Question #1 of 14

Question ID: 1575451

A company with a moderate approach to working capital management would *most likely* fund:

A) permanent current assets using long-term funds, and fund seasonal current assets using short-term funds. ✓

B) both permanent and seasonal current assets using short-term funds. ✗

C) permanent current assets using short-term funds, and fund seasonal current assets using long-term funds. ✗

Explanation

Companies with a moderate approach to working capital management typically prefer using cheaper, short-term financing to fund seasonal (variable) working capital needs, while using long-term financing to fund permanent working capital needs.

(Module 25.1, LOS 25.c)

Question #2 of 14

Question ID: 1575454

Which of the following companies' working capital management is *most* indicative of a moderate approach?

	Permanent working capital needs are funded using:	**Variable working capital needs are funded using:**
Company A	Long-term debt	Equity
Company B	Equity	Short-term debt
Company C	Short-term debt	Long-term debt

A) Company A. ✗

B) Company B. ✓

C) Company C. ✗

Explanation

Companies with a moderate approach to working capital management typically prefer using long-term financing (like long-term debt or equity) to fund permanent working capital needs, while using short-term financing (like short-term debt) to fund variable working capital needs.

(Module 25.1, LOS 25.c)

Question #3 of 14

Question ID: 1575447

While conducting market research, an analyst observes that significant amounts of a company's sales are prepaid, while inventory levels are generally very low. The analyst should *most appropriately* conclude that the company has a:

A) low cash conversion cycle. ✓

B) high cash conversion cycle. ✗

C) high days of inventory on hand. ✗

Explanation

High levels of prepaid sales along with low levels of inventories—typical of airlines—imply low cash conversion cycles. Low inventory levels would imply low days of inventory on hand.

(Module 25.1, LOS 25.a)

Question #4 of 14

Question ID: 1575445

If the days of inventory on hand, days sales outstanding, and days payable outstanding all doubled, a positive cash conversion cycle (CCC) would:

A) increase by a factor of less than 2. ✗

B) double. ✓

C) remain unchanged. ✗

Explanation

The CCC is calculated by adding the days of inventory on hand and the days sales outstanding, and subtracting the days payable outstanding. A doubling of all components of a positive CCC would double the value of the CCC.

In fact, the doubling of all components of the CCC would double the value of any CCC (even if negative), with the exception when the CCC is zero.

(Module 25.1, LOS 25.a)

Question #5 of 14

Question ID: 1575444

The cash conversion cycle (CCC) would *most likely* decrease if:

A) days sales outstanding increased. ✗

B) days payable outstanding decreased. ✗

C) days of inventory on hand decreased. ✓

Explanation

The CCC measures the time it takes for a company to convert its investments in inventory and other resources into cash inflows from sales. The CCC is calculated by adding the days of inventory on hand and the days sales outstanding, and subtracting the days payable outstanding. The CCC would, therefore, decrease if either the days of inventory on hand or the days sales outstanding decreased, or if the days payable outstanding increased.

(Module 25.1, LOS 25.a)

Question #6 of 14

Question ID: 1575449

A supplier offers 4/30 net 90 terms. The bank interest rate is 6.5%. Which source of financing is the cheapest?

A) The bank. ✓

B) The two cost the same. ✗

C) The supplier's offered terms. ✗

Explanation

The EAR of supplier financing = $(1 + 0.04 / 0.96)^{365/60} - 1 = 18.0\%$.

The cost of implicit supplier financing is much higher than the cost of explicit bank financing of 6.5%.

(Module 25.1, LOS 25.a)

Question #7 of 14

Question ID: 1575446

Buildup Design, Inc., expects a 20% reduction in its days payable outstanding from 50 to 40 days, while its days of inventory on hand and days sales outstanding would remain unchanged. What would be the *most likely* impact on the cash conversion cycle (CCC)?

A) The CCC would decrease by 10 days. ✗

B) The CCC would increase by 10 days. ✓

C) The CCC would increase by 20%. ✗

Explanation

The CCC is calculated by adding the days of inventory on hand and the days sales outstanding, and subtracting the days payable outstanding. A shorter days payable outstanding implies less generous credit terms by suppliers, where the company must pay its suppliers in a shorter time period. This would increase the CCC by 10 days.

