Financial management abstract recomandations

Finance

Case1: Credit Decision - Agarwal Case

On August 30, 2006, Agarwal Cast Company Inc., applied for a $200, 000 loan from the main office of the National bank of New York. The application was forwarded to the bank's commercial loan department. Gupta, the President and Principal Stockholder of Agarwal cast, applied for the loan in person. He told the loan officer that he had been in business since February 1976, but that he had considerable prior experience in flooring and carpets since he had worked as an individual contractor for the past 20 year. Most of this time, he had worked in Frankfert and Michigan. He finally decided to " work for himself" and he formed the company with Berry Hook, a former co-worker.

This information seemed to be consistent with the Dun and Bradstreet report obtained by the bank According to Gupta, the purpose of the loan was to assist him in carrying his receivables until they could be collected. He explained that the flooring business required him to spend considerable cash to purchase materials but his customers would not pay until the job was done. Since he was relatively new in the business, he did not feel that he could compete if he had to require a sizeable deposit or payment in advance. Instead, he could quote for higher profits, if he were willing to wait until completion of the job for payment. To show that his operation was sound, he included a list of customers and projects with his loan application. He also included a list of current receivables. Gupta told the loan officer that he had monitored his firm's financial status closely and that he had financial reports prepared every six months. He said that the would send a copy to the bank.

In addition, he was willing to file a personalfinancial statementwith the bank.

Question:

1. Prepare your recommendation on Agarwal Cast Company

Caselet 2

This case has been framed in order to test the skills in evaluating a credit request and reaching a correct decision. Perluence International is large manufacturer of petroleum and rubber-based products used in a variety of commercial applications in the fields of transportation, electronics, and heavy manufacturing. In the northwestern United States, many of the Perluence products are marketed by a wholly-owned subsidiary, Bajaj Electronics Company. Operating from a headquarters and warehouse facility in San Antonio, Strand Electronics has 950 employees and handles a volume of $85 million in sales annually. About $6 million of the sales represents items manufactured by Perluence. Gupta is the credit manager at Bajaj electronics. He supervises five employees who handle credit application and collections on 4, 600 accounts. The accounts range in size from $120 to $85, 000. The firm sells on varied terms, with 2/10, net 30 mostly. Sales fluctuate seasonally and the Examination Paper of Financial Management

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average collection period tends to run 40 days. Bad-debt losses are less than 0. 6 per cent of sales. Gupta is evaluating a credit application from Booth Plastics, Inc., a wholesale supply dealer serving the oil industry. The company was founded in 1977 by Neck A. Booth and has grown steadily since that time. Bajaj Electronics is not selling any products to Booth Plastics and had no previous contact with Neck Booth. Bajaj Electronics purchased goods from Perluence International under the same terms and conditions as Perluence used when it sold to independent customers. Although Bajaj Electronics generally followed Perluence in setting its prices, the subsidiary operated independently and could adjust price levels to meet its own marketing strategies. The Perluence's cost-accounting department estimated a 24 per cent markup as the average for items sold to Pucca Electronics. Bajaj Electronics, in turn, resold the items to yield a 17 per cent markup. It appeared that these percentages would hold on any sales to Booth Plastics. Bajaj Electronics incurred out-of pocket expenses that were not considered in calculating the 17 per cent markup on its items. For example, the contact with Booth Plastics had been made by James, the salesman who handled the Glaveston area. James would receive a 3 per cent commission on all sales made Booth Plastics, a commission that would be paid whether or not the receivable was collected. James would, of course, be willing to assist in collecting any accounts that he had sold. In addition to the sales commission, the company would incur variable costs as a result of handling the merchandise for the new account. As a general guideline, warehousing and other administrative variable costs would run 3 per cent sales. Gupta Holmstead approached all credit decisions in basically the same manner. First of all, he considered the potential profit from the account. James had estimated first-year sales to Booth Plastics of $65, 000. Assuming that Neck Booth took the, 3 per cent discount. Bajaj Electronics would realize a 17 per cent markup on these sales since the average markup was calculated on the basis of the customer taking the discount. If Neck Booth did not take the discount, the markup would be slightly higher, as would the cost of financing the receivable for the additional period of time. In addition to the potential profit from the account, Gupta was concerned about his company's exposure. He knew that weak customers could become bad debts at any time and therefore, required a vigorous collection effort whenever their accounts were overdue. His department probably spent three times as muchmoneyand effort managing a marginal account as compared to a strong account. He also figured that overdue and uncollected funds had to be financed by Bajaj Electronics at a rate of 18 per cent. All in all, slow - paying or marginal accounts were very costly to Bajaj Electronics. With these considerations in mind, Gupta began to review the credit application for Booth Plastics. Questions:

1. How would you judge the potential profit of Bajaj Electronics on the first year of sales to Booth Plastics and give your views to increase the profit?

2. Suggestion regarding Credit limit. Should it be approved or not, what should be the amount of credit limit that electronics give to Booth Plastics.

END OF SECTION B

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Section C: Applied Theory (30 marks)

? This section consists of Applied Theory Questions.

? Answer all the questions.

? Each question carries 15 marks.

? Detailed information should form the part of your answer (Word limit 200-250 words). 1. Define Capital Structure. Discuss the important factors that should be considered while determining Capital Structure.

2. What is the concept of working capital? Discuss the dangers of inadequate as well as excessive working capital.