

The Purchase Order

Student brief

Ilupeju Industrial Supplies has won the largest order in its history.

An oil-services contractor has placed a ₦180 million purchase order for valves, fasteners, and safety equipment, to be delivered in thirty days. The contractor is a subsidiary of an international group, has never missed a payment to anyone, and settles ninety days after delivery.

Ilupeju's supplier in Guangzhou requires payment thirty days after shipment. The goods cost ₦140 million.

So the money leaves on day thirty and returns on day one hundred and twenty. **Ilupeju must fund ₦140 million for ninety days.** It does not have ₦140 million.

Three options are available, plus the option of declining.

Exhibit 1 • The four options

THE FOUR OPTIONS

Ilupeju must fund ₦140 million for ninety days.

OPTION	WHAT IT IS	COST	WHAT IT REQUIRES
A • LPO financing	A finance house funds the full ₦140m against the purchase order, repaid directly by the customer	4% per month, charged on the full amount	The order and the customer's confirmation. Nothing about Ilupeju's own accounts
B • Bank credit	The bank will extend ₦80m against the existing facility — no more. The remaining ₦60m must come from Ilupeju's own cash	28% a year, plus a 1% arrangement fee on the ₦80m advanced	Bank approval and headroom on the facility
C • Supplier terms	The Guangzhou supplier extends payment from 30 days to 120 days, covering the entire gap	A 3% increase in the price of the goods	A trading relationship the supplier is willing to protect
D • Decline the order	—	Profit forgone	—

Ilupeju's own ₦60 million under option B is not free. It is currently earning 28% by offsetting the existing line of credit.

Question 1 • 15 minutes

For each of options A, B, and C, compute the total financing cost in naira and the resulting net profit on the order.

For option B, remember that Ilupeju's own ₦60 million is not free.

Then express each option's cost as an **effective annual rate** so the three are comparable. Be careful what you divide by: a rate is only comparable to another rate if both are measured on the same amount of money.

Question 2 • 13 minutes

Rank the three financing options by cost. Then rank them by **how likely Ilupeju is to actually be able to use them**.

The two rankings are not the same. Explain why, and say what that tells you about how credit is priced in this market.

Question 3 • 9 minutes

Recommend an option.

Then: the customer pays ninety days after delivery in principle. Suppose they take one hundred and fifty days instead. Recompute the cost of your recommended option, and say whether your recommendation changes.