

# [Managing financial resources and decisions essay sample](https://assignbuster.com/managing-financial-resources-and-decisions-essay-sample/)

[Finance](https://assignbuster.com/essay-subjects/finance/)

It is more important to manage the available resources in an organization as resources are scare. No matter whether it is financial or non financial organizations must manage them effectively in order to get the maximum out come from it. Planning thus plays a vital role in this sense. More importantly organizations should plan for its financial resources in order to curtail additional costs and as well as to mitigate risks and uncertainties involved in it.

This report will brief about the given investment plan of “ JS & Co”, Feasibility of the given project using different project appraisal techniques, different financial sources available to the business, information needs of different decision makers and also a concise assessment on JS & CO’s forth coming five year’s performance using the details provided etc.

When preparing this report information was gathered through various sources in addition to class room reference materials such as internet, books etc, which are mentioned at the end of this report.

BRIEF OVER VIEW TO J SAINSBURY’S & CO

Sainsbury’s Supermarkets is the UK’s longest standing major food retailing chain, having opened its first store in 1869. The Sainsbury’s brand is built upon a heritage of providing customers with healthy, safe, fresh and tasty food. Quality and fair prices go hand-in-hand with a responsible approach to business. Sainsbury’s stores have a particular emphasis on fresh food and they strive to innovate continuously and improve products in line with customer needs.

They now serve over 18. 5 million customers a week and have a market share of around 16 per cent. Their large stores offer around 30, 000 products and offer complementary non-food products and services in many of their stores. Their TU clothing range is in its fifth year and has one million transactions per week. An internet-based home delivery shopping service is also available to nearly 90 per cent of UK households.

REPORT CONTENT

TASK 1

SOURCES OF FINANCE

1. 1 DIFFERENT SOURCES OF FINANCING AVAILABLE TO THE BUSINESS

A company may source money for a variety of reasons. There are varieties of forms where a company can source money. These sources may be either short term or long term and may available either internally or externally. As per the given scenario JS & Co can source money from both internal as well as external sources which can be either short term or long term which are mentioned below.

SHORT TERM SOURCES

Trade Credit

Credit Cards

Factoring

Over drafts

LONG TERM SOURCES

Bank Borrowings

Debentures

Retained Profits

New Share Issue

Preference Shares

Leasing Facilities

Venture Capital Companies

1. 2 IMPLICATIONS OF DIFFERENT SOURCES OF FINANCE

SHORT TERM SOURCES OF FINANCING

TRADE CREDITS

This is a period of time given to a business to pay for goods that they have received. I. e. According to the trade practices cash is not paid immediately for purchases. Thus the deferral payment represents a source of finance.

ADVANTAGES:

Flexible and almost spontaneous

No rigid rules, restrictions.

Formal documentation procedures not required therefore does not consume more time.

DISADVANTAGES:

Not suitable to finance large funding requirements.

Inability to meet due dates will result in paying additional cost as penalties or as interest.

CREDIT CARDS

A credit card is very much similar to trade credit. Many businesses have their own credit card. Company can make purchases using its credit card, and can pay for them after a particular period of time. Typically a one month period will be given to the credit card holder to pay the credit amount without any interest.

ADVANTAGES:

It is a useful way of managing expenses as if paid off in full within the stipulated period; it will not incur any cost to the credit card holder.

DISADVANTAGES:

Not suitable to finance large funding requirements, investment projects etc.

In ability to pay off in full will lead to incur penalty interests which are normally higher than the prevailing market interest rates on short term loans.

FACTORING

Sale of trade receivables to an external party called “ factor” that is willing to bear the credit risk associated with such trade credits purchased by it at a commission, and provides funds in advance of collection.

ADVANTAGES:

Useful to avoid immediate liquidity problems and cover up short term funding requirements

Ability of transferring the risk of bad debts associated with the trade credit.

DISADVANTAGES:

Inability to raise large amount of funds and depends on the amount of trade receivables available to the company.

