Questions	WCM Part 5 , Payables Management
1	Theory Discussed in class
2	Theory Discussed in class
3	HW Typed
4	CW
5	HW Typed
6	Theory Discussed in class
7	Theory Discussed in class

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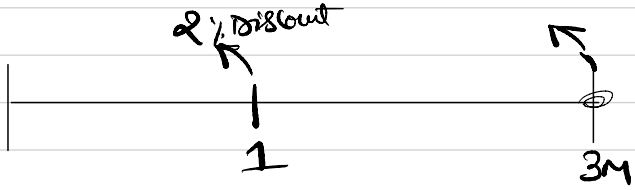
Sol 4

WN



(i)

option ①		option ②	
Pay at end of 3M		Take overdraft and pay at 1M.	
Amt Paid at end of 3M = ₹3,00,000		O/D required	3,00,000 − 2% = 2,94,000
		+ Int on overdraft (2,94,000 × 2/12 × 14.5%)	= + 7105
		Total Amt Paid at end of 3M = ₹3,01,105	

Advice: Reject early payment option because there is a loss of ₹ 1105 because of early payment.

(ii) If Supplier offers discount of 3% on early payment.

option ①	option ②	
Pay at end of 3M	Pay at end of 1M & avail discount	
= ₹3,00,000	O/D raised to pay (3,00,000 − 3%)	₹ 2,91,000
	+ Int on O/D (2,91,000 × 14% × 2/12)	7032.5
	Total cost	2,98,032.5

Advice: We should accept discount and pay early as it causes because it saves ₹ 1967.5.

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Solution 3 -

If the company does not avail the cash discount and pays the amount after 45 days, the implied cost of interest per annum would be approximately:

$$\left(\frac{100}{100-2}\right)^{\frac{365}{35}} - 1 = 23.5\%$$

Now let us assume that ABC Ltd. can invest the additional cash and can obtain an annual return of 25% and if the amount of invoice is ₹ 10,000. The alternatives are as follows:

	Refuse discount	Accept discount
	₹	₹
Payment to supplier	10,000	9,800
Return from investing ₹ 9,800 between day 10 and day 45: $\frac{35}{365}$× ₹ 9,800×25%	(235)	
Net Cost	9,765	9,800

Advise: Thus, it is better for the company to refuse the discount, as return on cash retained is more than the saving on account of discount.

Solution 5 -

(a) Rohit's argument of comparing 2% discount with 12% bank loan rate is not rational as 2% discount can be earned by making payment 5 days in advance i.e. within 10 days rather 15 days as payments are made presently. Whereas 12% bank loan rate is for a year.

Assume that the purchase value is ₹100, the discount can be earned by making payment within 10 days is ₹2, therefore, net payment would be ₹98 only. Annualized benefit

$= \frac{₹2}{₹98} \times \frac{365\ days}{5\ days} \times 100 = 149\%$

This means cost of not taking cash discount is 149%.

(b) If the bank loan facility could not be available, then in this case the company should resort to utilise maximum credit period as possible.

Therefore, payment should be made in 30 days to reduce the interest cost.