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	31-3-07	31-3-08	31-3-09
Liabilities	Actual	Estimated	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	31-3-08	31-3-09
	Actual	Estimated	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%

4) In the present case of M/s Vithal Enterprises, Market analysis is comparatively easy because they are supplying products to only one customer. Various methods of Market analysis are not applicable here. M/s Vithal Enterprises have collected and analysed the data in respect of budget allocation for defence expenditure, the amount spent by Ammunition Factory in the last 3 years and their budget for the next year. Since, the customer is a Govt. Organisation, this information can be obtained by using the right to information act also.

M/s Vithal Enterprises are facing limited competition compared to normal projects, because their customers purchase the goods only from the short listed suppliers. Since, there are only few short listed suppliers, Vithal Enterprises can collect information about them by liasoning with his clients. Moreover, ammunition factory first invites quotations from the short listed suppliers and opens them in the presence of all suppliers. So, there is transparency in the system and one can get the information about the competitors. Hence, M/s Vithal Enterprises need not go for Market Survey and for general advertising and marketing strategies. He can only beat the competition by quoting lesser price and this can be done by reducing cost of manufacturing and going for lesser profit margin. Moreover, he has to maintain cordial relations with his clients. He can use the Delphi method, by getting the opinion of the officials working in the ammunition factory. He can repeatedly collect the information from them till some consensus is arrived at about the quality of the product they require.

5) a) **As per Tandon Committee Recommendations**

SN	Particulars	31-3-07	31-3-08	31-3-09
1	Current Assets	1.93	2.48	2.85
2	Other Current Liabilities	0.12	0.13	0.14
3	Working Capital Gap (3=1-2)	1.81	2.35	2.71
4	Net Working Capital	0.31	0.85	1.21
5	25% of WCG	0.45	0.59	0.68
6	MPBF.1 (6=3-4)	1.50	1.50	1.50
7	MPBF.2 (7=3-5)	1.36	1.76	2.03
8	MPBF lower of 6 and 7	1.36	1.50	1.50

b) **As per Nayak Committee Recommendations**

		31-3-07	31-3-08	31-3-09
1	Projected sales	11.70	13.46	15.47
2	Working Capital required (25%) of above	2.92	3.36	3.87
3	Margin money 5% of Sales	0.58	0.67	0.77
4	Working Capital Limit from Bank (4= 1-2)	2.34	2.69	3.10

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Case Study 2

Details of the Project M/s Swarupa Bamboo Works

M/s Swarupa Bamboo Works was started on 27-3-2007 with the manufacturing of Bamboo Furniture and Articles.

Cost of Project	Cost of Land and Building: Rs. 13.00 lacs Plant and Machinery: Rs. 2.30 lacs Others: Rs. 1.44 lacs Margin Money for Working Capital: Rs. 1.26 lacs Total Cost : Rs. 18.00 lacs
Means of Finance	Capital: Rs. 5.00 lacs Term Loan from Bank : Rs. 13 .00 lacs Total: Rs. 18.00 lacs Cash Credit Limit: Rs. 05.04 lacs

Projected Balance Sheet

Projected Balance Sheet of M/s. Swarupa Bamboo Works (Figures in lacs)					
Particulars	As on 31-3-08	As on 31-3-09	Particulars	As on 31-3-08	As on 31-3-09
Liabilities			**Fixed Assets**		
Capital	5.00	5.78	Land and Building	11.70	10.53
Profit	3.78	3.98	Furniture and Fixtures	0.45	0.41
Drawings	-3.00	-3.00	Plant and Machinery	2.07	1.86
Net Worth	5.78	6.76	**Total Fixed assets**	**14.22**	**12.80**
Term loans from Bank	13.00	11.00	Preliminary Expenses	1.08	0.81
Cash Credit	4.00	4.10	Debtors	6.30	6.93
Creditors	0.30	0.33	Inventory	1.01	1.11
Other Current Liabilities	0.00	0.02	Cash and Bank Balance	0.37	0.46
Total Current Liabilities	4.30	4.45	Other Current Assets	0.10	0.11

