Sources of finance for kfc finance essay

KFC began with Colonel Harland Sanders. He discovered his penchant for cooking when he was only 9 years old. Through the years he grew up to become a personage the world knows as Colonel Sanders, founder of KFC.

He reached celebrity status in 1952, when he decided to franchise his famous Kentucky Fried Chicken recipe blends of 11 herbs and spices to the rest of America. By the early 70's, that special recipe reached Malaysia.

KFC Holdings owns approximately 27 Kedai Ayamas and 4 Ayamas Depots, making them the nation's first branded chicken and chicken-based retain chain. KFC Holdings operates the KFC chain of restaurants in Malaysian, Singapore and Brunei (523 restaurants) and the Rasamas chain of restaurants in Malaysia (about 37 outlets).

Sources of finance are where finance comes from. There are three kinds of sources which are Bank loans, Owner's (share) capital and Trade credit .

Finance is money which is a scarce resource. To obtain it, a business has to compete for it. Individuals, the government and other businesses all seek money to finance their needs. Those with money to lend will lend it provided the rate of return (interest), the risk and flexibility (how quickly the money can be repossessed) are consistent with their expectations.

The word ' lend' often implies to short-term; the word ' invest' implies to long-term. Individuals or organisations that lend money, expect to get their money back, with a fixed annual return in a comparatively short time. Those who invest in a company become part-owners – share holders. They expect regular payment of cash dividends (whose size varies with the company's success) plus an increase in the value of their shares.

A major source of finance for many businesses is the retained profit from sales to customers. A business just starting up or one expanding rapidly has to raise its finance from other sources. There are three kind of finance question which relates the finance which the management should consider.

Duration: for how long is the finance required?

Cost: which source of finance is the least expensive?

repayment: what level is acceptable

Duration

Duration depends on the reason the money is needed. No-one would take out a 25 year mortgage to finance the purchase of a personal HiFi. Few people would buy a house with a bank overdraft. Businesses apply the same principles of matching the purpose of finance with the source of finance. This makes sense all round. For the business it ensures that finance is guaranteed as long as it is needed.

For the investor it ensures that adequate security is available for the duration of the loan – as in the case of a 20 year loan secured against a property that will continue to have value for all the 20 years.

Cost

In general, businesses look for the cheapest source of finance. The easiest way to compare the cost of finance is to express the annual payment to lenders/investors as a percentage of the amount of finance provided. Interest on a loan can be expressed in percentage terms. So can the rate of return to shareholders.

Return on investment in shares = Dividend per share, share price change since the start of year

The rate of return expected by shareholders becomes the cost to the business of using this form of finance.

Repayment

A business should not get into a position where all of its profits are being swallowed up in interest payments. There is a real danger of borrowing too much. The same applies to individuals.

Type of sources of finance:

government purchase

loan stock

leasing

venture capital

hire purchase

ordinary shares

warrant

retailed earning

borrowings

Ordinary Shares

Ordinary shares also known as common stock or voting share is a share of stock giving stockholders the right to vote no matters of corporate policy and the composition of the members of the board of directors.

Ordinary shares are issued to the owners of a company. They have a nominal or ‘ face’ value, typically of RM1 or 50 cents. The market value of a quoted company’s shares bears no relationship to their nominal value, except that when ordinary shares are issued for cash, the issue price must be equal to or be more than the nominal value of the shares.

Preference Shares

Preference shares, also called preferred stock or preferred shares, is typically a higher ranking stock than common stock, and its terms are negotiated between the corporation and the investor. Preference shares usually carries no voting rights, but may carry priority over common stock in the payment of dividends and upon liquidate

Preference shares may carry a dividend that is paid out prior to any dividends being paid to common stock holders. Preference shares may have a convertibility feature into common stock. Preference stockholders will be paid out in assets before common stockholders and after debt holders in bankruptcy. Terms of the preferred stock are stated in a " Certificate of Designation".

From the company's point of view, preference shares are advantageous in that:

· Dividends do not have to be paid in a year in which profits are poor, while this is not the case with interest payments on long term debt (loans or debentures).

· Since they do not carry voting rights, preference shares avoid diluting the control of existing shareholders while an issue of equity shares would not.

· The issue of preference shares does not restrict the company's borrowing power, at least in the sense that preference share capital is not secured against assets in the business.

