Working Capital Management Job Interview Questions And Answers

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Working Capital Management Interview Questions And Answers Guide.

Question - 1:

Do you know what are the sources used for financing temporary requirement of working capital?

Ans:

The sources used for financing temporary requirement of working capital are:
1) Spontaneous Sources
  a. Trade Credit
  b. Outstanding Expenses
2) Inter Corporate Deposits
3) Commercial Papers
4) Banks
5) Advances received form customers
6) Various short term provisions
7) Fixed deposits for a period of 1 year or less

View All Answers

Question - 2:

What is Variable working capital?

Ans:

Variable working capital is that portion of the total capital that is required over and above the fixed working capital. This working capital is required to meet the seasonal needs and some contingencies. The requirement of this type of working capital changes with the changes in the level of activity.

View All Answers

Question - 3:

What is Fixed working capital?

Ans:

Fixed working capital is that portion of the total capital that is required to be maintained in the business on the permanent basis or uninterrupted basis. This working capital is required to invest in fixed assets. The requirement of this type of working capital is unaffected due to the changes in the level of activity.

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Question - 4:

Do you know what current liabilities can be used as spontaneous sources for financing the working capital?

Ans:

Following current liabilities can be used as spontaneous source of financing the working capital:
1) Trade Credit
2) Outstanding Expenses
Trade credit is an arrangement in which a company buy goods or services without making immediate cash payment. If a company buys raw materials from the suppliers on credit basis, it gets the raw material for utilization immediately with the facility to make the payment at the delayed time. By accepting the delayed payment, the suppliers of raw material finance the requirement of working capital. It is an essential element of capitalization in an operating business because it can reduce the capital investment required to operate the business if it is managed properly.
Outstanding expenses are the expenses that are unpaid at the end of the accounting period, which means they are payable but not yet paid. This may apply to salaries, wages, telephone expenses, electricity expenses, water charges etc. All the outstanding expenses come under nominal accounts and must be credited.

View All Answers

Question - 5:

Explain what factors affect working capital requirement?

Ans:

Factors affecting working capital requirement:

1) Nature of business
2) Size of the organization
3) Phase of trade cycles
4) Production policies
5) Turnover of inventories
6) Dividend Policies
7) Trading terms
8) Length of production cycle
9) Profitability
10) Seasonal Variations.

View All Answers

Question - 6:

What is Outstanding expenses?

Ans:

Outstanding expenses are the expenses that are unpaid at the end of the accounting period, which means they are payable but not yet paid. This may apply to salaries, wages, telephone expenses, electricity expenses, water charges etc. All the outstanding expenses come under nominal accounts and must be credited.

View All Answers

Question - 7:

What is Trade credit?

Ans:

Trade credit is an arrangement in which a company buy goods or services without making immediate cash payment. If a company buys raw materials from the suppliers on credit basis, it gets the raw material for utilization immediately with the facility to make the payment at the delayed time. By accepting the delayed payment, the suppliers of raw material finance the requirement of working capital. It is an essential element of capitalization in an operating business because it can reduce the capital investment required to operate the business if it is managed properly.

View All Answers

Question - 8:

What is the primary objective of working capital management?

Ans:

The primary objective of working capital management is to avoid over investment or under investment in current assets, as a very large amount of funds are blocked in current assets in practical circumstances. Management of working capital ensures that sufficient cash is available to meet day to day cash requirements. Maximization of profits is another primary objective of working capital management. The management of working capital involves managing inventories, accounts receivable and payable, and cash. In other words, the goal of working capital management is to ensure that a firm is able to continue its operations and that it has sufficient ability to satisfy both maturing short-term debt and upcoming operational expenses.

View All Answers

Question - 9:

What is working capital?

Ans:

Working capital represents the operating liquidity available to a business organization. Working capital may mean Gross Working Capital or Net Working Capital. Gross Working Capital is equal to Current Assets and Net Working Capital is equal to Current Assets less Current Liabilities.

View All Answers

Question - 10:

Do you know spontaneous source of financing variable working capital?

