Topic : Managing Financial Resources and Decisions

Paper Type : Coursework

Word Count : 3000 Words

Pages : 12 pages

Referencing Style : Harvard Referencing

Education Level: Graduation

Managing Financial Resources and Decisions

Student Name

Student ID Number

Course Code

Managing Financial Resources and Decisions

Task 2: Alpha Plc

For any company the cost of sources of finance have significant implications on the choice of a particular source of finance or a combination of more than one source. The choice affects the overall cash flows of the company and ultimately affects the profitability of the company (Drury, 2008). Considering the case of Alpha Plc. Finance director has recommended two sources of fiancé. First is a five year £ 12 million floating rate term loan from a clearing bank, at an initial interest rate of 10% and the second is rights issue at a discount of 15% on the current market price. The company's current share price is 180 pence. Each of these sources has different costs and implications on the company. For example the cost of the loan for the company is the same as its interest rate which is 10% initially and is expected to change subject to conditions in the agreement. This means that at the end of first year Alpha Plc. is expected to incur an interest expense amount of £ 1, 200, 000 which can be paid out of the expected profit before tax of £ 9, 680, 000 (25% increase in previous Profit before interest and taxation) without lowering the liquidity of the company.

On the other hand if Alpha Plc. chooses to issue rights issue the company will have to float 7843137 shares @ 153 pence per share. Assuming that the investors expects the same return of 25 pence per share (although investors are likely to have expectation of higher returns); ultimately the company will have to have sufficient profit after interest and taxation to meet the expectations. However, the calculations below show that the company will not have sufficient profit after interest and taxation to pay dividend amount.

					£
Share Price					1.8
Rights Price @ 15% discount					1.53
Number of Shares to be issued					7843137
Amount to be paid keeping the same dividend @ 25 pence per share					1960784
Income Available for ordinary shares after 1 year					£ 000
Expected Profit before interest and Taxation					9680
Interest Expense					1448
Profit after Interest					8232
taxation @ 25%					2058
Income Available for ordinary shares					6174

Thus pursuing the loan option is viable and profitable for Alpha Plc.

Information Needs of Decision Makers

The primary decision maker is the entrepreneur and thus the information needs of entrepreneurs are highest priority. The entrepreneur attempts to operate business with high profitability and uses a number of financial planning tools (explained in next section) to monitor the business health to maintain profitability and achieve sustainable growth. Another decision maker category comprising of investors also need information to decide whether to invest in a business and how much to inves. Their aim is to maximize their wealth therefore they also monitor the health of the business. Among others another significant group requiring information is the law enforcement agencies and tax authorities that need financial information to conduct their duties and ensure that business transactions and activities conducted are legal, ethical, and beneficial for the society as a whole (Brigham and Ehrhardt, 2013).

Financial Planning Tools

There are a number of financial planning tools used by various decision maker groups as mentioned in previous section. For example entrepreneurs use budgets to manage cash flows, investors use financial statements prepared by accountants to make their decisions, and government authorities conduct audits to gain information they need. All these are financial planning tools that are used by different groups of decision makers with different information needs as well as different interests in business activities. One of the most commonly used financial planning tool is the ratio analysis based on the financial information provided in the financial statements (Brigham and Daves, 2012). This tool offers a number of ratios that reflect profitability, liquidity, operational efficiency of a business during a financial period. Ratios for different periods of same company and ratios of different companies for the same period are usually computed to make comparison of the performance of a company. Based upon the evaluations derived from such tools decision makers formulate strategies for financial planning to achieve their individual aims and objectives and maintain interests regarding the business (Brigham and Ehrhardt, 2013).

