NAME = IRSHAD WALI

ID = 13940

PROGRAM =BBA/ 6TH SEMESTER

INSTRUCTOR = MS MARYAM SALEEM

SUBJECT = FINANCIAL MANAGEMENT

**Q1**

**Answer**

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| --- | --- |
| **Sources of Fund** | **Uses of Fund** |
| Funds provided by operations  Net Profit $5  Depreciation $5  Decrease, other assets $5  Decrease ,Cash $2  Increase, account payable $3  Increase, Accrued tax $2  Increase, long term debt $15  Increase, Common stock $6  **Total $43** | Addition to fixed assets $8  Dividends $3  Increase, account receivable $7  Increase, inventory $5  Decrease, note payable $20  **Total $43** |

**Q2**

**Answer**

ABC Corporation

Statement of Cash Flow

Year ended December 31 20X2

* **Cash Flow From Operating Activities**

Net Income $5

Depreciation $5

Cash used by current and related operating current liabilities

Increase, Account Payable $3

Increase, Accrued Tax $2

Increase, Account Receivable ($7)

Increase, Inventory ($5)

Net Cash Provided by Operating Activities $3

* **Cash Flow from Investing Activities**

Addition to fixed assets ($8)

Proceed from sales of other assets $5

Net cash provided by investing activities ($3)

* **Cash Flow from Financing Activities**

Decrease in short term bank borrowing ($20)

Addition to long term debt $15

Proceeds from sales of stock $6

Dividends Paid ($3)

Net cash provided by financing activities ($2)

Increase in cash and cash equivalent ($2)

Cash and cash equivalent, December 31 20X1 $5

Cash and cash equivalent, December 31 20X2 $3

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| --- |
|  |

**Q3 A**

**Answer:** Policy A is the most stable of the three alternatives. From all levels of output, Policy A provides more current assets than any other policy. The greater the level of current assets, the greater the liquidity of the organization, all other things equal. Policy A is seen as preparing the firm for almost any conceivable current asset need; it is the financial equivalent to wearing a belt and suspenders. Policy C is least liquid and can be labeled “aggressive.” This “lean and mean” policy calls for low levels of cash and marketable securities, receivables, and inventories. We should keep in mind that for every output level there is a minimum level of current assets that the firm needs just to get by. There is a limit to how “lean and mean” a firm can get. We can now summarize the rankings of the alternative working capital policies in respect to liquidity as follows:

**High 🡨-----------🡪 Low**

**Liquidity** Policy A B C

Though policy A clearly provides the highest liquidity, we need to recast the familiar return on investment (ROI) equation as follows:

**ROI = Net profit**

**Total assets**

From this equation we can see that decreasing the amounts of current assets held (for example, a movement from Policy A toward Policy C) will increase our potential profitability. If we can reduce the firm’s investment in current assets while still being able to properly support output and sales, ROI will increase. Lower levels of cash, receivables, and inventory would reduce the denominator in the equation; and net profits, our numerator, would remain roughly the same or perhaps even increase. Policy C, then, provides the highest profitability potential as measured by ROI.

Movement from Policy A toward Policy C results in other effects besides increased profitability. Decreasing cash reduces the firm’s ability to meet financial obligations as they come due. Decreasing receivables, by adopting stricter credit terms and a tougher enforcement policy, may result in some lost customers and sales. Decreasing inventory may also result in lost sales due to products being out of stock. Therefore more aggressive working capital policies lead to increased risk. Clearly, Policy C is the most risky working capital policy. It is also a policy that emphasizes profitability over liquidity. In short, we can now make the following generalizations:

**High 🡨--------🡪 Low**

**Liquidity** Policy A B C

**Profitability** C B A

**Risk** C B A

**(B)**

* **Answer:** **MATURITY MATCHING:**

Maturity matching or hedging approach is a strategy of working capital financing where we finance short term requirements with short-term debts and long-term requirements with long-term debts. The underlying principle is that each asset should be financed with a financial instrument having almost the same maturity.

* Example:

To understand it with an example, assume a company bought machinery with a life of 5 Years’ worth $10 million. Let’s assume if there are two options to finance it i.e., issue of 10 Year debenture or apply for cash credit renewable every year. What will you opt for? The obvious answer would be 5 Year Debenture.

Q4(A)

Answer:

**Permanent Working Capital:** Permanent working capital is minimum amount of investment in raw materials, inventory, finished goods, accounts receivable and cash balance which a firm needs to have in order to carry on a desirable level of business activity.

* Its minimum level of investment required for a firm to carry on the operations without any interruption.
* It varies without seasonal requirements

**Example:**

1. Payments, Salary
2. Minimum stocks of inventory
3. Telephone and Electricity Bills

**Q 4B**

* **Answer: WORKING CAPITAL MANAGEMENT:**

Working capital management is essentially an accounting strategy with a focus on the maintenance of a sufficient balance between a company's current assets and liabilities. An effective working capital management system helps businesses not only cover their financial obligations but also boost their earnings.

* **SIGNIFICANCE OF WORKING CAPITAL MANAGEMENT:**

For one thing, the current assets of a typical manufacturing firm account for over half of its total assets. For a distribution company, they account for even more. Excessive levels of current assets can easily result in a firm realizing a substandard return on investment. However, firms with too few current assets may suffer shortages and difficulties in maintaining smooth operations.