Managing financial resources and decisions js and co

ASSIGN BUSTER

JS and co is a medium sized retailer formed by two partners, James and Sainsbury, who are running it in the UK since 1869. The retailer specializes in quality food products but it sells other non-food products as well. This company got very good success in the market from the past three years. During this discussion we are going to discuss about this company sources of finance, finance as a source, financial decisions, and financial performance.

The broad view of this company in our discussion:

P1 (sources of Finance)

P2 (Finance as a resource)

P3 (Financial decisions)

P4 (Financial performance)

P1 (SOURCES OF FINANCE)

IDENTIFY THE SOURCES OF FINANCE AVAILABLE TO THE BUSINESS

When a company is growing rapidly, for example when contemplating investment in capital equipment, its current financial resources may be inadequate. Few growing companies are able to finance their expansion plans from cash flow alone. They will therefore need to consider raising finance from other external sources. In addition, managers who are looking to buy-in to a business or buy-out a business from its owners may not have the resources to acquire the company. They will need to raise finance to achieve their objectives.

There are a number of potential sources of finance to meet the needs of a growing business

– Existing shareholders and directors funds

– Business angels

– Clearing banks (overdrafts, short or medium term loans)

– Factoring and invoice discounting

– Hire purchase and leasing

– Venture capital

A key consideration in choosing the source of new business finance is to strike a balance between equity and debt to ensure the funding structure suits the business.

The main differences between borrowed money (debt) and equity are that bankers request interest payments and capital repayments, and the borrowed money is usually secured on business assets or the personal assets of shareholders and/or directors. A bank also has the power to place a business into administration or bankruptcy if it defaults on debt interest or repayments or its prospects decline.

ASSESSING THE IMPLICATIONS OF DIFFERENT SOURCES.

Financial institutions that transcend national boundaries and engage in such activities as extensive inter bank contracts, over-the-counter derivatives contracts, quit, bond, and syndicated loan issuance, and trading activities globally has led to stronger interconnections, innovation, and growth. While tighter interdependencies can increase the efficiency of the global financial

system by smoothing credit allocation and risk diversification, they have also increased the potential for cross-market and cross-border disruptions to spread swiftly. In addition, financial innovations have enabled risk transfers that were not fully recognized by financial regulators and institutions themselves, and have complicated the assessment of counterparty risk, risk management, and policy responses. Although linkages across institutions have traditionally focused on solvency concerns, the current crisis reminds us of the relevance of liquidity spillovers, specifically that

(1) Interconnectedness means difficulties in rolling over liabilities may spill over to the financial system as a whole; and that

(2) Rollover risk associated with short-term liabilities is present not only in the banking sector but, equally importantly, in the nonblank financial sector. Thus, it is essential to improve our understanding and monitoring of direct and indirect financial systemic linkages, including by strengthening techniques to assess systemic link-ages, and thereby contribute to making systemic-focused supervision feasible.

Four complementary approaches to assess financial sector systemic linkages and focuses on this definition of systemic risk: 2

The network approach

The co-risk model

The distress dependence matrix

The default intensity model

CHOOSING THE APPROPRIATE SOURCE OF FINANCE FOR THE BUSINESS.

There are a number of ways of raising finance for a business. The type of finance chosen depends on the nature of the business. Large organizations are able to use a wider variety of finance sources than are smaller ones. Savings are an obvious way of putting money into a business. A small business can also borrow from families and friends. In contrast, companies raise finance by issuing shares. Large companies often have thousands of different shareholders.

To gain extra finance a business can take out a loan from a bank or other financial institution. A loan is a sum of money lent for a given period of time. Repayment is made with interest. The lender of money needs to know all the business opportunities and risks involved and will therefore want to see a detailed business plan. The lender may also want some form of security should the business run into financial difficulty, and may therefore prefer to provide a secured loan.

Another way of raising short-term finance is through an overdraft facility with a bank. The borrower is given permission to take out more from their account than they have put in. The bank fixes a maximum limit for the overdraft. Interest is charged on the overdraft daily.

Businesses may also qualify for grants. Government and private funds are sometimes made available to businesses that meet certain conditions. For example, grants and loans may be available to firms setting up in rural areas or where there is high unemployment.

Out comes:

By this module I understood the different long term and short term sources of finance with the implications of choice of one source over the other and any advantages and disadvantages of sources different sources of finance.

P2 (FINANCE AS A RESOURCE)

ASSESS AND COMPARE THE COSTS OF ABOVE MENTIONED SOURCES OF FINANCE.