Loan Stock

Common or preferred stock shares that are used as collateral to secure a loan from another party. The loan will earn a fixed interest rate, much like a standard loan, and can be secured or unsecured. A secured loan stock may also be called a convertible loan stock if the loan stock can be directly converted to common shares under specified conditions and with a pre-determined conversion rate, as with an irredeemable convertible unsecured loan stock (ICULS).

Retained Earnings

Retained earnings refer to the portion of net income which is retained by the corporation rather than distributed to its owners as dividends. Similarly, if the corporation makes a loss, then that loss is retained and called variously retained losses, accumulated losses or accumulated deficit. Retained earnings and losses are cumulative from year to year with losses offsetting earnings.

Retained earnings are reported in the shareholders' equity section of the balance sheet. Companies with net accumulated losses may refer to negative shareholders' equity as a shareholders' deficit. A complete report of the retained earnings or retained losses is presented in the Statement of retained earnings or Statement of retained losses.

The major reasons for using retained earnings to finance new investments, rather than to pay higher dividends and then raise new equity for the new investments, are as follows:

a) The management of many companies believes that retained earnings are funds which do not cost anything, although this is not true. However, it is true that the use of retained earnings as a source of funds does not lead to a payment of cash.

b) The dividend policy of the company is in practice determined by the directors. From their standpoint, retained earnings are an attractive source of finance because investment projects can be undertaken without involving either the shareholders or any outsiders.

c) The use of retained earnings as opposed to new shares or debentures avoids issue costs.

d) The use of retained earnings avoids the possibility of a change in control resulting from an issue of new shares.

Borrowings

Receiving something of value in exchange for an obligation to pay back something of usually greater value at a particular time in the future. Borrowings are divided into three terms.

Short term lending may be in the form of:

a) An overdraft, which a company should keep within a limit set by the bank. Interest is charged (at a variable rate) on the amount by which the company is overdrawn from day to day;

b) A short-term loan, for up to three years.

Medium-term loans are loans for a period of from three to ten years. The rate of interest charged on medium-term bank lending to large companies will be a set margin, with the size of the margin depending on the credit standing and riskiness of the borrower. A loan may have a fixed rate of interest or a variable interest rate, so that the rate of interest charged will be adjusted every three, six, nine or twelve months in line with recent movements in the Base Lending Rate.

Longer-term bank loans will sometimes be available, usually for the purchase of property, where the loan takes the form of a mortgage.

Leasing

Leasing is a process by which a firm can obtain the use of a certain fixed assets for which it must pay a series of contractual, periodic, tax deductible payments. The lessee is the receiver of the services or the assets under the lease contract and the lessor is the owner of the assets. The relationship between the tenant and the landlord is called a tenancy, and can be for a fixed or an indefinite period of time (called the term of the lease). The consideration for the lease is called rent. There are two basic forms of lease: " operating leases" and " finance leases".

Operating leases

Operating leases are rental agreements between the lessor and the lessee whereby:

a) The lessor supplies the equipment to the lessee

b) The lessor is responsible for servicing and maintaining the leased equipment

Finance leases

Finance leases are lease agreements between the user of the leased asset (the lessee) and a provider of finance (the lessor) for most, or all, of the assets expected useful life.

Suppose that a company decides to obtain a company car and finance the acquisition by means of a finance lease. A car dealer will supply the car. A finance house will agree to act as lessor in a finance leasing arrangement, and so will purchase the car from the dealer and lease it to the company. The company will take possession of the car from the car dealer, and make regular payments (monthly, quarterly, six monthly or annually) to the finance house under the terms of the lease.

Hire Purchase

Hire purchase is the legal term for a contract developed in the United Kingdom. It is also called closed-end leasing. In cases where a buyer cannot afford to pay the asked price for an item of property as a lump sum but can afford to pay a percentage as a deposit, a hire-purchase contract allows the buyer to hire the goods for a monthly rent. When a sum equal to the original full price plus interest has been paid in equal installments, the buyer may then exercise an option to buy the goods at a predetermined price (usually a nominal sum) or return the goods to the owner

Venture Capital

Venture capital (also known as VC or Venture) is a type of private equity capital typically provided for early-stage, high-potential, growth companies in the interest of generating a return through an eventual realization event such as an IPO or trade sale of the company. Venture capital investments are generally made as cash in exchange for shares in the invested company. It is typical for venture capital investors to identify and back companies in high technology industries such as biotechnology and ICT (information and communication technology