OVER DRAFTS

Businesses will often have an arrangement with the bank whereby the bank will pay the extra money provided the business will pay them back in a fairly short period of time, with interest. An overdraft is a form of loan therefore.

ADVANTAGES:

Important to avoid short term liquidity problems in the business.

DISADVANTAGES:

1. The interest rate on an overdraft can be quite high, especially for small firms where the risk to the bank that they might not get their money back is greater.

2. Businesses are not allowed to exceed their overdraft limit.

LONG TERM SOURCES OF FINANCING

BANK BORROWINGS

Banks are an important source of longer term finance. Banks may lend sums over long periods of time. This time period for repayment may vary according to the amount of loan borrowed. Typically this grace period will extend from five years to 25 years.

ADVANTAGES:

Ideal to finance large investment projects or to satisfy large funding requirements.

DISADVANTAGES:

Cost of servicing the loan (paying the money and interest back) can be high. If interest rates rise then it can add an additional cost over its financial expenses.

Lack of flexibility as it is required to satisfy formal documentation procedures.

Rigid rules, regulations and conditions

DEBENTURES

This is a form of long term loan that can be taken out by a public limited company for a large sum and it will be paid back over several years.

ADVANTAGES:

Can be used to serve large and long term funding requirements.

Ability to pay the interest rate stipulated, irrespective of market interest rate variations.

DISADVANTAGES:

It may be required to keep securities.

May required paying a higher interest rate than that of the market interest rate in order to attract the investors.

RETAINED PROFITS

This is a source of finance that involves no implicit or explicit cost at all. Retained profits would only be available to a business that was already in existence. If the business had a successful trading year and made a profit after paying all its costs, it could use some of that profit to finance future activities. In the early stages of business growth, it may be necessary to put back a lot of the profits into the business.

ADVANTAGES:

No implicit or explicit cost at all.

DISADVANTAGES:

Company can utilize whatever the revenue reserves available to them. Therefore it’s a limited source of finance.

If the company had recorded losses over the past years there may not be enough retained profits for it to use.

NEW SHARE ISSUE

A share is a part ownership of a company. Shares relate to companies set up as private limited companies or public limited companies (PLCs). Especially the Public Limited Company’s has the ability to trade its shares to the general public and gather money. There fore this can be recognized as a way of raising large amount of funds at a comparatively a low cost.

ADVANTAGES:

For the business it is a relatively a cheap way of raising new funds.

Provide new funds for the expansion of the business, therefore more suitable for the companies which are seeking to grow.

Not required to declare dividends on the years in which the profits are poor. This may not be so in the case of such other funding sources as bank borrowings, debentures, and preference shares etc.

DISADVANTAGES:

Increase diluting the control of existing shareholders as it carries voting rights.

PREFERENCE SHARES

Shares which carries a fixed percentage of dividends and do not have voting rights, issued by a public limited company in order to finance its long term funding requirements.

ADVANTAGES:

As debentures preference shares too have the ability to pay the stipulated interest rate irrespective of market interest rate escalations.

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)

It is not secured against assets in the business.

DISADVANTAGES:

Issuing preference shares will lower the company’s gearing unless they are redeemable.

In order to attract to investors, as debentures it may require paying a higher interest rate than the market interest rate.

Cumulative preference shares are entitled to carry forward its unpaid dividend to later years.

LEASING FACILITIES

A lease effectively means that the business is paying for the use of a product but do not own it. It is also called ‘ hiring’.

A lease agreement on a van, for example, might mean that the firm pays out £350 per month for a three year lease. At the end of the three years the vehicle returns to the owner.

ADVANTAGES:

It can be cheaper to arrange a lease rather than having to buy equipment outright

Leases can be very flexible – equipment might only be needed for a short time or for a particular project and so does not warrant being bought outright.

The company that owns the equipment, machinery or vehicles is responsible for the maintenance and this can help reduce costs for the business.

The payments made are generally fixed and will not therefore change as interest rates change. This helps business plan more effectively.

DISADVANTAGES:

Under lease option businesses may not get the ownership of the assets.

