**MID SEMESTER**

**ASSIGNMENT**

**WORKING CAPITAL MANAGEMENT**

**SUBMITTED BY:**

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**Q No. 1.**

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

Working capital is a basic necessity to carry out business operations of a firm and managing its activities efficiently and meet its short run obligations. Working capital Management deals with day to day activities of a firm and its current assets in terms of cash for a time frame of a year rather than long term investment decisions. WCM comprises of cash equivalents, Inventories, accounts receivables, and account payables. WCM influences on the profitability risk and liquidity of the firm as the firm that invests more in current assets is more liquid which reduces the firm liquidity risk while decreasing overall rate of return as the return of current asset is less than the return of other assets. While lower investment in the working capital expressed as aggressive working capital policy is associated with higher return and higher risk more investment in the working capital expressed is conservative working capital policy associated with lower return and lower risk. The firm chooses between aggressive and conservative working capital policies.

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

Business capitals are as follows

**Fixed Capital:** Money allocated to Long term investments. Real estate, Equipment purchases

**Working Capital:** Money allocated to Daily Operations. Inventory, Payroll

Maintaining an adequate amount of working capital is critical for all business but especially vital for seasonal businesses with limited opportunities for peak sales time throughout the year. Business owners with fluctuating customer’s sales and businessmen dealing with a seasonal business usually understand that a majority of their sales will happen during a certain time of a year. This predictability of sales figures can help entrepreneur know what to expect for the remaining months. Smart business owners will manage their capital investment and avoid making major repairs and investments during a slow season instead invest their funds back into the operations. When time are goods and cash is following companies in volatile a seasonal industries such as tourism, farming or construction might adopt conservative working capital policies to buffer against risk. Conservatively managed working capital will help lower you risks of short term cash shortages but might hurt your long term profitability as low return is expected.

**C. If the firm follows Hedging approach to financing, how would it finance its current assets?**

Hedging approach also known as Maturity matching is a strategy of working capital management in order to finance short term requirements with short-term debts and long-term requirements with long-term debts. Each asset is compensated with a debt having almost the same maturity. Seasonal expansion activities in inventories are financed with short term debts or liabilities. Funds are acquired for a limited period for purchases of additional inventory, and when that period is over the cash needed to repay the loan will be generated by the safe 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.

**Q No. 2.**

**A. Discuss the important variables in selection of the marketable securities for investment.**

Three important variables in marketable securities

1. SAFETY
2. MARKETABILITY
3. YIELD AND MATURITY

**SAFETY:** Safety of marketable securities is deemed most necessary. Its probability of earning same number of amount originally invested. Treasury securities which are considered certain if held to maturity is a standard of safety for marketable securities. Securities other than treasury issued, the safety of these securities can vary depending on the issuer and the type of security issued. Higher the degree of safety is most likely to be considered for investment.

**MARKETABILITY:** The marketability of a security relates to the owners ability to convert it into cash on short notice. Security can be considered safe if held to maturity, but it does not necessary means it’s easier to sell before maturity without incurring a loss.

**YIELD AND MATURITY:** The yield and return on a security is related to the interest and or appreciated of principal provided by the security. Some securities notable treasury bills do not pay interest instead they are sold at a discount and redeemed at face value.

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

Net float is the combination of the mail float, processing float, and availability float, and so represents the full duration of all types of check payment float. The net float is important when a business makes payments and receives payments primarily with checks. It is not an issue when electronic payments are used.

**CONTROLLING DISBURSMENT:**

* Isolate duties. The base of a good internal control system is separation of duties.
* Review authorized signor. Carefully consider who are your authorized signor.
* Consider requiring dual signatures.
* Remember the wire transfers.
* Reconcile bank accounts in a timely manner.

**Q No. 3.**

**A. What is outsourcing? Why a company outsource some or all of its receivables.**

Outsourcing is a business practice of hiring a party outside a company to perform services and create goods that traditionally were performed in house by the companies own employees and staff.

Some of the following are main reasons behind outsourcing company’s receivables

1. Improves customer interactions.
2. Helps refocus on the necessities.
3. Integrated collection system.
4. Gives you control.
5. Reduces administrative overhead and costs.
6. Streamlines billing and payment processes.

**B. Discuss the three motives for holding cash?**

There are three types of holding cash

**TRANSACTIONS MOTIVES**

Transactions Motive refers to holding cash balances which are necessary in everyday transactions of a firm.

**SPECULATIVE MOTIVES**

It is a tactic used by investors/ traders to hold cash so as to make the best use of any investment opportunity that arises later on.

**PRECENTIONARY MOTIVES**

A motive to keep cash for force majeure situation or any unforeseen circumstance or an emergency.