

3.7D: Cash Flow: Activity



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3.7 CASH FLOW: ACTIVITY D

Read the case study below and answer the questions that follow.

CASH FLOW DRYING UP FOR SMALL INDIAN FIRMS



Sonali Patel has a problem. Her company, Mojj Engineering Systems, makes large-scale equipment for food and chemical plants. Her customers keep ringing up and saying: “We don’t need the equipment yet – hold it in stock,” “Can we have an extra discount?” or even “We will only buy it if you give us credit.”

“Three months ago we had no idea things could happen as quickly as this,” said Ms Patel. “It was too sudden to prepare for it.” She was, of course, complaining about the global recession and the speed with which it hit many businesses.

Ms Patel has already paid cash for all of her raw materials. Completed machines are filling up the yard in her factory. She will not get any money back for the materials bought, or for labour costs, until she delivers these machines and is paid for them. The finance the business was planning to use for expansion to a new factory is now being used to pay for the increase in working capital.

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QUESTIONS: 20 MARKS, 40 MINUTES

1. Explain the term 'working capital'. **[3 marks]**
2. Interpret why Ms Patel is finding it so difficult to control her working capital. **[7 marks]**
3. Evaluate three ways in which Ms Patel could try to reduce the finance tied up in working capital. **[10 marks]**