Advantages and disadvantages of payback method finance essay

ASSIGN BUSTER

Generally individuals analysis the world as consisting of a big digit of alternative. Futures studies evolve as a method of investigative the alternative futures and identify the majority possible.

There are some assumptions regarding forecasting:

1. There is no means to shape what the prospect resolve be among inclusive belief. In spite of the method that we utilize around willpower forever be an component of hesitation pending the predict possibility have move towards to go by.

2. There determination for all time be unsighted spots in forecasts. We cannot, for instance, calculate totally new technology for which there are no active paradigms.

3. Given that forecasts to policy-makers will assist them prepare social policy. The original common rule, in twist, will influence the outlook, thus shifting the correctness of the estimate.

Forecasting techniques:

Genius forecasting – This process is base on a grouping of instinct, nearby, and chance. Psychics and precious stone ball reader is the largely tremendous holder of intelligence forecasting. Their forecasts are base completely on instinct. Science narrative writers have now and then described innovative technologies with strange correctness. Majority science normally ignores this truth for the reason that the implication are basically too hard to recognize.

Trend extrapolation – These methods monitor trend and cycles in chronological facts, and then use numerical technique to extrapolate to the opportunity. The assertion of all these technique is that the forces dependable for create the past, will keep on running in the future. This is frequently a suitable statement when forecasting short term horizons, but it falls little when create average and extensive term forecasts.

Consensus methods – Forecasting complex organization frequently engage looking for expert estimation from supplementary than one person. Each is an expert in his own directive, and it is throughout the combination of this view that a last approximate is acquire.

Simulation methods – Simulation methods involve using analogy to model difficult systems. This analogy can take on numerous forms. A mechanical analogy might be a storm tunnel for modelling aircraft presentation. An equation to forecast an economic evaluate would be numerical analogy.

Mathematical analogy is of exacting consequence to futures investigated. They have been particularly winning in many forecasting applications, mainly in the substantial sciences. In the social sciences yet, their correctness is rather diminished. The unexpected difficulty of public systems makes it complicated to contain all the appropriate factors in any representation.

Decision trees – Decision trees initially known as graphical devices to assist demonstrate the structural associations among unusual kinds. These trees were formerly offered as a sequence of yes/no (dichotomous) choices. As our perceptive of response loops enhanced, resolution trees became more difficult. Their formation became the establishment of computer flow charts.

Computer technology has make it possible creating complex structured trees.

Combining Forecasts

It is clear that no forecasting technique is suitable in all circumstances. There is considerable verification to exhibit that combining character forecasts creates obtains in forecasting exactness. There is also substantiation that accumulation quantitative forecasts to qualitative forecasts diminish exactness. Research has not yet exposed the circumstances or methods for the best combinations of forecasts. Combining forecasts provide us with a way to reimburse for deficiencies in a forecasting method. By selecting balancing methods.

Difficulties in Forecasting Technology

To conclude above all it refers to this confrontation to alter as weakness, however, it may be greatly deeper. Cognitive difference of opinion presumption in psychology has helped us recognize that disagreement to alter is an ordinary individual attribute. It is exceptionally complex to course of action further than our latitudes of recognition in forecasting new technologies.

“ When a notable except mature scientist states that somewhat is likely, he is approximately definitely accurate. When he states that a little is not possible, he is exceptionally almost certainly incorrect.”

Revenue Forecast: Budget revenue forecast contain a exceptionally diverse exposure. Additional partly sampled countries the forecast accomplish not

widen clear of central government behavior. The scope of exposure is associated to a country's level of economic expansion with superior income countries in particular individuals in the western, having more inclusive communal sector exposure. These revenue forecasts comprise sub national governments and public enterprises. A few countries also comprise forecasts of the social security management.

A second aspect of forecast exposure is the time sphere. Nearly all urban countries contain shifted using requisite medium term forecast as a planning device. Similar imitative have been projected for small income countries. Two third of the sampled countries only generate one year forward anticipated still a large alternative produces medium term forecasts. This number possibly will, conversely exaggerate the predominance of medium term forecaster. Amongst counties through multiyear forecast, nearly all universal forecasting perspective is three years. High income in the sample utilize this additional normally.

The further part of the forecasting relates to within year forecasts. Valuable cash flow and debt management necessary thorough technical inside year forecast. In the bulk of countries, revenue forecasts are broken down into monthly targets. A somewhat more aggregated advance is used in 20% of the sample, which produces periodical forecasts. About two countries produce forecasts exclusively on yearly basis.

