Case 12

KHANNA MANUFACTURING COMPANY

Khanna Manufacturing Company Limited (KMC) is engaged in manufacturing rubber-based products used in a variety of commercial applications. The company is located in Noida near Delhi and is one of the leading suppliers of these products to a large number of companies engaged in manufacturing automobile accessories, electronic and light engineering products. In recent years, the competition in this type of business has intensified. KMC has been able to face this competition and has been growing rapidly. The main reasons for its growth have been its good image for quality products, technological improvements leading to increased production capacity, cost advantage and strong marketing team.

During the last two years of operation, the company has been facing frequent cash deficit problems, as a result of which the company has not been able to meet its obligation to pay to its suppliers in time, and this has forced the company to postpone its payments. The company's reputation as a credit-worthy customer has gone down. Mr Khanna speculates that if this experience is repeated, the suppliers would force the company for cash payments for its purchases. To prevent the occurrence of this type of unforeseen events, he wanted to plan his cash in a better way.

Mr Khanna asked his finance manager Mr V P Iyer to develop the monthly cash forecasts for the period starting from January 1999 to June 1999. Mr Iyer obtained the following actual sales figures from the records of the last three months:

		(Rs in lakh)
October	1998	240
November	1998	280
December	1998	320

Mr Iyer first tried to find out the sales forecasts for the next seven months. After consulting with Mr Khanna, he developed the following forecasts:

		(Rs in lakh)
January	1999	260
February	1999	210
March	1999	160
April	1999	240
May	1999	200
June	1999	160
July	1999	200

Over the past three years. KMC had averaged 25 per cent of the company's total sales as cash sales, the remaining 75 per cent of the sales being accounts receivable. Forty per cent of these accounts receivables were collected in the first month after sales, 30 per cent collections took place in the second month after the sales and the remaining receivables were collected in the last month.

KMC's average consumption of raw material is 80 per cent of the sales. The accounts indicated that 40 per cent of this is paid in the month of sales itself, 55 per cent in the following month and the remaining in the third month.

Mr Iyer anticipated payments for wages and salaries to be as follows:

	(Rs in lakh)
January	42
February	39
March	32
April	40
May	32
June	28

The other general administrative expenses were assumed to be about Rs 2.5 lakh per month. Mr Iyer was aware of the 16 per cent annual interest payment liability on Rs 20 lakh of borrowing to be paid in the month of March. A tax payment on 1998 income of Rs 2.5 lakh is due in April. Mr Iyer estimated that KMC's tax liability for the next accounting year is expected to be Rs 24 lakh, for which the company would be required to pay the tax in advance. Quarterly instalment of such liability would be due in March, June, September and December. He also found that a capital expenditure of Rs 70 lakh is planned in February, of which 50 per cent will have to be paid in the same month and the remaining in May. The company has a cash balance of Rs 1,40,000 as on December 31, which is the minimum desired level of cash. For projecting the cash flows for the next six months, Iyer assumed the prices and costs to remain constant.

After collecting the information about cash flows, Iyer created a file in spread sheet by classifying each item of cash flows systematically into cash and payments. While entering the amounts of cash flows he was sure how to input these figures.

His immediate concern was that as and when any change in sales or collection experience is made, the cash flow forecasts should automatically get updated. Before entering the figures in the worksheet file, he wanted to plan it more systematically.