A company might raise new funds from the following sources:

The capital markets:

i) New share issues, for example, by companies acquiring a stock market listing for the first time

ii) Rights issues

· Loan stock

· Retained earnings

· Bank borrowing

· Government sources

· Business expansion scheme funds

· Venture capital

· Franchising.

Ordinary (equity) shares

Ordinary shares are issued to the owners of a company. They have a nominal or ‘ face’ value, typically of $1 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.

Deferred ordinary shares

Are a form of ordinary shares, which are entitled to a dividend only after a certain date or if profits rise above a certain amount. Voting rights might also differ from those attached to other ordinary shares.

Ordinary shareholders put funds into their company:

a) By paying for a new issue of shares

b) through retained profits.

New shares issues

A company seeking to obtain additional equity funds may be:

a) An unquoted company wishing to obtain a Stock Exchange quotation

b) An unquoted company wishing to issue new shares, but without obtaining a Stock Exchange quotation

c) A company which is already listed on the Stock Exchange wishing to issue additional new shares.

EXPLAINING THE IMPORTANCE OF FINANCIAL PLANNING

Financial planning

it is a process which presents before an individual, organization or even a country, the current financial position and the adjustments in the spending pattern, in order to meet the goals.

Importance of Financial Planning

It is important to plan finances in order to reap long term benefits through the assets in hand. The investments that one makes are structured properly and managed by professionals through financial planning. Every decision regarding our finances can be monitored if a proper plan is devised in advance. The following points explain why financial planning is important.

Cash Flow: Financial planning helps in increasing cash flow as well as monitoring the spending pattern. The cash flow is increased by undertaking measures such as tax planning, prudent spending and careful budgeting.

Capital: A strong capital base can be built with the help of efficient financial planning. Thus, one can think about investments and thereby improve his financial position.

Income: It is possible to manage income effectively through planning. Managing income helps in segregating it into tax payments, other monthly expenditures and savings.

Family Security: Financial planning is necessary from the point of view of family security. The various policies available in the market serve the purpose of financially securing the family.

Investment: A proper financial plan that considers the income and expenditure of a person helps in choosing the right investment policy. It enables the person to reach the set goals.

DESCRIBE THE INFORMATION NEEDS OF DIFFERENT DECISION MAKERS.

Commonly used indicators such as the gross national product (GNP) and measurements of individual resource or pollution flows do not provide adequate indications of sustainability. Methods for assessing interactions between different sectoral environmental, demographic, social and developmental parameters are not sufficiently developed or applied. Indicators of sustainable development need to be developed to provide solid bases for decision-making at all levels and to contribute to a self-regulating sustainability of integrated environment and development systems.

(a) To achieve more cost-effective and relevant data collection and assessment by better identification of users, in both the public and private sectors, and of their information needs at the local, provincial, national and international levels;

(b) To strengthen local, provincial, national and international capacity to collect and use multicultural information in decision-making processes and to enhance capacities to collect and analyze data and information for decision-making, particularly in developing countries;

(c) To develop or strengthen local, provincial, national and international means of ensuring that planning for sustainable development in all sectors is based on timely, reliable and usable information;

(d) To make relevant information accessible in the form and at the time required to facilitate its use.

DESCRIBE THE IMPACT OF FINANCE ON THE FINANCIAL STATEMENTS.

Financial statements (or financial reports) are formal records of the financial activities of a business, person, or other entity.

All the relevant financial information of a business enterprise presented in a structured manner and in a form easy to understand, is called the financial statements. There are four basic financial statements:

Balance sheet: also referred to as statement of financial position or condition, reports on a company's assets, liabilities, and Ownership equity at a given point in time.

Income statement: also referred to as Profit and Loss statement (or a " P&L"), reports on a company's income, expenses, and profits over a period of time. Profit & Loss account provide information on the operation of the enterprise. These include sale and the various expenses incurred during the processing state.

Statement of retained earnings: explains the changes in a company's retained earnings over the reporting period.

Statement of cash flows: reports on a company’s cash flow activities, particularly its operating, investing and financing activities.

For large corporations, these statements are often complex and may include an extensive set of notes to the financial statements and management discussion and analysis. The notes typically describe each item on the balance sheet, income statement and cash flow statement in further detail. Notes to financial statements are considered an integral part of the financial statements.

Outcome:

By this module, I identify the costs of finance as a resource, how to make up a budget on the basis of given information and implication of failure to finance adequately.