Ans:

Spontaneous source of financing variable working arises in the normal course of business operations. It is also known as current liabilities. This source of financing is unsecured in nature and varies with the level of sales. They do not have any explicit cost attached to the same.

View All Answers

Question - 11:

Tell me what are Inter-corporate Deposits (ICDs)? What are their main characteristic features?

Ans:

Inter Corporate Deposits indicates unsecured short term funding raised by one company from another company. They are dependent on personal contacts. Following are their main characteristics:
1)They are for a very short period of time i.e 3 months or 6 months.
2)They are unsecured source for raising funds.
3)They are not regulated by any law.
4)It is a relationship based borrowing made by the company.
5)They involve high risk and high returns
6)Useful in solving temporary capital crisis.

View All Answers

Question - 12:

What is working capital cycle?

Ans:

The working capital cycle measures the amount of time that elapses between the moment when the organization commences its business with a certain amount of cash, and the moment when the organization receives payment for its goods or services. Thus, in this cycle cash available to the organization is converted back in the form of cash. Good working capital cycle balances incoming and outgoing payments to maximize working capital. A short working capital gives an idea to the organization that the business has good cash flow.

View All Answers

Question - 13:

Explain what are commercial papers? Who can issue commercial papers?

Ans:

Commercial papers are an unsecured promissory note issued at a discount with a fixed maturity of 1-270 days. The rate of discount is decided by the issuer and is not regulated. It carries higher interest repayment rates than bonds. It is basically money market securities issued by large banks and corporation to get money to meet short term debt obligations and are backed by corporation's promise to pay face value on the maturity date of the commercial note. It is of fixed maturity. Firms with excellent credit rating from a recognized rating agency will be able to sell their commercial paper at a reasonable price. A company can issue the Commercial Paper provided:
1) The minimum tangible net worth of the company should not be less than Rs.40mn as per the latest audited balance sheet.
2) Company has been sanctioned working capital limits by banks or Financial Institutions.
3) Borrowed amount of the company is classified as a standard asset by the bank.
4) The company should have minimum credit rating from an agency approved by RBI.

View All Answers

Question - 14:

Tell me who can invest in commercial papers?

Ans:

Following persons can invest in commercial papers:
1) Individuals
2) Banks
3) Corporate Bodies incorporated in India
4) Unincorporated Bodies
5) Non resident Indians
6) Foreign Institutional Investors

View All Answers

Question - 15:

Explain which credit rating agencies are authorized by RBI to provide a credit rating for Commercial Papers?

Ans:

Following Credit rating agencies are authorized by RBI to provide a credit rating for Commercial Papers:
1) CRISIL (Credit Rating Information Services of India Ltd.)
2) ICRA (Investment Information and Credit Rating Agency of India Ltd.)
3) CARE (Credit Analysis and Research Ltd.)
4) FITCH Rating India Ltd.

View All Answers

Question - 16:

Explain what is the process for issuing commercial papers?

Ans:

Every company issuing the CP should appoint a scheduled bank as the issuing and paying agent. The authorized authority is required to satisfy itself about the satisfactory credit rating. A resolution is required to be passed by the Board of Directors approving the issue and authorizing the official to execute the relevant documents, as per RBI norms. It should also verify the documents submitted by the issuing company and issue a certificate that the documents are in order. The issuer should disclose to its potential investors its financial position. The issue has to be completed within two weeks of opening.

View All Answers

Question - 17:

Explain what is the nature of a commercial paper?

Ans:

1) It can be issued for the maturity period of 7 days to 1 year.
2) It has the denomination of Rs. 5 lakhs and every single investor should invest minimum Rs. 5 lakh in the commercial paper.
3) Every issue including the renewal will be considered to be the fresh issue.
4) The amount shall be within the overall limit sanctioned by the Board of Directors.

View All Answers

Question - 18:

Tell me how is the amount of assistance that a bank can provide for your working capital calculated?