Impact of Sources of Finance on Financial Statements

Sources of finance not only affect the profitability of the business but they also have impacts on various aspects of business most prominently the liquidity of the business. Similarly the options mentioned above also have different implications on the financial statements of Alpha Plc. The floated interest term loan will decrease the liquidity of the company because in case of liquidation the banker will preferred to be repaid before shareholders can recover their amount

making the rather unattractive for potential investors (Brigham and Daves, 2012). On the other hand if the Alpha decides to offer shares the equity side will increase causing a decrease in financial leverage as well as a decrease in return on equity. Such implications have significant impact on the investors' decisions therefore management needs to carefully examine their potential impacts while making decisions (Brigham and Ehrhardt, 2013).

Task 3.1 Sajid's Retail Outlet

Financial Budget for Retail Outlet				
	January	February	March	April
Opening Balance	50000	15,740	19,100	14,840
Inflows				
Cash from sales	11,340	20,160	21,840	23,360
Total	11,340	20,160	21,840	23,360
Outflows				
Purchases	1200	12100	13100	14100
Expenses	2,400	2,700	3,000	2,900
personal Drawings	2000	2000	2000	2000
Capital Expenditure	40000		8000	
Total	45600	16800	26100	19000
Net Cash Flow	15,740	19,100	14,840	19,200

Suggestions to Improve Budget

There are a number of opportunities that can be exploited by Sajid to improve cash budget of his retail outlet. For example Sajid is realising only 60% of the total sales that occur in any given month and the remaining 40% in next. If Sajid could improve the amount that he realises each month then extra cash is gained each month. There are a number of tactics that can be applied for example offering cash discounts, and sales promotion packages can be introduced to increase cash sales and discourage credit sales.

Sajid pays 90% of the purchase amount in the next month in which purchases occur. If Sajid could renegotiate and reduce the amount payable, for instance to 10% or less then it Sajid will have extra cash There are a number of tactics that can be used for example finding suppliers with minimum rates, optimising inventory levels, asking for discounts for cash purchases, etc. Sajid can also save cash by minimising expenses. Furthermore, Sajid could negotiate at later point in

time for instance next. A huge amount of 40,000 for Capital Expenditure is paid in January. Sajid could renegotiate with the vendors and make uniform and smaller payments.

Considering the drawings, Sajid withdraws 2,000 every month for personal use. It is recommended that Sajid primarily try to finance personal expenses without withdrawals, if that is impossible then Sajid must minimise cash withdrawals to maximise cash available. All the extra cash can be reinvested in healthy investment opportunities to earn more income for the business.

Task 3.2 X Ltd.

The unit price on option A Cost plus pricing method is

Option A cost Plus Pricing Strategy		
Total Cost		440000
Unit Cost		220
Mark-up		66
Price		286

The Unit Price of option B: Return on Capital Employed Pricing

Option B price based on Return on Capital Employed		
Required return/ Profit	25% of Capital Employed	250000
Total Cost	Fixed + Variable Costs	440000
Revenue	Profit + Total Cost	690000
Price	Revenue/ Volume	345

Manufacturers tend to set prices of their products by using Cost-plus pricing method. Cost plus pricing strategy enables the manufacturers to both direct and indirect costs that were incurred during the production while adding a desired percentage of mark-up in the total revenue. Thus cost plus pricing yields an optimal gross profit per sale. However, cost plus pricing strategy does not account marketing-oriented considerations and usually leads to following common problems (Guerreiro, Cornachione Jr, and Kassai, 2012).

- *Limits Differentiation*: A cost-plus pricing strategy does not addresses innovation put into product development
- *Lacks Market Orientation*: it also ignores marketability considerations
- *No Competitive Consideration*: it is entirely internal process oriented and ignores competitors' prices

- *Production Inconsistency*: production costs are mostly dynamic but the prices cannot be changed with same pace therefore there exists a functional problem

Considering the overall profitability company, the cost plus pricing policy is associated with following drawbacks (Bellamy and Benson, 2012).

