**Working Capital Management**

Learning Problems

Managing the Float at Anders Inc.

Anders Inc. issues on average CAD 125,000 in cheques each day, which are mailed to suppliers and settled in approximately seven days. The company receives CAD 145,000 in payments from customers by cheque daily, which are settled the next day.

**REQUIRED:**

1. Calculate the disbursement, collection, and net floats.
2. Is Anders managing its floats effectively? Discuss.

Locked Boxes at Edson Telecom

Edson Telecom has customers throughout Canada. It receives approximately 850 cheques per day, averaging CAD 425. The company estimates it takes approximately seven days for these cheques to be mailed, processed, and settled. The treasurer feels this can be reduced to three days by introducing locked boxes throughout Canada at a fee of CAD 0.10 per cheque. Funds can currently be invested at 2.50% per annum.

REQUIRED:

1. Should Edson introduce locked boxes?

Investing in Treasury Bills at ABBA Company

ABBA Company is considering buying CAD 100,000 in treasury bills as a short-term investment. They trade at a discount of 1.53% and mature in 180 days. The dealer charged a CAD 200 fee when the investment was purchased. The discount rate is expressed on an annual basis.

REQUIRED:

1. Calculate the effective annual return.

Optimal Credit Terms at Dexter Industries

Dexter Industries has sales of CAD 135,000, and its credit terms are net 30. If the credit terms are extended to net 45, the company expects sales to increase to CAD 150,000. These more generous credit terms will cause the bad debt percentage to increase from 0.90% to 1.35% and will require another CAD 1,250 in collection costs.

Dexter has a contribution margin of 75.00% and a gross profit percentage of 55.00%. Its inventory turnover ratio is 5.0, and its short-term borrowing rate is 5.00%. All sales are on credit.

REQUIRED:

1. Should the credit terms be extended?

Optimal Credit Terms at Jackson Inc.

Jackson Inc. currently sells all its products on credit with terms 2/10, net 30. The collection period averages 14 days, with 85.00% taking the discount. Next year's sales are forecasted to be CAD 2,600,000, but the company feels that this could be increased to CAD 3,500,000 if terms 3/10, net 60 are extended. At this level, 65.00% of sales would take the discount, and the collection period would increase to 31 days. Bad debt expense would also rise from 1.00% to 2.00%.

Jackson has a contribution margin of 25.00% and a gross profit percentage of 60.00%. Its short-term borrowing rate is 5.00%, and it has an inventory turnover ratio of 5.0.

REQUIRED:

1. Should the credit terms be extended?

Optimal Credit Terms at Hoboken Company

Hoboken Company is considering shortening its payment period and eliminating its early payment discount due to a recent economic slowdown. Credit terms are currently 3/10, net 60, and would be reduced to net 30.

Approximately 70.00% of customers pay at the end of the payment period, and the other 30.00% pay after 10 days and take the cash discount. With the new terms, customers are expected to pay after 30 days.

Average monthly sales are currently CAD 500,000, but they are expected to fall to CAD 465,000 with the change. Variable costs are 80.00% of sales, and the gross profit percentage is 50.00%. The bad debt percentage is expected to fall from 2.00% to 1.75%. Its inventory turnover ratio is 6.0, and the short-term borrowing rate is 5.00%.

REQUIRED:

1. Should the credit terms be reduced?

**EOQ, Safety Stock, Re-order Point at Holland Ltd.**

Holland Ltd. manufactures small engines. The CFO estimates how many units of a particular part to order. Holland uses 13,000 units per year and operates 260 days per year. Re-stocking costs are CAD 5.35 per order, and carrying costs are CAD 2.45 per unit. It takes five working days for an order to arrive. The cost of a stockout is CAD 21.00. The following probabilities were supplied by the treasury department for the 5-day order period:

|  |  |
| --- | --- |
| Order Period Demand | Demand Probability (%) |
| 100 | 5 |
| 150 | 25 |
| 250 | 40 |
| 350 | 25 |
| 400 | 5 |

Holland is considering carrying safety stocks of 0, 100, or 150 units.

REQUIRED:

1. Determine the EOQ.
2. Determine the most cost-efficient safety stock.
3. Determine the reorder point, including safety stock.
4. Discuss why this is the appropriate safety stock level.

**EOQ, Safety Stock, Re-order Point at Ashern Inc.**

Ashern Inc. is an auto parts wholesaler. The company’s operations manager is determining the appropriate order size for one of its high-demand items. They estimate demand will be 26,000 units per year. Currently, re-stocking costs are CAD 57.76 per order, and carrying costs are 5.00% of the cost of the product, which is CAD 95.32. It takes ten working days on average for an order to be delivered, and demand averages 100 units per day. During the company’s seasonal high, it can sometimes take up to 13 days for an order to arrive, and demand can be as high as 125 units per day. The business operates 260 days per year. Stockout costs are high relative to carrying costs due to low interest rates.

