SAMPLE CASE STUDIES – FINANCE

Case Study 1

M/s Vithal Enterprises

1) Introduction:

Shri Vishal Shantilal Hajeri is the Sole Proprietor of M/s Vithal Enterprises. Mr.Hajeri has passed BE Electronics from Pune University, in first class in the year 2002. He has also passed his MBA from Pune University in the year 2005. He started his own manufacturing unit in July 2006 under the firm name and style of M/s Vithal Enterprises.

2. Scope for Business:

He is on the approved list of manufacturers for supply of spare parts to ordinance factory of the Defence Department since 2006. The department has to purchase the spare parts only from the approved list. To that extent the competition is limited.

3. Constitution: The business is a proprietary concern

4. Infrastructure:

a) Premises: He is doing business in rented premises at Pune at the following address: Opposite Dhayareshwar Mangal Karyalaya, Dhayari Phata, Sinhagad Road, Pune-51. His father has purchased land at Ambegaon Budruk for Rs. 3.00 lacs admeasuring 10 R (Sq.Feet) on 26-10-2004. Since the present rented premises his very small, Mr. proposes to build a factory shed admeasuring 1200 sq. feet on the plot. The project report is for the purpose of loan for constructing the premises.

b) Suppliers of raw materials: Raw materials viz. Ferrous and Non ferrous Metals required by him are available at Pune and Mumbai.

c) Employees: There are 7 employees with a minimum service of 2 years. Two are DME and the rest are ITI qualified.

d) Electricity: He needs 20 HP connection for which he will submit the application as soon as the construction starts.

e) Machinery: He has purchased necessary machinery out of his funds.

f) Furniture: Necessary furniture is already purchased.

5. a) Cost of the Project:

Sr.No	Particulars	Amount in Lacs
1	Land	3.00
2	Construction of premises and electricity	8.00

3	Margin money for working capital	1.00
	Total	**12.00**

b) Means of Finance:

Sr.No	Particulars	Amount (Lacs)
1	Margin Money (58% of the project cost)	7.00
2	Term Loan from Bank (42% of the cost)*	5.00
	Total	**12.00**

6. Profitability Estimates:

Amount In lacs

	Profit and Loss A/c for	31-3-07	31-3-08	31-3-09
1	Sales	9.46	11.70	13.46
2	Interest/other income	0.00	0.00	0.00
3	Total income	9.46	11.70	13.46
4	Manufacturing expenses	6.14	7.97	9.29
5	Selling and Administrative expenses	0.52	0.59	0.77
6	Depreciation	1.37	1.28	1.25
7	Total Interest	0.34	0.78	0.72
8	Profit before tax	1.09	1.08	1.43
9	Provision for tax	0.01	0.01	0.04
10	**Net profit**	**1.08**	**1.07**	**1.39**

7. Projected balance sheet:

As on Liabilities	31-3-07 Actual	31-3-08 Estimated	31-3-09 Projected
Capital and Reserves	6.90	7.12	7.44
Total Term loans	5.26	4.80	4.29
Total current liabilities	1.62	1.63	1.64
Total Liabilities	**13.78**	**13.55**	**13.37**
Assets	31-3-07 Actual	31-3-08 Estimated	31-3-09 Projected
Total Fixed assets	11.85	10.57	10.32
Total Non current assets	0.00	0.50	0.20
Debtors	0.45	0.65	0.75
Inventory	1.42	1.76	2.02
Cash and Bank Balance	0.06	0.07	0.08
Other Current Assets	0.00	0.00	0.00
Total Assets	**13.78**	**13.55**	**13.37**

Questions

1) Evaluate whether the firm can convert itself into a Private limited Co.

2) Advise the firm about different sources of finance available to them.

3) Calculate the capital mix and cost of capital of the firm.

4) Advise the firm about the Marketing Strategy to be adopted.

5) Assess the working capital requirements of the firm.

Possible Solutions

1) The project is relative small. Conversion into a Private limited Co. results in avoidable expenditure. The firm will have to comply with several provisions of Indian Companies' Act. At present there is no need to convert itself into a Private limited Co.

2) Since this entity is a proprietary firm, it generally raises two types of funds — proprietor's savings and loans from banks, non–banking financial corporations, friends, and relatives. However, a public limited company can raise funds through various sources, such as issue of equity and preference shares, issue of debentures, term loans from banks, and retained earnings. Amongst the Banks they should negotiate with banks and choose the bank which offers comparatively lowest cost.

3) M/s Vithal Enterprises had bought a term loan of Rs. 5 lacs from a bank at a rate of 12.25%, which was to be repaid in five years. They have incurred the following expenses in connection with the loan:

Mortgage expenses	: 10,000
Processing fees of the bank:	5,000
Consultant's charges	: 5,000
Stamp Duty	: 5,000
Miscellaneous expenses	: 5,000
Total	: 30,000

$$12.25\% + \frac{30{,}000/5}{(5{,}00{,}000/2)} \text{ X } 100 = 12.25 + 2.4 = 14.65\%$$

A company calculates the cost of equity, cost of preference cost of debenture and cost of term loans to compare them and to choose the most optimum mix of the capital. The mix of capital when the weighted average cost of capital is the lowest is the optimum mix.

Cost of Equity = PAT/Equity = 1.08/6.9 =15.65%

Weighted Average Cost of Capital = Proportion of equity x cost of equity + Proportion of debt x cost of debt = (6.8/12.16) X .1565 + (5.26/12.16) X .1465 = 15.08%