- Prices are inflexible or have limited flexibility therefore the pricing strategy is inefficient and cannot accommodate changes due to changes in market
- Since the prices are not based on market research therefore management ignores conducting market research which can be used by competitors to gain competitive advantage
- The prices obtained from this strategy also ignore customers' affordability. Due to neglecting customers and their ability to pay for the products the product is likely to lose its market share

On the other hand ROCE addresses all these concerns rather efficiently as compared to cost plus pricing method. Considering the prices calculated above although the ROCE price is higher but it is more efficient and offers more flexibility as compared to its counterpart. Thus ROCE price is recommended.

Task 3.3 Axis Ltd

Investment Appraisal				
Net Present Value Method				
	Project 1		Project 2	
Year	Cash Flow	Present Value	Cash Flow	Present Value
0	-100,000	-100000	-60000	-60000
1	29000	26363.64	20000	18181.82
2	32000	26446.28	20000	16528.93
3	25000	18782.87	15000	11269.72
3	20000	15026.3	15000	11269.72
Net Present Value		-13380.9		-2749.81

Since Net Present Values of both projects are negative therefore it implies that none of the projects is beneficial for the company (Caglayan and Demir, 2014). It is recommended that Axis Ltd. should not invest in any of these projects.

Average Rate of Return Method		
	Project 1	Project 2
Year	Earnings	Earnings
1	29000	20000
2	32000	20000
3	25000	15000
3	20000	15000
Total	106000	70000
Average Return	35333.33	23333.33
Average Rate of Return	35.33%	38.89%

Considering the average rate of return method for comparison of two investment appraisal projects the decision maker must choose the project that offers higher rate of return (Brealey, 2012). In case of Axis Ltd. Project two offers higher average rate of return therefore project 2 should be selected.

Payback Method				
	Project 1		Project 2	
Year	Cash Flow	Cumulative	Cash Flow	Cumulative
0	-100,000	-100000	-60000	-60000
1	29000	-71000	20000	-40000
2	32000	-39000	20000	-20000
3	25000	-14000	15000	-5000
3	20000	6000	15000	10000

In Payback period method the management should choose the project which recovers the initial investment earlier than the other projects (*Ibid*). In case of project 1 and 2 of Axis Ltd. both projects recover initial investment at the end of year 3. However considering the initial investment required project 2 is lower and the amount recovered by Project 2 is higher it is recommended that Axis Ltd. should select Project 2 if it is using this method for appraisal of projects.

Final Recommendation

Both the average rate of return method and payback period method ignore the time value of money and thus NPV is the most suitable and practical method that should be used by Axis Ltd. Now the results of NPV method show that NPVs of both Project 1 and Project 2 are negative which indicate that none of the projects are viable for the company. Therefore this paper highly recommends that Axis Ltd. should not invest in any of these projects. Instead Axis Ltd. should either look for other projects and select the one which gives highest NPV or do not invest in any project and deposit it in a bank to earn prevailing interest in the market.

Task 4: Financial Statements

The actual result of a business is net profit or net loss. It is found out by preparing a Profit and Loss Account. So apparently, Trading Account may seem useless. Even then, a separate Trading Account is prepared due to the following advantages being derived from it. The maximum limit to Net Profit or Net Loss: Gross Profit or Gross Loss known by a Trading Account is the maximum limit up to which Net Profit may be obtained or Net Loss sustained. By proper management, a major portion of the Gross Profit may be retained as Net Profit and by a comparison of Gross Profits for some years; valuable confusions may be drawn for the progress of the business (Shah, 2013).

This statement is prepared to show the financial condition of a business as ageing concern on a certain date. The values of Assets shown in it are not adjusted according to the market condition. They may realise more or less than the amounts shown therein. Again, Provisions for Bad Debts, etc. do not agree with the real position. So the financial position shown by it is not real. It is document showing the approximate position of a business (Fridson and Alvarez, 2011).

