**CASE 30.2 – Cash Management**

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**Month Opted: June 2023**

**Payal Plastics Company**

Payal Plastics Company (PPC) is engaged in the manufacture of plastic-based products for home us. The company is located in Faridabad in Haryana. It is one of the leading suppliers of plastic products in the markets of Haryana, Punjab and Delhi. In recent years the competition has intensified and many small' manufacturers have entered the market. PPC has been able to face the competition on the strength of the quality and price of its products. In spite of high competition, it has grown rapidly.

PPC is a profitable company, but it has been facing liquidity problem for a couple of years. The company has defaulted in paying its obligations and has stretched payment to its creditors. This has affected company’s creditworthiness. The company management is worried that the frequent stretching of credit payments might cause suppliers to demand cash payments for purchases. The managing director, therefore, wants the finance manager to prepare a cash budget and make a plan for meeting a deficit situation.

The finance manager set to develop a monthly cash budget for the period starting from April 2019 to September 2019. She obtained the actual sales figures from the records of the last three months, and based on the past trends and future market prospects, developed the sales forecasts as shown below:

|  |  |  |  |
| --- | --- | --- | --- |
| **Actual Sales** | **(Rs. Lakhs)** | **Sales Forecast** | **(Rs. Lakhs)** |
| January | 240 | April | 260 |
| February | 280 | May | 210 |
| March | 320 | June | 160 |
|  |  | July | 240 |
|  |  | August | 200 |
|  |  | September | 160 |
|  |  | October | 200 |

Of the total sales, PPC's cash sales are 20% and credit sales 80%. The company's credit terms are 30 days. But it is able to collect only about 50% of the accounts receivables in the first month after sales. About 30% collections take place in the second month after the sales and the remaining in the third month of sales.

PPC's products require a very heavy use of material. The average consumption of raw material is 70% of sales. The company buys 60% of the materials required for the next month m the previous month. Suppliers’ credit terms are 30 days. But the records show that the company pays for 60% of purchases in a month, 20% in two months and the remaining in three months. The following payments are expected for wages and salaries:

|  |  |  |  |
| --- | --- | --- | --- |
| **Month** | **(Rs. Lakhs)** | **Month** | **(Rs. Lakhs)** |
| April | 42 | July | 40 |
| May | 39 | August | 32 |
| June | 32 | September | 28 |

The fixed and variable general administrative and marketing expenses are estimated to be about Rs. 2.5 lakh per month and 5% of sales, respectively. Power and fuel expenses are expected to be 4% of sales and depreciation Rs. 12 lakh per month. The company has planned a capital expenditure of Rs.70 lakh, of which 50% will be paid in May and the remaining in June. On a Rs. 20 lakhs borrowing, half­ yearly interest at 16% annual rate is to be paid in the month of June. A tax payment on the previous year's profit of Rs.2.5 lakh is due in April. The financial manager estimated that PPC's tax liability for the year is expected to be Rs. 24 lakhs, which is payable in equal instalments in March, June, September and December. The company is expected to have cash and bank balance of Rs.140,000 in the beginning of April.

After collecting the information. about cash flows, the finance manager created an Excel 7file by classifying each item of cash flows systematically into cash receipts and

payments. Her concern was that as and when any change in sales or collection experience is made the cash flow forecasts should automatically get updated.

**Discussion Questions**

1. Prepare a Cash Budget for PPC and Provide an explanation for the results.
2. Assume Sales forecasts are off by +/- 10%. What are the implications? Show calculations (revised cash budgets)

1. Prepare a Cash Budget for PPC and Provide an explanation for the results.

**Answer** – According to the previous reports and our estimate, PPC is a profitable company, but it has been facing liquidity problem for a couple of years. The company is facing problems in paying its obligations to its creditors. This has affected company’s creditworthiness. The company is facing the situation of deficit cash balance. It is difficult for the company to manage and pay its obligations on time. So, the finance manager has prepared a ‘Monthly Cash Budget’ to estimate the amount and time of the cash inflows and the outflows to manage the company’s cash deficit situation. The cash budget is prepared for the period starting from April 2019 to September 2019.

The sales figure is estimated based on the actual sales figure from the records of the last three months and the past trends and future market prospects.

In the months between April to September 2019, the company is making profits ranging from 50 Lacs to 80 Lacs. But the cash budget statement tells us about the cash position of the company. The company has cash surplus only in the month of April of Rs. 3,08,700. In the following months, the company is facing the situation of cash deficit balance ranging from 20 Lacs to 75 Lacs. Also, the cash surplus of April is not much, so the company must finance the deficit with loan. The company needs a loan of Rs. 1,00,00,000 to manage its cash deficit situation. This loan is taken in the month of April itself because the surplus in the month was not up to the mark, so these funds will help the company to be on the safer side. This helps the company to manage the cash deficit situation easily.

Assumptions:

1. Tax Rate on previous year loan is @35% pa.
2. Interest Rate on New Loan taken is @16% pa.

For reference to calculations refer - [Project 3 Submitted by Pancham Khullar.xlsx](Project%203%20Submitted%20by%20Pancham%20Khullar.xlsx)

2. Assume Sales forecasts are off by +/- 10%. What are the implications? Show calculations (revised cash budgets)

Answer – To take into consideration the deviation of the sales forecast from the estimated amount, the company can increase the loan amount that is to be taken because if the sales forecast is off by +10%, then it will not impact the cash budget. Instead, it will help to strengthen the budget. But, if the sales forecast is off by -10%, then it might affect the cash budget in the later stages. So, to reduce the risk of defaulting on the payment obligations, the company should go with the loan amount of Rs. 1,10,00,000. This will help the company to manage any contingencies easily.

As seen in the Monthly Cash Budget, when the sales forecast is off by +10%, then the loan amount of Rs. 1,00,00,000 is sufficient to pay all the obligations. But if the company goes by Rs. 1,00,00,000 loan and if the sales forecast is off by -10%, then the company may be in cash deficit situation of Rs. 2,03,506.67 in the month of September 2019.

So, to be on the safer side, the company can opt to go with the loan amount of Rs. 1,10,00,000 so that it may not face any problem in the future.

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