Ans:

Working capital assistance is provided by the bank in order to bridge the gap between current assets and current liabilities, which can be fund based and non-fund based. In order to obtain credit from bank for meeting working capital requirements, the company need to estimate its working capital requirements and is required to approach the bank along the necessary supporting documents. On the basis of the documents, the bank will decide the amount of assistance which may be given to the company after considering the margin requirements. This margin money provides the cushion against the reduction in the value of the security. If the company fails to fulfill its obligations then the bank may realize the security for recovering dues from the company. The percentage of margin money depends upon the credit standing of the company, fluctuations in the price of security or the directives of Reserve bank of India.

View All Answers

Question - 19:

What are the disadvantages of commercial papers?

Ans:

Disadvantages of commercial papers:
1) It is available only to a few selected blue chip and profitable companies.
2) By issuing commercial paper, the credit available from the banks may get reduced.
3) Issue of commercial paper is very closely regulated by the RBI guidelines.

View All Answers

Question - 20:

What are the advantages of commercial papers?

Ans:

Advantages of commercial papers:
1) It is quick and cost effective way of raising working capital.
2) Best way to the company to take the advantage of short term interest fluctuations in the market
3) It provides the exit option to the investors to quit the investment.
4) They are cheaper than a bank loan.
5) As commercial papers are required to be rated, good rating reduces the cost of capital for the company.
6) It is unsecured and thus does not create any liens on assets of the company.
7) It has a wide range of maturity
8) It is exempt from federal SEC and State securities registration requirements.

View All Answers

Question - 21:

Explain what is non-fund based lending?

Ans:

Non fund based lending, where the lending bank does not commit any physical outflow of funds. The funds position of the lending bank remains intact. The non-funding based lending can be maid in two forms:
1) Bank Guarantees
2) Letter of Credit

View All Answers

Question - 22:

Tell me in what form can a bank disburse the amount of assistance it has extended to a company?

Ans:

A bank can disburse the amount of assistance in any of the following forms:
1) Non-fund based lending
a. Bank Guarantee
b. Letter of Credit
2) Fund based lending
a. Loan
b. Overdraft
c. Cash Credit
d. Bills purchased/Discounted
e. Working Capital term loans
f. Packing Credit

View All Answers

Question - 23:

What is letter of credit (LC)?

Ans:

Letter of Credit is a non fund based lending which is very regularly found in international trade. This facility is given when the exporter and importer are unknown to each other. In this case, the importer applies to his bank (Issuing Bank) in his country to open a letter of credit in favour of exporter whereby the importers' bank undertakes to pay the exporter on fulfilling the terms and conditions specified in the letter of credit.

View All Answers

Question - 24:

What are the different parties involved in a LC?

Ans:

Following are the parties involved in a letter of credit :
1) Importer
2) Issuing Bank, Bank of Importer
3) Advising Bank, which is in Exporter's country, which notifies the exporter about opening of letter of credit.
4) Confirming Bank, confirms the letter of credit in case the exporter is not satisfied about the security offered by the importer.
5) Exporter, who is the beneficiary

6) Negotiating Bank, whom the exporter submits the documents.

View All Answers

Question - 25:

Tell me what are bank guarantees? How do they work?

Ans:

Bank Guarantee is a non fund based lending given by the bank to ensure that the liabilities of a debtor will be met. This facility enables the customer to acquire goods, buy equipment and thereby expand business activity. This process can be explained with the help of an example. Suppose X and Y are two companies both unknown to each other, in which X wants to purchase some material from Y Company. As the company Y does not know the company X and is concerned whether company Y will make the payment or not. Bank Z of Company X opens the bank guarantee in favour of company Y Bank Z in which it undertakes to make the payment to Company Y, if the company fails to make payment to company Y. In this way, interests of company Y are protected as it is assured to get the payment either from company X or from its Bank Z. As such, it becomes non fund based lending for Bank Z as it does not commit any outflow of funds. Bank Guarantee transactions will be applicable in case of credit transactions.

View All Answers

Question - 26:

Explain what are the advantages of a LC to an exporter?

Ans:

Advantages of Letter of Credit to an Exporter:
1) Exporter is guaranteed payment upon presentation of specified documents.
2) It eliminates the risk of dealing with an unknown importer in a different country.
3) It becomes easier for the exporter to secure pre order financing.
4) Importer cannot refuse payment by raising a complaint about the goods.

