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 DEGREE MBA 3.5 (MS)

 SUBJECT WORKING CAPITAL

 TEACHER DR ABID USMAN

 ASSIGNMENT MID TERM

QNO 1 (A) some firms finances their working capital with short term financing. What impact would this decision have on their profitability and risk?

ANS: Firms need working capital to begin its business operations. Carry on its activities efficiently and meet its short run obligations. Working capital management is concerned with day to day activities rather than long term investment decisions. Working capital is a part of a firms current assets which are converted into cash within a year or less in this sense working capital components are cash cash equivalents, Inventories, accounts receivables, and account payables. The style of WCM may have a considerable influence on the profitability risk and liquidity of the firm. The firm that invests more in current assets is more liquid than a firm that does not invest. This will reduce the firm liquidity risk while decreasing overall rate of return because 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 higher risk more investment in the working capital expressed is conservative working capital policy associated with lower return and lower risk. The firm has to choose between aggressive and conservative working capital policies depending on its purpose.

QNO 1 (B) Some company finance their seasonal current assets with long term financing what impact would this policy have on their profitability and risk?

ANS: Business has two kind of capital fixed and working capital. Fixed capital is money allocated for long term investments. Such as real estate and equipment purchases. While working capital meets day to day need of operations including inventory and payroll. Working capital difference between current asset and current liability. Maintain 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. Unlike most business owners with customer’s sales that constantly fluctuate people pursuing 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 the dodged for the remaining months on the calendar. Smart business owners will manage their capital investment and avoid making major repairs and investments during a slow season instead smart entrepreneur 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. If you employ a conservative working capital policy there plenty of cash in the bank you warehouses are full of inventory and your payables are all up to date. Employee need not turn in their old pencils before they are allowed to have new ones. If you compute the working capital ratio currents assets divided by current liability a conservative policy might yield a ratio above 2.0. That is you have more than $2 in current assets for every dollar of short term liabilities. Conservatively managed working capital will help lower you risks of short term cash shortages but might hurt your long term profitability because excess cash doesn’t earn much of a return

QNO 1 (C): If the firm follows hedging approach to financing how would it finance its current assets?

ANS: Maturity matching or hedging approach 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. The underlying principal is that each asset should be compensated with a debt instrument having almost the same maturity.

Seasonal expansions 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 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. 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 exact of maturity period of current assets and sources of finance is always not possible because of uncertainty involved.

QNO2 (A): Discuss the important variables in selection of the marketable securities for investments?

ANS: three important variables in marketable securities

* SAFETY
* MARKETABILITY
* YIELD AND MATURITY

SAFETY

The most basic test that marketable securities must pass concerns safety of principles. This refers to the likelihood of getting back the same number of dollars originally invested safety is judged relative to us treasury securities which are considered certain if held to maturity. For securities other than treasury issues the safety of these securities will vary depending on the issuer and the type of security issued. A relatively high degree of safety is a must of a security to be seriously considered for inclusion in the firm’s short term marketable securities portfolio.

MARKETABILITY

The marketability of a security relates to the owners ability to convert it into cash and short notice. Although it is possible that a security could be quite “safe” it held to maturity his does not necessarily mean that it is always possible to easily sell the security before maturity without incurring a loss. If your instructor (a very honest person we might add)

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.

QNO2 (B): what is meant by net float? How a company can play its float through controlling its disbursement.

ANS: 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 signors. Carefully consider who your authorized signors are
* Consider requiring dual signatures.
* Remember the wire transfers.
* Reconcile bank accounts in a timely manner.

QNO3 (A): what is outsourcing? Why a company outsource some of all its receivables.

ANS: 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.

Why company outsource some of all its receivable.

ANS: There is some of the following:

* Improves customer interactions.
* Helps refocus on the necessities.
* Integrated collection system.
* Gives you control.
* Reduces administrative overhead and costs.
* Streamlines billing and payment processes.

QNO3 (B): Discuss the three motives for holding cash?

ANS: There are three types of holding cash

* TRANSACTIONS MOTIVES
* SPECULATIVE MOTIVES
* PRECENTIONARY MOTIVES

TRANSACTIONS MOTIVES

Transactions Motive refers to holding cash balances. To holding the cash balances which are necessary in everyday transactions of a firm is known as the transactions motive.

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. Description: Keeping all money invested doesn't seem attractive all the time.

PRECENTIONARY MOTIVES

The desire to keep extra money in case an unforeseen situation requires a capital outlay. For example, one may wish to save extra money to pay for medical bills in case of an accident.