VENTURE CAPITAL COMPANIES

Venture capital is becoming an increasingly important source of finance for growing companies. Venture capitalists are groups of (generally very wealthy) individuals or companies specifically set up to invest in developing companies. Venture capitalists are on the lookout for companies with potential. They are prepared to offer capital (money) to help the business grow. In return the venture capitalist gets some say in the running of the company as well as a share in the profits made.

ADVANTAGES:

Venture capitalists are often prepared to take on projects that might be seen as high risk which some banks might not want to get involved in.

DISADVANTAGES:

The advantages of this might be outweighed by the possibility of the business losing some of its independence in decision making.

1. 3 CHOOSING THE APPROPRIATE SOURCE OF FINANCE FOR THE BUSINESS

Therefore JS & Co source funds from,

Bank Loans

Debentures

Preference shares

Retained Profits

Venture Capital Companies

According to the requirement of the company it should select the best sources of finance that reduce the cost of financing. If the project involves more risk than it is vise to source funds through venture capital companies, In order to finance its proposed investment projects.

TASK 2

FINANCE AS A RESOURCE

2. 1 ASSESSING AND COMPARING THE COST OF SELECTED SOURCES OF FINANCE

Cost involved in above mentioned sources are as follows.

BANK LOANS

Cost involve in Bank borrowings is the interest rate.

The interest rates attached to the bank loans may vary according to the way in which the Bank of England sets interest rates. Cost of servicing the loan (paying the money and interest back) is high. If interest rates rise then it can add to a business’s costs and this has to be taken into account in the planning stage before the loan is taken out.

DEBENTURES

The cost involved in Debentures is also the interest rate.

Company may require issuing debentures at a higher interest rate than the market interest rate in order to attract investors.

PREFERENCE SHARES

The cost involved in preference stock is also the fixed percentage of dividend.

At the time of issuing Company may require issuing debentures at a higher interest rate than the market interest rate in order to attract investors.

Cumulative preference shares may require carrying forward its unpaid dividends to later years.

RETAINED PROFITS

No explicit or implicit cost when utilizing Retained Profits.

LEASING

Cost involves in obtaining a leasing facility too will be the interest.

This may be quiet high with comparison to prevailing market lending rates.

VENTURE CAPITAL COMPANIES

They are prepared to offer capital (money) to help the business grow. In return the venture capitalist gets some say in the running of the company as well as a share in the profits made.

May flow a part of company’s profits to the venture capital company.

2. 2 IMPORTANCE OF FINANCIAL PLANNING.

Many sources of financing are available to a company when seeking to fulfill its funding requirements. Some of them can be generated internally where as some of them to be obtained externally. Firm can fulfill its short term and as well as long term funding requirements from these sources. But the most important thing in this regard is to reduce the cost involved in financing. Thus the company should carry out a proper planning in order to determine the appropriate mix of financing.

IMPACT OF FINANCE ON FINANCIAL STATEMENTS

Obtaining finance through bank loans, debentures, leasing and as well as through venture capital and preference shares may increase the gearing of the company. (Gearing means the relationship between the long term liabilities that a business has and its capital employed.)

Issuing preference shares will reduce the company’s gearing. (Redeemable preference shares are normally treated as debt when gearing is calculated thus it increase the gearing).

It is required for the company to incur a huge cost as interest payments when obtaining funds from those sources. This will lead to reduce its retained reserves and as well as deteriorating its Earnings per Share (EPS) ratios too on which share holders and prospective investors are largely focusing on.

If the company source funds from short tem sources it will lead to increase short term liabilities and may result in reducing of working capital (Current Assets- Current Liabilities) available to the company which in terns creates liquidity problems.

According to the calculations we made it can be said that the company has the ability to grow rapidly and also the proposed investment project thus helps the company for its expansion as it generates positive cash inflows.

When compared with the industry records it can be said that the company may be one of the leading player in the industry as it reflects better performance over the industry records.

In order to maintain this position further company should carry out proper planning, especially when implementing proposed investment project to obtain funds from low cost financing sources.

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