WORKING CAPITAL drift study

The working capital drift study represents a image of difference in current assets, current liabilities and working capital over a phase of point. Such an

study enables us to study upward and downward drift in current liabilities and its result on the working capital situation. The drift study is a means of monetary judgment anywhere the change in the factor are compare with the pedestal year supercilious the base year as 100.

In the current study a report – presenting drift of working capital as well as its arrangement has been made. It is it systematic and significant study since each section of working capital has got the link of causes and effects.

Subsequent chart below shows the formation and drift of working capital of Jaipur dairy ltd. during the time below re-examine.

STRUCTURE AND TREND OF WORKING CAPITAL OF JAIPUR DAIRY DURING 2005 TO2008

PERTICULAR

2005-2006

2006-2007

2007-2008

CURRENT ASSETS

CASH

322389. 24

855819. 51

836439. 2

BANK

18632795. 88

35936348. 16

27218462. 16

LOAN AND ADVANCES

71220809. 88

84836477. 65

77115112. 92

DEBTORS

300805197. 7

311027760. 6

356580000. 4

STOCK

377580243. 7

427327384. 8

465048573. 5

TOTAL (A)

768561436. 4

859983790. 7

926798588. 2

CURRENT LIABILITIES

CURRENT LIABILITIES AND PROVISIONS

526439722

512950750. 7

442009648. 8

TOTAL (B)

526439722

512950750. 7

442009648. 8

NET WORKING CAPITAL (A-B)

242121714. 4

347033040

484788939. 4

Task-2

Sources of Finance Available and various costs associated with obtaining the Finance:

A company might raise new funds from the following sources:

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

Differed 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.

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.

Rights issues

A rights issue provides a way of raising new share capital by means of an offer to existing shareholders, inviting them to subscribe cash for new shares in proportion to their existing holdings.

Preference shares

Preference shares have a fixed percentage dividend before any dividend is paid to the ordinary shareholders. As with ordinary shares a preference dividend can only be paid if sufficient distributable profits are available, although with ‘ cumulative’ preference shares the right to an unpaid dividend is carried forward to later years. The arrears of dividend on cumulative preference shares must be paid before any dividend is paid to the ordinary shareholders.

Loan stock

Loan stock is long-term debt capital raised by a company for which interest is paid, usually half yearly and at a fixed rate. Holders of loan stock are therefore long-term creditors of the company.

Debentures with a floating rate of interest

These are debentures for which the coupon rate of interest can be changed by the issuer, in accordance with changes in market rates of interest. They may be attractive to both lenders and borrowers when interest rates are volatile.

Security

Loan stock and debentures will often be secured. Security may take the form of either a fixed charge or a floating charge.

a) Fixed charge; Security would be related to a specific asset or group of assets, typically land and buildings. The company would be unable to

dispose of the asset without providing a substitute asset for security, or without the lender's consent.

b) Floating charge; With a floating charge on certain assets of the company (for example, stocks and debtors), the lender's security in the event of a default payment is whatever assets of the appropriate class the company then owns (provided that another lender does not have a prior charge on the assets). The company would be able, however, to dispose of its assets as it chose until a default took place.

The redemption of loan stock

Loan stock and debentures are usually redeemable. They are issued for a term of ten years or more, and perhaps 25 to 30 years. At the end of this period, they will " mature" and become redeemable (at par or possibly at a value above par).

Retained earnings

For any company, the amount of earnings retained within the business has a direct impact on the amount of dividends. Profit re-invested as retained earnings is profit that could have been paid as a dividend. 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:

Bank lending

Borrowings from banks are an important source of finance to companies. Bank lending is still mainly short term, although medium-term lending is quite common these days.

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.

Leasing

A lease is an agreement between two parties, the “ lessor” and the “ lessee”. The lessor owns a capital asset, but allows the lessee to use it. The lessee makes payments under the terms of the lease to the lessor, for a specified period of time.

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

c) The period of the lease is fairly short, less than the economic life of the asset, so that at the end of the lease agreement, the lessor can either

i) Lease the equipment to someone else, and obtain a good rent for it, or

ii) sell the equipment second-hand.

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.

Hire purchase

Hire purchase is a form of instalment credit. Hire purchase is similar to leasing, with the exception that ownership of the goods passes to the hire purchase customer on payment of the final credit instalment, whereas a lessee never becomes the owner of the goods.