Cash Flow Statement is issued as an important tool of Financial Statement analysis to the management. It helps the management to assess the ability of an enterprise to generate cash resources from its different activities and the needs of the enterprise to utilize those cash resources into its dj’1erent activities. Analysis of sources and application of cash for different activities of an enterprise enables its management to prepare the reliable cash flow projection for the future planning. Cash Flow Statement is very much useful for a short term planning of an enterprise (Brigham and Ehrhard, 2013). As Cash Flow Statement locates various Inflows and outflows of cash for different activities of a concern, the management of the concern can easily

assess the cash position of those activities and can also easily identify the stronger and weaker area of cash position of the different activities of the concern (Brigham and Houston, 2011).

Formats of Financial Statements

In the preparation of financial statements there are different formats used. Whatever formats used the results will be the same. There is no prescribed format for the preparation of the income statement. The company should select a method of presenting its expenses by either function or nature; this can either be as encouraged, on the face of the income statement, or in the notes. There are accounting standards such as IFRS (International Financial Reporting Standards) and GAAP (Generally Accepted Accounting Principles) which are practices that are accepted globally (Shah, 2013).

Different types of businesses use different formats. For example; a sole trader would prepare simple profit and loss account compared to a public limited liability company which will have to prepare based on IFRS or CAAP. When financial statements are not prepared based on standards it's difficult to compare with other organisations. Some businesses prepare a single step income statement format where all expenses classified by function and are deducted from total income to give income before tax. The other is a multi-step format where cost of sales is deducted from sales to show gross profit, and other income and expense are presented to give income before tax. The difference between these two formats is that the single format does not show the margins while the multi-step format gives the margin by classifying what is direct cost and indirect cost. These classifications are important in making good financial decisions. The single step format leads to low quality accounting information (Brigham and Daves, 2012).

Research Design and Analyses for Psychology Quantitative Coursework Assignment

Ratio Analysis

Ratios	Formulae	A plc	B plc
A - Liquidity Ratios			
1) Current Ratio	*Current Assets / Current Liabilities*	2.02	2.79
2) Cash Ratio	*(Cash + Cash Equivalents + Invested Funds) / Current Liabilities*	0.20	0.31
B - Gearing Ratios			
1) Debt-to-Equity Ratio	*Total Debt / Total Equity*	0.89	0.62
2) Debt Ratio	*Total Debt / Total Assets*	0.41	0.45
C - Investment Ratio			
1) Price-to-Earnings Ratio	*Share Price per share / Earnings per share*	22.42	19.12
2) Price-to-Sales Ratio	*Share Price per share / Sales per share*	1.52	1.12

Interpretation

Current ratio shows the ability of the company to meet its liabilities using its current assets (De Franco, *et al.*, 2011). The ratios of both A Plc. and B Plc. are ideal level. They show that after paying off the current liabilities out of current assets both companies still have half of current ratios left. This is very attractive for potential investors and credit ratings of both companies. The cash ratio shows how much of the current liabilities can be paid off by using available cash in the business. A Plc. can pay 20% of the current liabilities whereas B Plc. can pay off 30%. This implies that B Plc. has a better cash ratio. Higher ratios are favourable for both shareholders because of better chances of recovering their investments.

The gearing ratios show how much of the company's activities are financed by owners' equity as compared to external debt. This is called leverage of the company. Higher leverage is unfavourable for the company. Investors are more attracted to firms with lower ratios because lenders are preferred in case of liquidation leaving less for investors to recover for their investments (Brigham and Houston, 2011). The debt to equity ratio of B Plc. is better than A Plc.

while Debt ration of A Plc. is better than B Plc. However for an investor both companies have almost same leverage and the difference between the two is negligible.

The investment ratios of a company show attractiveness of a company for investors. For example the P/E ratio shows how much are the investors earning out of every pound invested in the company. While the price to earnings ratio shows how much sales are being generated out of every pound being invested in the company (Zimmerman, J. L., & Yahya-Zadeh, 2011). Comparing the P/E ratio of A Plc. and B Plc. it is inferred that A Plc. offers higher earnings out of every £1 invested as compared to B plc. Furthermore, A Plc. is generating more revenue out of every £1 invested as compared to B plc. This shows that an investor is likely to choose A Plc. over B Plc.

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