Franchising

Franchising is a method of expanding business on less capital than would otherwise be needed. For suitable businesses, it is an alternative to raising extra capital for growth. Franchisors include Budget Rent-a-Car, Wimpy, Nando's Chicken and Chicken Inn

Other possible alternatives can be used by KFCH

KFC Holdings have been running their operation with all the types of source of finance as stated above. In order to further enhance themselves as well improving their investors' relations, they can apply other kind of source to run their business

KFC has not issue warrants throughout the financial year. Warrants are, in effect, options granted by the business that entitle the holder to subscribe for a specified quantity of ordinary shares, for a specified price at, or after, a specified time- usually several years following their issue. The business would usually issue the warrants in one of two ways, that is to sell them, in which case it would derive a cash inflow, or attach them to a loan stock issue as a ' sweetener' or incentive to investors to take up the loan stock.

Apart from that, KFC can even issue Employee's Share Option Scheme at various options. An employee share scheme is one way to give employees a stake in your business and help improve its performance. As employees normally have to remain with the business to get this benefit, share schemes encourage loyalty and can help you retain valued staff. They act as an incentive or reward and may also help recruitment. (Extracted from Business

Link, http://www. businesslink. gov. uk/bdotg/action/layer? topicId= 1074472937)

In fact, KFC could even use hire purchase to source their finance. Hire purchase is referred to sales promotion device that creates customers' purchasing power in the form of a fixed cost, fixed period installment loan, secured by a lien on the purchased item as the collateral. In case of capital equipment, the customer repays the loan from the earnings generated by the purchased asset (which otherwise would have remained unsold due to the customers' lack of cash).

During the repayment period the buyer has the possession and use but not the ownership (title) to the item. Only upon the full payment of the loan, the title passes to the buyer. Also called installment buying, it is a social innovation that expands the economy with additional income.

(Extracted from Business Dictionary. com, http://www. businessdictionary. com/definition/hire-purchase. html)

APPENDIX

Share capital

From the financial statement for the year 2008, KFC holdings issued 1, 000, 0000 new ordinary shares valued RM1. 00 each for the year 2008 and 2007. . However, only 198, 275 shares at RM 1. 00 each was issued and fully paid.

SHARE CAPITAL

Number of Ordinary

Shares of RM1 each Amount

2008 2007 2008 2007 2008 2007

‘ 000 ‘ 000 RM’000 RM’000

Authorised

At 1 January/ 31 December 1, 000, 000 1, 000, 000 1, 000, 000 1, 000, 000

Issued and fully paid

At 1 January/ 31 December 198, 275 198, 275 198, 275 198, 275

Retained Earnings

The percentage of net earnings not paid out as dividends, but retained by the company to be reinvested in its core business or to pay debt. It is recorded under shareholders’ equity on the balance sheet.

The formula calculates retained earnings by adding net income to (or subtracting any net losses from) beginning retained earnings and subtracting any dividends paid to shareholders:

KFC Holdings recorded RM 316, 703, 000 of retained earnings in year 2008 compared to RM 257, 611, 000 in year 2007 for company. This shows that KFC retained their net earnings higher in year 2008 so that they can reinvest in its core business to pay its debt.

Borrowings

Borrowings are classified under short term borrowings and long term borrowings. KFC Holdings borrowed RM 20, 000, 000 in year 2008 while there were no borrowings for the year 2007 under company.

On the other hand, KFC's long term borrowings amounted to RM 40, 000, 000 in year 2008 compared to RM 60, 000, 000 in year 2007. The total borrowings for the two years were RM 60, 000, 000 respectively. (Refer note: 26)

The term loans granted to the Company are secured by the following:

i First and third party charge over certain land and buildings as disclosed in Note 12(b) and

Note 15

ii Deposits pledged with licensed banks as disclosed in Note 18

iii Corporate guarantee of the Company and a related company

iv Debenture of a subsidiary's assets

Company

2008 2007

RM’000 RM’000

Short term borrowings

Secured

Term loans 20, 000 –

Unsecured

Term loans – –

20, 000 –

Long term borrowings

Secured

Term loans 40, 000 60, 000

Unsecured

Term loans – –

40, 000 60, 000

Total borrowings

Secured

Term loans 60, 000 60, 000

Unsecured

Term loans – –

60, 000 60, 000

Leasing

KFC’s leasing is analysed as long term leasehold land and short term leasehold land. The group’s long term leasehold land notched RM 63, 733, 000 in 2008 compared to RM 63, 868, 000 in 2007. However, their short term leasehold land was RM 68, 000 in 2008 while in year 2007, it was RM 73, 000. Overall, their total leasing was RM 63, 841, 000 and RM 63, 941, 000 for the two years respectively.

