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Q.1

(A) Some firms finance their working capital with short term financing. What impact this decision have on their profitability and risk

**Answer**

Forgone in view, scenario given for analysis and comments it enlist fowling thing to be discuss one by one:-

* To understand working capital under short term financing
* Impact of the same on firm’s profit and risk

Working capital is a financial metric It generally involves the liquidity available to business or entity. Moreover, working capital is considered a part of operating capital it covers current asset and current liabilities. Each firm intend to maintain its balance between its current asset and current liabilities in order to meet its day to day operation activities, Hence the efforts and steps which are taken placed by financial manger to manage the problems that arise in attempting to manage the current asset and current liabilities is known as working capital Managements.

Working capital management is concerned with short term decision generally relating to the next one year so therefore short term financing is preferred.

Short term working capital is essentially providing business funds for short time period of a year or less and it helps and effect it profitability in the manners as follow:-

* It enables firms to hold stock of raw materials and finished goods
* By short term financing money needed for daily operation can be meet and firm’s product may be sold on credit to take high return
* It also help to increase the volume of production at a short notice
* Firm can get Raw material on discount by availing cash payment opportunity
* Short term funds are also required to allow flow of cash during the operating cycle

Taking into consideration above points we can conclude that in short run firm’s profitability can improve if it decide to avail short term financing For example a firm deals with seasonal business alike winter garments. Firms can raise its revenue by selling the garments on credit for a period expense and other daily operation transactional activities may be meet by acquiring short term financing to mange its working capital.

On other hand if firms remain unable to pay its short term loan due to any circumstances it can lead firm toward risk as its generally said “The shorter the maturity scheduled of a firm’s debit /obligation the greater the risk to meet principle and interest payments” In addition short-term interest rates fluctuate much more than long-term interest rates. Rolling over short-term debt year after year will subject you to greater fluctuation in your financing costs as a result

B.

Some companies finance their seasonal current asset with long term financing. What impact would this policy has on their profitability and risk.

Ans. B

This part of question is also relate with portion of working capital management which refer about financing of assets (seasonal e.g inventory, deprecating asset account receivable) also known as Temporary current asset these seasonal current assent are required to be mange in case of sudden increase in Account Receive able and inventory due to rise in sale to meet seasonal and natural deserter demand with conservative approach by adopting long term financing.

We take current pandemic COVID-19 scenario cause badly up rise in the demand of Surgical Mask, santizer and Life boy soap. To meet such type of unseen demand company fiancé temporary (seasonal) current asset by adopting long term financing as on emergency basis company have to bear extra cost to fulfil the requirement of people and consequently these products will be sold out at market high price which will be result in increase in revenue and as well as in profit of the company.

Generally Life insurance companies and pension funds, on the other hand, have liabilities that are many years in the future. They would prefer to make longer term loans so that there isn’t the need to reinvest the money every year

(C) If the firm follows Hedging Approach to finance, how would finance its current Asset

**Ans. C**

**Hedging approach** also known as Maturity **matching**  is a strategy of working capital financing wherein short term requirements are met with short-term debts and long-term requirements with long-term debts.

Short term or seasonal variations in current assets would be financed with short term debt the permanent component of current asset and all fixed asset would be financed with long term debit or equity.

For example, a seasonal expansion in inventories should be financed with short term loan or liabilities.  The rationale of the hedging principle is straight forward.  Funds are needed for a limited period say for purchase of additional inventory, and when that period is over, the cash needed to repay the loan will be generated by the sale of extra inventory items.  Obtaining the needed funds from a long terms source would mean that the firm would still have the fund after the inventories had already been sold.  In this case, the firm would have excess liquidity, which it either holds in cash or marketable securities until the seasonal increase in inventories occurs again.  The result of all this would be lowers the profits of the firm.  The financing mix as suggested by the hedging approach is a desirable financing pattern.  However, it may be noted that the exact match of maturity period of current assets and sources of finance is always not possible because of uncertainty involved.

Forgone in view, it identified that when firm need to be finance rationally taking into consideration asset life it go for hedging approach.

Q-2

1. Discuss the important variable in selection of the marketable securities for investment.

**Ans. A**

Investments decisions of any business firms play a significance roll to determine future and expansion of the business and it’s a key component of financial management .It is known as very sensitive decision and required foresightness and calculated figures.