Government assistance

The government provides finance to companies in cash grants and other forms of direct assistance, as part of its policy of helping to develop the national economy, especially in high technology industries and in areas of high unemployment. For example, the Indigenous Business Development Corporation of Zimbabwe (IBDC) was set up by the government to assist small indigenous businesses in that country.

Venture capital

Venture capital is money put into an enterprise which may all be lost if the enterprise fails. A businessman starting up a new business will invest venture capital of his own, but he will probably need extra funding from a source other than his own pocket. However, the term ‘ venture capital’ is more specifically associated with putting money, usually in return for an equity stake, into a new business, a management buy-out or a major expansion scheme.

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.

Task-3

Appraisal:

Appraisal means an approval of an export credit proposal of an exporter.

While appraising an export credit proposal as a commercial banker,

obligation to the following institutions or regulations needs to be adhered to.

Any investment decision involves risk, because it

Deals with the future

Firms are likely to have a number of alternatives to

Choose from

Investment appraisal techniques can help them to do

Choose the best option

Two techniques of Investment Appraisal:

Pay back method:

The simplest method of investment appraisal

This measures how quickly the returns from the

Investment covers the cost of the investment

The formula is as follows:

PAYBACK PERIOD= INVESTMENT REQURIED/NET ANNUAL CQASH FLOW

A firm will calculate the payback period of a project

If it is acceptable then the project will be undertaken

If there is more than one possible project, then the one

With the shortest payback period will be selected

Average Rate of Return Method:

This method measures the net return each year as a

Percentage of the initial cost of the investment

If the ARR is acceptable then the project will be

Undertaken

If there is more than one possible project, then the one

With the highest ARR will be selected

Formula:

((Return – Capital) / Capital) Ã- 100% = Rate of Return

Advantages of ARR:

It clearly shows the profitability of a project

It allows easy comparison between projects

The opportunity cost of investment can be taken into account

Disadvantages of ARR:

ARR method is more complex than Payback method

It does not consider the effects of inflation on the

Value of money over a time period.

Net Present Value Method:

The Net Present Value (NPV) is the primary Discounted Cash Flow technique enclosed here. It depends opportunity cost to set an assessment on cash inflows arising from capital investment. Opportunity cost is the estimation of what is sacrificed as an effect of a particular decision. The concept of present value as being the cash corresponding currently of a figure receivable at a presently date. To visualize, what a business might accomplish now with the cash sums it should wait some time to receive.

Formula:

The fact is that, if anybody receives cash he or she generally like to save it or put it in the bank to earn reasonable interest on it. Therefore, what a business sacrifices through waiting for earning cash is the interest lost on the sum that would have been saved.

NPV is a technique where cash inflows earned in future years are discounted back to their present value. It calculates by using a discount rate corresponding to the interest that would contain cash received on the sums.

Discounted Cash Flow Analysis:

Discounted cash flow method use to predict the attractiveness of an investment opportunity. This method uses future free cash flow prediction and discounts it to find present value, and it is used to evaluate the

opportunities of an investment. If the predicted value is higher than the cost then the investment proposal is appropriate to invest.

Formula:

Risk and Uncertainty:

The environment inside which investment proposals are undertaken is eternally changing. The predictions that are made for the profit and costs are frequently reliable upon sets of relatively undecided assumptions. However reasonable these assumptions might be it is obviously significant to differentiate involving two projects that say have the identical NPV but for which we have diverse degrees of assurance regarding fundamental assumptions.

Risk and uncertainty are consequently essential proportions of a project's attraction. practically we can differentiate between:

Risk-probabilities of outcome are know

Uncertainty- probabilities of outcome cannot be predicated

Concluding all possible Alternatives for communal and classified Sector:

Though there is requirement to reflect on the particular method, other alternative must be examined to make sure that the chosen appraisal is the best way of achieving desired goals. For instance, it is desirable to think about:

Substitute scale or standard of project.

Alternative operating methods.

Different types of appraisal.

In practice it is frequently simple not realistic to consider all options.

Task-4

Pay back method:

Pay back method is the simplest method of investment appraisal. It measures when the returns from the investment recover the cost of investment. It will calculate the payback period of the investment. If the project is acceptable then the it will be undertaken. If there is more than one appropriate investment appraisal then the shortest payback period will be selected.