P3 (FINANCIAL DECISIONS)

ANALYZE BUDGETS AND MAKE APPROPRIATE DECISIONS

How much unbudgeted downside risk you should manage

Worst-case scenario (given catastrophic losses) vs. regret

The value (and cost) of compliance with regulations (for example, SOX)

Real Options: The Value of Midcourse Corrections to Projects

One of the fundamental insights of modern financial theory is that options have value. The phrase “ We are out of options” is surely a sign of trouble. However, because corporations (and other organizations) make decisions in

a dynamic environment, they usually have midcourse options that should be considered in project valuations:

The Option to Abandon a project: Has value if return (or savings) turns out to be lower than expected

The Option to Expand a project: Has value if return (or savings) turns out to be higher than expected

The Option to Delay a project: Has value if the underlying variables are changing with a favorable trend

The Option to Outsource a project: Has value if internal resources don’t have required experience and expertise

In practice, companies sometimes have other choices. They can delay the decision until later, when more information is available. Or, they can call in outside help, even after having deciding not to do so at the outset. Such investment timing options can dramatically affect a project’s estimated mean NPV and risk. Projects that can easily be modified in these ways are more valuable than those that do not provide such flexibility. The more uncertain the outlook, the more valuable this flexibility becomes.

CALCULATE UNIT COSTS AND MAKE PRICING DECISIONS USING RELEVANT INFORMATION.

Defining Costs

There are several types of costs to consider when conducting a breakeven analysis, so here’s a refresher on the most relevant.

Fixed costs: These are costs that are the same regardless of how many items you sell. All start-up costs, such as rent, insurance and computers, are considered fixed costs since you have to make these outlays before you sell your first item.

Variable costs: These are recurring costs that you absorb with each unit you sell.

Setting a Price

This is critical to your breakeven analysis; you can't calculate likely revenues if you don't know what the unit price will be.

Psychology of Pricing: Pricing can involve a complicated decision-making process on the part of the consumer, and there is plenty of research on the marketing and psychology of how consumers perceive price. Take the time to review articles on pricing strategy and the psychology of pricing before choosing how to price your product or service.

Pricing Methods: There are several different schools of thought on how to treat price when conducting a breakeven analysis. It is a mix of quantitative and qualitative factors.

The formula: Don't worry, it's fairly simple. To conduct your breakeven analysis, take your fixed costs, divided by your price, minus your variable costs. As an equation, this is defined as:

Breakeven Point = Fixed Costs/(Unit Selling Price – Variable Costs)

This calculation will let you know how many units of a product you'll need to sell to break even.

Above the breakeven point, every additional unit sold increases profit by the amount of the unit contribution margin, which is defined as the amount each unit contributes to covering fixed costs and increasing profits. As an equation, this is defined as:

ASSESS THE VIABILITY OF A PROJECT USING INVESTMENT APPRAISAL TECHNIQUES.

Learning Outcome

Assessment Criteria

1. Understand the nature of accounting, accountability and stewardship within a business environment

Understand the nature and purpose of book-keeping and accounting and the difference between them.

Be able to:

Explain the difference between book-keeping, financial accounting and management accounting.

Identify different stakeholders and their interest in the financial position of the business.

Explain how accounting can be used for planning, decision making and control.

Be able to:

Identify and describe the fundamental accounting concepts of going concern, accruals, consistency, prudence and true and fair.

Identify the key elements of financial statements (income, expenses, assets, liabilities, capital) and describe their relationship using the accounting equation.

1. Understand the nature of accounting, accountability and stewardship within a business environment (continued)

Identify the main financial statements and explain how they are compiled (Profit and Loss Account, Balance Sheet and Cash Flow Statement).

Describe how financial accounts are regulated using accounting standards.

2. Understand how financial statements can be analysed and interpreted to judge the performance of a business

Understand how financial statements can be analysed and interpreted using ratio analysis so that stakeholders can judge the performance of a business.

Be able to:

Identify likely users of ratio analysis and explain how they might use the information.

Calculate and interpret profitability ratios (gross profit, net profit, ROCE, asset turnover).

Calculate and interpret liquidity ratios (current ratio, acid test ratio, debtor days, creditor days, stock turnover days).

Calculate and interpret investment ratios (gearing, interest cover, simple EPS)

Use ratio analysis to make comparisons between one business over time, two businesses or to compare results to industry standards.

Explain the benefits and limitations of ratio analysis.

3. Understand the importance of working capital maintenance (continued)

Explain how creditors can be used as a source of finance and identify the costs of trade credit.

Explain how the elements of working capital can be managed effectively to minimise borrowing and its associated costs.

Understand how a cash flow forecast can be used to predict and manage future working capital requirements.

Be able to:

Distinguish between ‘ cash’ and ‘ profit’.

Identify and understand the implications of non-cash accounting adjustments such as depreciation and provision for bad debts.

Prepare a simple cash flow forecast and identify periods of cash excess or cash shortage.