As here we are concern to invest in marketable securities generally it for short term and the cash surplus built up in excess of daily cash requirements can be invested in readily marketable short-term securities. These securities are also called as ‘cash equivalents

The primary criteria a firm should use in selecting short-term marketable securities in its portfolio should consider the following principles:

**(a) Default Risk:**

The funds invested in short-term marketable instruments should be safe and secure as regards repayment of principal and interest

**(b) Marketability:**

The liquidity is the basic objective of investment in these instruments. It should offer the facility of quick sale in the market as and when need arises for cash, with low transaction cost, without loss of time and no erosion of amounts invested with fall in price of investments.

**(c) Maturity Date:**

Firms generally invest in marketable securities that have relatively short maturities. The maturity periods of different investments should match with the payment obligations like dividend payment, tax payment, capital expenditure, interest payments on debt instruments etc.

**B.** What is meant by the net float? How company can play with its float through controlling its disbarment

**Ans. B**

In finance Float is known as the amount in transaction (disbarments or collection that is still in process and not yet debited or credited against your company bank account mark as final. It involves

* Disbursement float
* Collection float

**Disbursements float**: is when you write a check and the recipient has not yet cashed the check

**Collection float:** Collection float occurs when you deposit a check but the bank has not yet credited it into your account

In the light of above we can define **Net float** “as the sum of disbursement and collection floats”

For example company had issued cheques of Rs1 million worth and it is not debited from company bank account

Similarly customer deposited cheque against company account of Rs0.5 million and it was not credit yet against company account

Hence the net flow will be of 15 million at specific date

**“It is always desiration of any company to delay payments and speed up its collections”**

In order to meet this statements company adopt following techniques to delay disbursement and speed up it collection to be benefitted for company

## Manage Disbursement Float

For disbursements,

* Payment through cheque instead of cash
* Dispatch cheque through mail instead of handed over to recipients
* To give cheque of other city clearing

It will as you will have the mailing time, the processing time and the time it takes for the bank to actually clear the banking system and transfer funds out of your business's bank account

## Manage Collection Float

To speed up your collection float, you must compress the time between receiving cash and checks and depositing them in the bank.

* To designate a post office box for all invoice payments.
* Remote deposit with your bank.
* To receive payment through RTGS (Real Time Gross Settlements) and RBV (Respond Bank vouchers instead of cheque of other bank

**Q-3**

**A-**What is outsourcing? Why a company outsource some or all of its receivable

**Ans A**

Out sourcing is subcontracting certain business operation to an outside firm it also  referred to as "contracting out") alike shifts tasks, operations, jobs, or processes to an external workforce, by contracting with a third party for a significant period of time.

Company generally outsource

* To reduce costs
* To Improve efficiency
* If a specific project is for short time
* Lack of technical labour force
* Own setup required complication or span of time
* When order required to meet urgent and company is already on its peak production
* Company has some better opportunity to invest rather than to buy some machinery
* To avoid government regulation

Outsourced functions can be performed by the third party either onsite or offsite of the business.

For example as a cost-saving measure, outsourcing can have significant impacts in sectors like manufacturing or services industry. In the Pakistan if Chief burger buy its own bike for home delivery it will carry to much cost and required and hand sum amount in lum sum. Therefore owner of chief burger will prefer to hire bike service from third party to save cost and as well as efficiency.

B. Discuss the three motives for holding cash.

**Ans. B**

Cash is most important and loveable instrument of the world as it has power to buy every thing in the world therefore every person wish to hold cash all the time to meet its day to day requirements

Similarly any organizations firm or company prefer to hold cash due to the same explanation for holding cash in a portfolio was summarized by John Maynard Keynes, after which Keynesian economics or Keynesian

Motives for Holding Money

In his publication on The General Theory of Employment, Interest, & Money, Keynes outlined three reasons, or motives, for holding money or cash:

* **Transaction Motive**:  to pay for goods or services.  It is useful for conducting everyday transactions or purchases.
* **Precautionary Motive**:  it's a relatively safe investment.  Cash investments rarely lose value (as can stocks or bonds) and are therefore held for safety reasons in a balanced portfolio.
* **Asset or Speculative Motive**:  it can provide a return to their holders.