View All Answers

Question - 27:

What are the different types of LC?

Ans:

Different types of Letter of Credit:
1) Revocable Letter of Credit
2) Irrevocable Letter of Credit
3) Confirmed Irrevocable Letter of Credit
4) Transferable Letter of Credit
5) Revolving Letter of Credit
6) Credit available by installments
7) Back to Back Letter of Credit
8) Anticipatory Credit or Red Clause
9) Green Clause Letter of Credit
10) Deferred Payment Letter of Credit
11) Standby Letter of Credit

View All Answers

Question - 28:

Explain what is fund based lending? What are the various forms in which fund based lending may be made by banks?

Ans:

Fund based lending, where the lending bank commits the physical outflow of funds. The various forms in which fund based lending may be made by banks:
1) Loan
2) Overdraft
3) Cash Credit
4) Bills Purchased/Discounted
5) Working Capital Term Loans
6) Packing Credit

View All Answers

Question - 29:

Explain the advantages of a LC to an importer?

Ans:

Advantages of Letter of Credit to an Importer:
1) Importer is guaranteed to receive timely delivery of goods.
2) It makes structuring an advantageous payment schedule easy.
3) Expediting customs clearance and ultimate delivery as the documents are received quickly.
4) It gives an assurance to the importer that the payment will only be made to the exporter upon presentation of documents evidencing the shipment of goods.
5) It reduces the risk of non-performance of the exporter.

View All Answers

Question - 30:

Explain what were the main issues studied by Tandon committee to exercise control over working capital?

Ans:

The main issues studied by Tandon committee to exercise control over working capital were:
1) Can the norms be evolved for current assets and for debt equity ratio to ensure minimum dependence on bank finance?
2) How the quantum of bank advances may be determined?
3) Can the present manner and style of lending be improved?
4) Can an adequate planning, assessment and information system by evolved to ensure a disciplined flow of credit to meet genuine production needs and its proper supervision?

View All Answers

Question - 31:

Explain what forms of security does a bank need to provide security to a company?

Ans:

A bank needs following forms of security to provide security to a company:
1) Hypothecation
2) Pledge
3) Lien
4) Mortgage
a.) Hypothecation is a mode of security in which bank extends the assistance to the company against the security of movable property. Neither the property nor the possession of the goods hypothecated is transferred to the bank. If the company fails to repay the amount of assistance, in such case the bank has the right to sell the goods hypothecated to realize the outstanding amount of assistance granted by it to the company. A consumer entering into a mortgage agreement is an example of Hypothecation.
b.) Pledge is a mode of security in which bank extends the assistance to the company against the security of movable property. But the possession of the goods is with the bank and the goods pledged are in the custody of the bank. Thus, it becomes the duty of the bank to take care of the goods in the custody. In case the company is unable to repay the amount of assistance, the bank has the right to sell the goods pledged to realize the outstanding amount.
c.) Lien is a mode of security in which the bank retains the goods belonging to the company until the debt due to the bank is paid. Lien is of two types: Particular Lien and General Lien. Normally, Bank enjoys general Lien.
d.) Mortgage is a mode of security in which the legal interest in a specific immovable property is transferred as security for the payment of debt. The party who transfers the interest is called mortgager and party in whose favour the interest is so transferred is called mortgagee. The borrower possesses the property while the bank gets full legal title, subject to borrower's right, to repay to debt.

View All Answers

Question - 32:

Tell me what were the main issues studied by Tandon committee to exercise control over working capital?