Leasehold land with an aggregate carrying value of RM30, 434, 000 (2007: RM30, 822, 000) are pledged as securities for borrowings.

Group

2008 2007

RM’000 RM’000

At 1 January 63, 941 62, 687

Addition – 1, 830

Disposal – (106)

Acquisition of a subsidiary 722 –

Reclassification from property, plant and equipment – 333

Amortisation for the year (822) (803)

At 31 December 63, 841 63, 941

Analysed as:

Long term leasehold land 63, 773 63, 868

Short term leasehold land 68 73

63, 841 63, 941

INCOME STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2008

Group Company

Note 2008 2007 2008 2007

RM’000 RM’000 RM’000 RM’000

Revenue 3 2, 179, 788 1, 730, 371 97, 220 88, 000

Cost of sales 4 (1, 064, 548) (770, 048) – –

Gross profit 1, 115, 240 960, 323 97, 220 88, 000

Other income 22, 615 22, 797 30, 210 26, 972

Administrative expenses (118, 670) (109, 061) (28, 757) (22, 713)

Selling and marketing expenses (837, 547) (712, 109) – –

Other expenses (6, 622) (24) (2, 310) (26, 229)

Operating profit 175, 016 161, 926 96, 363 66, 030

Finance costs 5 (7, 559) (11, 302) (2, 887) (5, 823)

Profit before tax 6 167, 457 150, 624 93, 476 60, 207

Income tax expense 9 (47, 107) (45, 081) (9, 522) (23, 437)

Profit for the year 120, 350 105, 543 83, 954 36, 770

Attributable to:

Equity holders of the Company 118, 535 1 04, 269

Minority interests 1, 815 1, 274

120, 350 105, 543

Earnings per share attributable

to equity holders of the Company (sen):

Basic, for profit for the year 10 59. 8 52. 6

BALANCE SHEETS

AS AT 31 DECEMBER 2008

Group Company

Note 2008 2007 2008 2007

RM’000 RM’000 RM’000 RM’000

Assets

Non-current assets

Property, plant and equipment 12 615, 059 529, 658 19, 750 19, 908

Investments in subsidiaries 13 – – 354, 250 353, 590

Investment properties 14 898 2, 000 – 585

Prepaid land lease payments 15 63, 84 1 63, 941 – –

Intangible assets 16 69, 835 68, 063 – –

Other investment 17 – 4, 500 – –

Fixed deposits 18 – 6, 324 – 6, 324

749, 633 674, 486 374, 000 380, 407

Current assets

Inventories 19 158, 474 112, 312 – –

Trade and other receivables 20 128, 112 78, 972 222, 742 156, 642

Other investment 17 20, 203 – – –

Cash and bank balances 21 97, 985 140, 358 6, 797 11, 826

404, 774 331, 642 229, 539 168, 468

Total assets 1, 154, 407 1, 006, 128 603, 539 548, 875

Equity and liabilities

Equity attributable to equity

holders of the company

Share capital 22 198, 275 198, 275 198, 275 198, 275

Other reserves 23 47, 705 50, 963 22, 080 26, 560

Retained earnings 24 446, 178 352, 783 316, 703 257, 611

692, 158 602, 021 537, 058 482, 446

Minority interests 10, 232 6, 920 – –

Total equity 702, 390 608, 941 537, 058 482, 446

Non-current liabilities

Retirement benefit obligations 25 3, 313 3, 758 – –

Borrowings 26 65, 944 110, 907 40, 000 60, 000

Deferred tax liabilities 27 31, 602 25, 036 107 444

100, 859 139, 701 40, 107 60, 444

Current liabilities

Retirement benefit obligations 25 623 – – –

Borrowings 26 75, 111 12, 080 20, 000 –

Trade and other payables 28 275, 424 242, 110 6, 374 5, 985

Current tax payable – 3, 296 – –

351, 158 257, 486 26, 374 5, 985

Total liabilities 452, 017 397, 187 66, 481 66, 429

Total equity and liabilities 1, 154, 407 1, 006, 128 603, 539 548, 875