Advantages of Payback method:

It is extremely simple

It is useful where technology changes rapidly

Cost of machinery is recovered before new model comes out.

Helps prevent cash flow problems since

Money will be recovered as quickly as possible

Disadvantages of Pay Back Method:

Cash earned after the payback method is ignored

It does not account for the real value of money

The Return on Capital Employed Method

The return on capital employed method (ROCE) is also known as the accounting rate of return method or the return on investment ROI method of appraising a capital project is to predict the accounting rate of return that the project must yield.

Formulas for calculating ROCE:

ROCE = Estimated average profits___ X100%

Estimated average investment

The others include

Estimated total profits x 100%

ROCE= Estimated initial investments

Advantages:

It is quick and simple calculation

It involves general concept of return percentage

It is found by non financial managers

It consider the whole project life

Disadvantages:

It depends on accounting profits. Accounting profits are subject to a number of different accounting treatments.

It is a virtual measure rather than an complete measure and consequently takes no account of the size of the investment

It takes no account of the lengths of projects or appraisal

The analysis shows the effective and efficient management of working capital by the Jaipur Dairy.

RATIO ANALYSIS OF WORKING CAPITAL

Trend analysis show the trend of current assets, current liabilities and working capital only. It do not look watchfully the contribution of each item of working capital in the trend, whereas, it can be done easily by ratio analysis. The ratio analysis of working capital can be used by management as a means of checking upon the effectiveness in working capital management of the company. Following ratio haven used to analysis and interpret working capital of Jaipur dairy ltd.

Current ratio

Quick ratio

Absolute ratio

Stock or inventory ratio

Working capital turnover ratio

CURRENTRATIO

Current ratio is one of the important ratios used in testing liquidity of a concern. this is a good measure of the ability of company to maintain solvency over a short run. This is computed by dividing the total current assets by the total current liabilities and is expressed as:

IDLE CURRENT RATIO: 2: 1

If this ratio is higher than standards than it is assumed

Very good short -term liquidity/solvency.

Excess stocks, bad debts and idle cash.

Under trading

If this ratio is lower than standards than it is assumed

Unsatisfactory short-term liquidity.

Shortage of stocks, less credit sales, shortage of cash.

Over trading

CURRENT RATIO OF JAIPUR DAIRY LTD. DURING 2005 TO 2008

YEAR

CURRENT ASSETS

CURRENT LIABILITIES

CURRENT RATIO

(A)

(B)

(C)

(B)/(C)

2005-2006

768561436. 4

526439722

1. 46

2006-2007

859983790. 7

512950750. 7

1. 68

2007-2008

926798588. 2

442009648. 8

2. 01

INFERENCE:-

This table reveals that current ratio has increased that is making improvements in its short term solvency. It is because of increase in current assets as compared to current liabilities. Still this is lower than standard current assets ratio that shows a little bit unsatisfactory liquidity position of the company.

The Current Ratio for the year 2007-2008 has taken the Value of 2. 01: 1, which is very satisfactory and as per the standard required (2: 1). The current ratio of 2. 01: 1 indicates, that for every Rs 1 of current liability the company Rs 2 of current assets, which indicates more liquidity and hence more amount of working capital.

QUICK RATIO

The solvency of a company is batter indicated by quick Ratio. The fundamental this Ratio is to enable the financial management of a company to ascertain that would happen

If current creditors press for immediate payment and either not

Possible to push up the sales of closing or it id sold, a heavy loss is likely to be suffered. This problem arises because closing stock is two steps away from the cash and their price more or less uncertain according to market demand.

The term quick assets include all current assets except inventories and prepaid expenses. It shows the relationship of quick assets and current liabilities. The Ratio is calculated as following:

An indicator of a company's short-term liquidity. The quick ratio measures a company's ability to meet its short-term obligations with its most liquid assets. The higher the quick ratio, the better the position of the company.

Also known as the " acid-test ratio" or the " quick assets ratio".

IDLE QUICK RATIO 1: 1

QUICK RATIO OF JAIPUR DAIRYLTD. DURING 2005 TO 2008

YEAR

QUICK ASSETS

CURRENT LIABILITIES

QUICK RATIO

(A)

(B)

(C)

(B)/(C)

2005-2006

390981192. 7

526439722

0. 74

2006-2007

432656405. 9

512950750. 7

0. 84

2007-2008

461750014. 7

442009648. 8

1. 04

INFERENCE:-

Although it is less idle ratio still it has increasing trend that shows dairy's improving condition of short term solvency of Jaipur dairy.