Ans:

The observation and recommendations made by Tandon committee were:
1) Norms : The committee suggested 15 industries excluding engineering industries. These norms were suggested in following forms:
a. For Raw materials: Consumption in months
b. For Work in Progress: Cost of production in months
c. For Finished Goods: Cost of Sales in months
d. For Receivables: Sales in months
2) Methods of Borrowings : It introduced the concept of working capital gap which the excess of current assets over current liabilities other than bank borrowing. They also suggested three progressive methods to decide the maximum limits according to which banks should provide the finance.
3) Style of Lending : Is suggested that the cash credit limit should be bifurcated into two components i.e. Minimum level of borrowing required throughout the year should be financed by way of a term loan and the demand cash credit to take care for fluctuating requirements.
4) Credit Information Systems : The committee recommended the submission of a quarterly reporting system based on actual ass well as estimations, so that the requirements of working capital may be estimated on the basis of production needs.
5) Follow up, Supervision and Control : The committee suggested that there should be a proper system of supervision and control.
6) Norms for Capital Structure: The committee did not suggest any right norm for debt equity ratio, the committee opined that if the trend of debt equity ratio is worse than the medians, the banker should persuade the borrowers to strengthen the equity base as early as possible.

View All Answers

Question - 33:

What is Mortgage?

Ans:

Mortgage is a mode of security in which the legal interest in a specific immovable property is transferred as security for the payment of debt. The party who transfers the interest is called mortgager and party in whose favour the interest is so transferred is called mortgagee. The borrower possesses the property while the bank gets full legal title, subject to borrower's right, to repay to debt.

View All Answers

Question - 34:

What is Lien?

Ans:

Lien is a mode of security in which the bank retains the goods belonging to the company until the debt due to the bank is paid. Lien is of two types: Particular Lien and General Lien. Normally, Bank enjoys general Lien.

View All Answers

Question - 35:

What is Pledge?

Ans:

Pledge is a mode of security in which bank extends the assistance to the company against the security of movable property. But the possession of the goods is with the bank and the goods pledged are in the custody of the bank. Thus, it becomes the duty of the bank to take care of the goods in the custody. In case the company is unable to repay the amount of assistance, the bank has the right to sell the goods pledged to realize the outstanding amount.

View All Answers

Question - 36:
What is Hypothecation?
Ans:
Hypothecation is a mode of security in which bank extends the assistance to the company against the security of movable property. Neither the property nor the possession of the goods hypothecated is transferred to the bank. If the company fails to repay the amount of assistance, in such case the bank has the right to sell the goods hypothecated to realize the outstanding amount of assistance granted by it to the company. A consumer entering into a mortgage agreement is an example of Hypothecation.
View All Answers

Question - 37:
Explain what recommendations of Tandon committee were accepted by RBI according to its notification on 21st Aug 1975?
Ans:
According to the notification of RBI dated on 21st Aug 1975 accepted the following recommendations of Tandon committee:
1) Norms for Inventories and Receivables
2) Coverage
3) Methods of Borrowing
4) Style of Credit
5) Information System
View All Answers

Question - 38:
Explain Norms for Capital Structure?
Ans:
The committee did not suggest any right norm for debt equity ratio, the committee opined that if the trend of debt equity ratio is worse than the medians, the banker should persuade the borrowers to strengthen the equity base as early as possible.
View All Answers

Question - 39:
Do you know Follow up, Supervision and Control?
Ans:
The committee suggested that there should be a proper system of supervision and control.
View All Answers

Question - 40:
What are Credit Information Systems?
Ans:
Credit Information Systems : The committee recommended the submission of a quarterly reporting system based on actual ass well as estimations, so that the requirements of working capital may be estimated on the basis of production needs.
View All Answers

Question - 41:
What is Style of Lending?
Ans:
Is suggested that the cash credit limit should be bifurcated into two components i.e. Minimum level of borrowing required throughout the year should be financed by way of a term loan and the demand cash credit to take care for fluctuating requirements.
View All Answers

Question - 42:
What are Methods of Borrowings?
Ans:
It introduced the concept of working capital gap which the excess of current assets over current liabilities other than bank borrowing. They also suggested three progressive methods to decide the maximum limits according to which banks should provide the finance.
View All Answers

Question - 43:
What is Norms?
Ans:
Norms : The committee suggested 15 industries excluding engineering industries. These norms were suggested in following forms:
a. For Raw materials: Consumption in months
b. For Work in Progress: Cost of production in months
c. For Finished Goods: Cost of Sales in months
d. For Receivables: Sales in months

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