the statement ? Support your answer with necessary reasoning and examples.

- (b) EXCEL Limited has estimated that in the next quarter they are going to require Rs. 30 lakhs of cash to meet various payments. At present, the company is holding equivalent amount of marketable securities. Every time the company gets these securities converted into cash, it has to pay a fixed cost of Rs. 3,000 per conversion. It is estimated that the average yield on the marketable securities is 20%.

You are required to use the Baumol Model and determine the amount of marketable securities to be converted into cash per conversion.

7. (a) "In simulating financial decisions, the strategy that produces the best simulated result is not necessarily the optimal financial strategy." Do you agree with the statement? Support your answer with suitable reasons.

- (b) Globaltech Company is worried about huge investments in inventories. They want to reduce it so that its requirement for working capital gets reduced. For this purpose, it is contemplating a number of steps. One of them is to review its ordering policy. At present the firm is placing 10 orders of 4000 units each. This policy results in Rs. 2,000 as ordering cost and Rs. 5,000 as holding cost.

You are required to examine whether the present ordering policy is an optimum policy. If not, suggest a suitable policy and also find the resultant saving for the firm.

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

- (i) Factoring as a tool of managing receivables
- (ii) Interest Arbitrage in international financial markets
- (iii) Prudential Norms for Exposure Limits in Banks
- (iv) Credit Scoring System as a tool to determine the creditworthiness of a customer
- (v) Float
- (vi) Aggressive and Conservative Approaches to Working Capital Financing

