School of business studies

Business

While NPV is expressed in terms of value in units of currency, IRR is a rate that is expressed in percentage which tells how much a company can expect to get in percentage terms from a project down the years. NPV takes into account additional wealth while IRR does not calculate additional wealth. If cash flows are changing, the IRR method cannot be used while NPV can be used, and hence it is preferred in such cases. While IRR gives the same predictions, the NPV method generates different results in cases where different discount rates are applicable. NPV is calculated in terms of currency while IRR is expressed in terms of the percentage return a firm expects the capital project to return.

The EOQ of 267 units means that this is the economical quantity purchase since it minimizes the cost of ordering and holding inventory.

At EOQ: 266. 67 units Annual holding cost 266. 67units/2 x 0. 2 x 30 = RM800.

01 Ordering costs 6000/267. 66 x 200 = RM4483. 30 Purchase cost RM30 x (500x12) = RM 180000

Total annual inventory cost RM 185283. At a reorder quantity of 3000 packets, the total annual inventory cost = RM 189400.

At EOQ, the total annual inventory cost = RM 185284. 14. If Wita Sdn. Bhd orders at economic order quantity, the cost savings= RM 4104. 60

b) With a discount of 5% and an order quantity of 3000 units costs areas follows:

Purchases (180000x95%) 171000 Holding costs (3000/2x0. 2x30x95%) 8550

Ordering costs (6000/3000)x RM200 400.

Total annual cost 179950.

It is advised that With Sdn.

The 3 main stock costs are :

1. Holding Costs Holding costs also known as carrying costs will increase as the amount of stock held increases.
2. Ordering Costs There will be costs when placing orders with manufacturers. Such costs will include delivery costs, and also administrative costs involved in placing order (staff costs, telephone charges). The more orders have taken the higher the charges will be.
3. Shortage Costs It occurs when the firm runs out of stock. The cost is difficult to estimate but is essential in stock control. These may include. Loss of sale, and the consequent loss of contribution that would have been earned from that sale. Additional costs involved in making emergency orders for goods. The costs of lost production when stock-outs occur and production lines grind to a halt.

Question 4

- a) Overcapitalization happens to a firm if its working capital is excessive for its needs. Excessive inventory, receivables and cash and very few payables will lead to a low return on investment, with a long term funds tied up in non-earning short term assets. By comparing the volume of sales as a multiple of the working capital investment with the previous year or with similar companies, it should indicate whether the total volume of working capital is too high.

- b) Signs of overcapitalization. Inventory and receivables collection periods being too long could indicate that the volume of inventories or receivables is very high. A short period of credit taken from suppliers might indicate the volume of payables is too low.
- c) Overtrading occurs when a business is conducting its business operations with inadequate capital. It is also known as under-capitalization. When a business accepts work, and tries to fulfill it at a level that cannot be supported by its working capital or net current assets. It does not have enough cash and cannot obtain enough cash quickly.
- d) Symptoms of overtrading. Greatly increase in sales. Increase in receivable and longer time to pay. Taking longer credit from a supplier because the business does not have the cash flows to pay sooner. Unusual inventory movement. Fall sharply in response to growing sales demand. A falling of current ratio and quick ratio. Because increases in inventory and receivables are financed mainly by increases in trade payables and overdraft. A rise in bank overdraft.
- e) Measures to reduce overtrading. Financeexpansion with long term sources of funds. Better control of debtors, stocks and creditors to improve liquidity. Restrict company expansion or slow down the rate.