**REQUIRED:**

1. Determine the EOQ.
2. Determine the most cost-efficient safety stock.
3. Determine the reorder point, including safety stock.

**Specific Assignment Accounts Receivable at York Ltd.**

York Ltd. used CAD 350,000 in 90-day, higher-risk accounts receivable to secure an operating loan. The bank was willing to lend 70.00% of the value of the collateral if a specific assignment was provided. A processing fee of 1.00% of the face value of the receivables was levied along with an interest rate of 6.10%, which is the prime rate of 4.10% plus a premium of 2.00%.

REQUIRED:

1. Calculate the effective annual cost of borrowing.
2. Why is the effective cost of borrowing so much higher than the interest rate being charged by the bank?

Specific Assignment Inventory at Hansen Inc.

Hansen Inc. used CAD 750,000 in inventory to secure a 90-day operating loan. The bank was willing to lend 70.00% of the value of the collateral. A warehousing charge of CAD 3,000 was levied as the collateral must be stored in a public warehouse until sold. The bank must approve all sales. The loan interest rate is 6.10%, which is the prime rate of 4.10% plus a premium of 2.00%.

REQUIRED:

1. Calculate the effective annual cost of borrowing.
2. Why did the bank require that the inventory be stored in a public warehouse?

Factoring of Accounts Receivable at Willobey Industries

Willobey Industries sold CAD 250,000 in 90-day accounts receivable to a factor on a one-time basis, who advanced 80.00% of their value. A factoring fee of 1.40% was charged along with interest at an interest rate of 6.50%, which is the prime rate of 4.50% plus a premium of 2.00%. Cash discounts, sales returns and allowances, and bad debts relating to these receivables totalled CAD 38,500.

REQUIRED:

1. Calculate the effective annual cost of factoring.
2. What rebate will Willobey receive at the end of the factoring agreement?

**Operating Loan versus Factoring at Hecla Ltd.**

Hecla Ltd. currently finances its accounts receivable with a secured operating loan from the Bank of Montreal. Hecla has annual sales of CAD 15,000,000, which are evenly distributed throughout the year. It offers customers credit terms of 2/10, net 30, and approximately 40.00% take advantage of the early payment discount with an average collection period of 15 days. The remaining sales are collected within 38 days, with bad debts averaging 1.50%. Currently, Hecla spends CAD 200,000 on salaries and another CAD 7,500 on credit information, operating its credit department. The Bank of Montreal allows Hecla to borrow up to 75.00% of its accounts receivable at 4.20% per annum

Hecla has decided to investigate whether factoring is a better way to finance its accounts receivable on an ongoing basis and contacted Saturn Finance. Saturn indicated that their factoring fee would be 2.50% of accounts receivable and would include all costs relating to sales discounts and bad debts. They would advance 85.00% of receivables, and their lending rate would be prime of 3.00% plus 3.50%. Through improved credit management, Saturn estimates that it can increase Hecla’s sales by 5.00% and reduce its accounts receivable turnover in days by 10.00%. It indicates that Hecla’s bad debt percentage should fall to 1.25% through Saturn’s unique credit checking process.

**REQUIRED:**

1. How should Hecla finance its accounts receivable? Assume 360 days in a year.

Issuing Commercial Paper at Jackson Company

Jackson Company issued CAD 10,500,000 of 90-day commercial paper through a dealer to support its short-term financing needs. There was a discount of 1.79%, a 0.15% dealer fee, and a backup line-of-credit fee of 0.25%. S&P Global Markets awarded an A-1 credit rating and charged an assessment fee of 6.95 bps. All costs are expressed on an annual basis except for the credit rating charge, which is based on the value of the issuance.

REQUIRED:

1. Calculate the effective annual cost of borrowing.
2. How might the effective annual cost change if Jackson Company sold its commercial paper itself?

**Working Capital Management at a Canadian Company**

**REQUIRED:**

1. Access the most recent annual reports for Canadian Tire Corporation (CTC) found on its company website or through SEDAR.
2. Research these annual reports and analyze CTC’s working capital management over five years.
3. Prepare an approximately 200-word submission addressing Part 2, including a table outlining the trends in key financial ratios. All submissions should be well-researched, carefully written and edited before being posted to the discussion board.
4. Respond to the posts of at least three classmates.