(Module 25.1, LOS 25.a)

Question #8 of 14

Question ID: 1573309

The quick ratio is considered a more conservative measure of liquidity than the current ratio because the quick ratio excludes:

A) inventories. ✓

B) marketable securities. ✗

C) accounts receivable. ✗

Explanation

The quick ratio is usually defined as (current assets – inventories) / current liabilities. The quick ratio excludes inventories from current assets because inventories are not necessarily liquid. It is a more restrictive measure of liquidity than the current ratio, which equals current assets / current liabilities. Current assets that remain in the numerator of the quick ratio include cash and cash equivalents, accounts receivable, and short-term marketable securities.

(Module 25.1, LOS 25.b)

Question #9 of 14

Question ID: 1575448

A company's cash conversion cycle (CCC) has been gradually increasing over the last three years. Which of the following factors would *best* explain this change?

A) The company is turning over inventory faster.

B) The company's trade creditors have tightened their credit conditions.

C) The company is collecting its accounts receivables faster.

Explanation

An increasing CCC would signify a less efficient use of working capital. This could result from any of the following changes: (1) slower inventory turnover, (2) a slower collection of accounts receivable (meaning the company is less strict in its credit terms with its customers), and (3) a shorter payable period (meaning the company's trade creditors have tightened their credit terms and conditions and require faster repayment).

(Module 25.1, LOS 25.a)

Question #10 of 14

Question ID: 1575452

Which of the following scenarios is *most* consistent with a conservative approach to working capital management?

A) A company funds its rent expense using short-term debt.

B) A company holds significantly higher amounts of long-term assets than short-term assets.

C) A company funds its inventory needs using long-term debt.

Explanation

Companies with a conservative approach to working capital management typically finance working capital needs using long-term financing, including both equity and debt issuances. For example, they tend to use long-term funds to pay for permanent working capital like inventory, salaries, and rent. These companies typically hold higher levels of short-term assets compared to long-term assets.

(Module 25.1, LOS 25.c)

Question #11 of 14

Question ID: 1573308

A high cash conversion cycle suggests that a company's investment in working capital is:

A) too high.

B) appropriate.

C) too low.

Explanation

The cash conversion cycle is equal to average days of receivables plus average days of inventory minus average days of payables. High cash conversion cycles relative to those of comparable firms are considered undesirable. A cash conversion cycle that is too high implies that the company has excessive investment in working capital.

(Module 25.1, LOS 25.a)

Question #12 of 14

Question ID: 1573307

Which of the following *most* accurately represents the cash conversion cycle?

A) average days of receivables + average days of inventory + average days of payables.

B) average days of payables + average days of inventory – average days of receivables.

C) average days of receivables + average days of inventory – average days of payables.

Explanation

The cash conversion cycle, also called the net operating cycle is:

$$\text{cash conversion cycle} = \begin{pmatrix}\text{average days}\\ \text{of receivables}\end{pmatrix} + \begin{pmatrix}\text{average days}\\ \text{of inventory}\end{pmatrix} - \begin{pmatrix}\text{average days}\\ \text{of payables}\end{pmatrix}$$

The cash conversion cycle measures the length of time required to convert a firm's cash investment in inventory back into cash resulting from the sale of the inventory. A short cash conversion cycle is good because it indicates a relatively low investment in working capital.

(Module 25.1, LOS 25.a)

Question #13 of 14

Question ID: 1575450

Which of the following scenarios is *most* consistent with an aggressive approach to working capital management?

A) A company finances working capital using short-term funds. ✓

B) A company finances working capital using long-term funds. ✗

C) A company finances working capital using equity instead of debt. ✗

Explanation

Companies with an aggressive approach to working capital management favor using cheaper, short-term financing to fund their working capital needs.

(Module 25.1, LOS 25.c)

Question #14 of 14

Question ID: 1575453

A company's management recently decided to fund its inventory needs and rent expenses using long-term debt rather than short-term debt. The management's decision would *most likely* result in higher:

A) profitability. ✗

B) costs. ✓

C) equity. ✗

Explanation

The management's decision to use more long-term financing to fund working capital (like inventory costs and rent expense) is indicative of a more conservative approach to working capital management. The conservative approach typically results in higher funding costs (long-term debt costs are higher than short-term) and lower profitability—and therefore, equity.

(Module 25.1, LOS 25.c)