Quick ratio for the year 2007-08 is above the ideal standard. It is 1. 04: 1, which indicates that for every Re1 of current liability the company has Rs 1. 04 of current assets, hence the company is in sound position in terms of working capital position.

ABSOLUTE LIQUDITY RATIO

The absolute liquid ratio between absolute liquid assets and current liabilities is calculated by dividing the liquid assets and current liabilities. Expressed in formula, the ratio is:

Cash + Marketable Securities

= Absolute Liquidity Ratio

Current Liabilities

The term liquid assets include cash bank balance and marketable securities, if current liabilities are to pay at once, only balance of Cash and marketable securities will be utilized. Therefore, to measure the absolute liquidity of a business, this ratio is calculated.

IDLE RATIO: 0. 5: 1

The idea behind the norm id that if all creditors for demand for payment, at least 50% of their claim should be satisfied at once.

The table shown on the next page reflects the absolute liquidity ratio Jaipur Dairy Ltd.

ABSOLUTE LIQUIDITY RATIO OF JAIPUR DAIRYLTD. DURING 2005 TO 2008

YEAR	ABSOLUTE LIQUID ASSETS	CURRENT LIABILITIES	ABSOLUTE RATIO
(A)	(B)	(C)	(B)/(C)
2005-2006	18955185. 12	526439722	0. 04
2006-2007	36792167. 67		

512950750. 7

0. 07

2007-2008

28054901. 36

442009648. 8

0. 06

INFERENCE

This ratio is very below from idle ratio. It is making insecure creditors claim but it is getting increasing trend. It is needed to maintain this trend.

Ratios for all the above mentioned years right from 2005 up to 2008 are close to the standard. For year 2007-08, the ratio is well above the standard, which indicates the healthy picture of the company in terms of availability of working capital (quick assets) in order to meet current liabilities.

INVENTORY TURNOVER RATIO

Every firm has to maintain a certain level of inventory of finished goods so as to be able to meet the requirements of the business. But the level of inventory should neither to be high not to be low. It too high inventory means higher carrying cost and higher risk of stocks becoming obsolete whereas to low inventory may mean the loss of business opportunities. it is very essential to keep sufficient stock in business .

It is express in number of time. Stock turnover ratio or inventory turnover ratio indicates the no. of times the stock has been turned over during the period and evaluates the efficiency with which a firm an able to manage its inventory. This ratio indicates whether investment in stock is within proper limit or not.

HIGHER RATIO INDICATES:-

Stock is sold out fast.

Same volume of sales from less stock or more sales from

Same stock

Too high ratio shows stock outs or over trading.

Less working capital requirement.

LOWER RATIO REVEALS:-

Stock a sold out at a slow speed.

Same volume of sale for more stock or less sale from same stock.

More working capital requirement.

Too low ratio show obsolete stock or under trading.

Formula of stock turnover ratio:-

The ration is calculated by dividing the cost of goods sold by the amount of average stock at cost.

Inventory turnover Ratio =

Inventory turnover ratio measures the velocity of conversion of stock in to sales. Usually a high inventory turnover / stock velocity indicates efficient management of inventory because more frequently the stock are sold, the lesser amount of money is required to finance the inventory. Low inventory turnover ratio indicates inefficient management of inventory. in low inventory turnover implies over investment in inventories, the business, poor quality of goods, stock accumulation, accumulation of absolute and slow moving good and low profit as compared to total investment the inventory turnover ratio is also an index profitability where a high ratio signifies more profit ‘ a low ratio signifies low profit some time a high inventories.

INVENTORY TURNOVER RATIO OF JAIPUR DAIRY LTD. DURING 2005TO 2008

YEAR

COST OF GOOD SOLD

AVERAGE INVENTORY

INVENTORY TURNOVER(TIMES)

INVENTORY TURNOVER(DAYS)

(A)

(B)

(C)

(D) = (B)/(C)

(E)= 365/D

2005-2006

2955076031

377580243. 7

7. 83

46. 64

2006-2007

3501014350

427327384. 8

8. 19

44. 55

2007-2008

3995104641

465048573. 5

8. 59

42. 49

INFERENCE:-

As compared to year 2005-2006, in the year 2006-07, the inventory turnover increased to 8. 19 times. Similarly, in the year 2007-08 it increased to 8. 59 times, which indicates that the t