			Total Current Assets	**7.78**	**8.61**
Total Liabilities	**23.08**	**22.22**	**Total assets**	**23.08**	**22.22**

Profitability Estimates

Income	**31-3-08**	**31-3-09**
Sales	25.20	27.72
Interest Income/Other Income	0.00	0.10
Total income	25.20	27.82
Opening Stock	0.00	1.01
Purchase of Raw Materials	6.05	6.68
Labour Charges	7.56	8.32
Other Direct Expenses	0.50	0.55
Less Closing Stock	1.01	1.11
Cost of Goods Sold	13.10	15.44
Gross Profit	12.10	12.38
Expenses	**31-3-08**	**31-3-09**
Salary and Staff Expenses	1.44	1.58
Rent, Taxes, Insurance	0.10	0.11
Electricity and Water	0.76	0.84
Travelling	0.10	0.11
Other Administration Expenses	0.81	0.89
Total Expenses	3.21	3.53
Profit before DIT	8.89	8.85
Depreciation	1.58	1.42
Profit before Interest and Tax	7.31	7.43
Interest on Loans	1.95	1.80
Interest on Cash credit	0.63	0.61
Total Interest	2.58	2.41
Profit Before Tax	4.73	5.02
Provision for Tax	0.95	1.04
Net Profit	**3.78**	**3.98**

Questions

1) Analyse important Financial Ratios.

2) Prepare a Projected Cash Flow for 2008-09.

Possible Solutions

1)

Name of the Ratio	31-3-08	31-3-09	Observations
Debt-Equity Ratio	2.25	1.63	Debt-Equity Ratio is 2.25.:1 in the beginning which is better than the desirable ratio of 3:1. It improves further due to repayment of the loan instalments.
Net Profit to Sales Ratio	15.00	14.37	Net profit to Sales ratio ranges from 14% to 18% which is acceptable.
Retained profit to Net profit ratio	20.66	24.67	7% to 25% of the profit is retained in the business.
Return on Equity	65.40	58.88	
Return on Assets	16.38	17.92	
Current Ratio	1.81	1.93	Current Ratio ranges between 1.57 and 1.93 which is acceptable and better than desirable 1.33
Stock to Sales Ratio %	4.00	4.00	Stock is about 4% of sales which is reasonable.
Debtors to Sales Ratio %	25.00	25.00	Debtors to sales ratio is about 25% which is as per 25% norm
Creditors to Purchases Ratio%	3.89	3.88	Creditors to purchases ratio is 4% which is very meager.
Debt Service Coverage Ratio	3.75	1.90	As against a desirable ratio of 1.5, the average DSCR is 2.41. It ranges between 1.90 to 2.96

2)

	Particulars	31-3-09
1	Profit Before Interest and Tax PBIT	7.43

2	Increase in Capital	0.00
3	Depreciation	1.42
4	Increase in Term Loans	0.00
5	Increase in Unsecured Loan	0.00
6	Increase in Cash Credit	0.10
7	Sale of Fixed Assets	0.00
8	Decrease in Investments	0.00
9	Preliminary Expenses Written Off	0.27
10	Others (Increase in Current Liability)	0.05
A	Total sources	9.27
	Disposition of funds	
1	Preliminary and Pre-Operative Expenses	0.00
2	Increase in Capital Expenditure	0.00
3	Increase in Current Assets	0.74
4	Decrease in Long Term Loans	2.00
5	Decrease in Unsecured Loan	0.00
6	Increase in Investments	0.00
7	Interest	2.41
8	Taxation	1.04
9	Dividend/ Drawings	3.00
10	Others (Decrease in Current Liability)	0.00
B	Total Disposition	9.18
C	Net Surplus(+) or Deficit(-)	0.08
D	Opening Cash and Bank Balance	0.37
E	Closing Balance	0.46

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