4. Identify and assess different sources of funding available for business

Understand that there are a range of sources of finance available for businesses and those different types of finance are suitable for different purposes.

5. Understand and distinguish between costs based on their behaviour

Understand that costs can be classified in different ways based on their behaviour.

Outcome:

By this module I able to understand the different investment appraisal techniques and nature of long-term decisions.

P4 (FINANCIAL PERFORMANCE)

EXPLAIN THE PURPOSE OF MAIN FINANCIAL STATEMENTS

The three main financial statements are:

The balance sheet-which reports a corporation’s assets, liabilities, and stockholders’ equity as of a point-in-time (e. g., as of midnight of December 31, 2009).

The income statement-which reports a corporation’s revenues and expenses for a period of time, such as a year, quarter, month, 52 weeks, 13 weeks, etc.

The statement of cash flows (or cash flow statement)-which provides information on the change in a corporation’s cash and cash equivalents during the same period of time as the income statement.

The financial statements that are distributed outside of a company need to be prepared in accordance with generally accepted accounting principles (GAAP). For example, the cost principle generally requires that the balance sheet should report long-lived assets at cost minus accumulated depreciation. The matching principle requires that the cost of long-lived assets used in the business be allocated to various accounting periods in which they generate revenues or are used up.

ANALYSES FINANCIAL STATEMENTS USING APPROPRIATE RATIONS AND COMPARISONS, BOTH INTERNAL AND EXTERNAL.

1. CURRENT RATIO OR WORKING CAPITAL RATIO:

Current ratio may be defined as the relationship between current assets and current liabilities it is also known as working capital ratio.

Current assets

CURRENT RATIO =

Current liabilities

Year ended

2007-08

2006-07

2005-06

2004-05

2003-04

Current assets(in crores)

913. 27

2333

1614

1171

913. 27

Current liabilities(in crores)

1479

994

475

336

213

Ratio

0. 62

2. 347

3. 397

3. 485

4. 132

Interpretation:

A current ratio of 2: 1 is usually considered as ideal.

If it is less than 2, then it means the company is not enjoying the adequate liquidity.

In past five years it shows a decline in the ratios.

2. QUICK RATIO:

Formula = Current Assets – Inventory – Prepaid Expenses

Current Liabilities

Interpretation:

A quick ratio of 1 is considered ideal.

In all the five years, it was above 1, where the funds can be properly employed.

LEVERAGE RATIOS

1. DEBT EQUITY RATIO:

Debt-equity ratio, also known as External-Internal ratio is calculated to measure the relative claims of outsiders and the owners (i. e., shareholders)

against the firm's assets. This ratio indicates the relationship between the external equities or the outsider's funds and the internal equities or the share holder's funds.

Interpretation:

A DEBT EQUITY RATIO OS 2: 1 IS IDEAL.

IN 2004-06 THERE IS NO DEBT EQUITY RATIO.

IN 2007 AN 2008 IT SHOWED A NEGLIGIBLE VALUE.

2. PROPRIETORY RATIO:

It is the ratio between shareholders equity and Total Assets.

Formula= Shareholders Equity

Total Assets

YEAR

SHAREHOLDERS EQUITY

TOTAL ASSETS

RATIO

2004

125. 34

1309

0. 095

2005

140. 71

1651

0. 085

2006

285. 15

2257

0. 126

2007

291. 80

3389

0. 086

2008

298. 65

3987

0. 074

Interpretation:

A higher the proprietary ratio the better it is

In all the five years it is less than one.

It shows weak financial position of the business.

3. INTEREST COVERAGE RATIO:

It is the ratio between EBIT and Interest

Formula = EBIT

Interest

YEAR

EBIT

INTEREST

RATIO

2004

355

–

–

2005

410

–

–

2006

499

1

499

2007

693

6

115. 5

2008

834

13

64. 15

Interpretation:

The higher interest coverage ratio the better it is.

In 2004 there is no interest coverage ratio.

In 2006, 2007 & 2008 it showed a heavy ration which indicates a greater safety of

Out come:

By this I understood the basis business and accounting terminology used and should be able to interpret the information collected from financial statements using ratio analysis and could draw conclusions from it.

CONCLUSIONS

By this module I understood the different long term and short term sources of finance with the implications of choice of one source over the other and any advantages and disadvantages of sources different sources of finance. By this module I identify the costs of finance as a resource, how to make up a budget on the basis of given information and implication of failure to finance adequately. By this module I able to understand the different investment appraisal techniques and nature of long-term decisions. By this I understood the basis business and accounting terminology used and should be able to interpret the information collected from financial statements using ratio analysis and could draw conclusions from it.