

Effective Financial Planning



Matching

Definitions	Terms
Represented by the difference between Current Assets - Current Liabilities. It is essentially a firm's short term assets which aren't committed to creditors.	Working Capital
A source of short-term debt financing where a bank allows a firm's bank balance to go into a negative amount.	Overdraft
A situation where one company (lessor) purchases a product, and then leases it to another (the lessee) for a fee per period	Leasing
Where a company sells its accounts receivable to another party at a discount to face value, and in return receives the amount owed straight away whilst the other party collects the receivables as they are paid.	Factoring
The levels of stock that the business presently holds which it intends to sell in future.	Inventories
When a company is experiencing problems maintaining an adequate level of working capital, it can increase its cash levels by selling off a non-current asset to another party and then having the purchaser lease the item to the business.	Sale and Lease Back
Costs which do not change with the amount of output; they remain level at all times.	Fixed Costs
These costs depend on how much output the business produces. Examples include wages, machinery maintenance costs as well as cost of inputs.	Variable Costs
A means of making staff accountable for the company's expenses. Specific sectors or employees of a company are given set budgets within which to perform their operations.	Cost Centres
The composition of the products a company sells to its customers.	Sales Mix

True or False

- | | | |
|----------|----------|-----------|
| 1. True | 5. False | 9. False |
| 2. False | 6. True | 10. False |
| 3. True | 7. True | |
| 4. False | 8. False | |

Multiple Choice

- | | | |
|----|---|---|
| 1 | C | Working capital ratio |
| 2 | C | Working capital ratio |
| 3 | D | Ethical and legal aspects |
| 4 | A | Control of current assets |
| 5 | C | Control of current assets |
| 6 | D | Effective cash flow management |
| 7 | B | Control of current liabilities |
| 8 | C | Strategies for managing working capital |
| 9 | B | Strategies for managing working capital |
| 10 | C | Effective cash flow management |
| 11 | A | Ethical and legal aspects |
| 12 | D | Effective cash flow management |
| 13 | D | Effective profitability management |
| 14 | C | Effective profitability management |
| 15 | A | Effective profitability management |

Short Answer Questions**Question 1**

- (a) Working Capital Ratio = Current Assets / Current Liabilities = $33514 / 35169 = 0.95:1$
- (b) (i) There would be a decrease in cash of \$6000, and thus current assets would fall \$6000. Subsequently, there would be a fall in the working capital ratio to $(33514-6000) / 35169 = 0.78:1$
- (ii) There would be an increase in cash of \$5000, hence the working capital ratio would increase to $(33514 + 5000) / 35169 = 1.095:1$
- (iii) Accounts payable would fall by \$6000, and working capital would increase to $33514 / (35169 - 6000) = 1.15:1$ More information is required: if the accounts payable is paid in cash, this will affect working capital.

- (c) One of either:
- Terrific Toys can enter into a sale and lease back agreement to sell furniture it owns in order to boost cash levels
 - Terrific Toys can factor its accounts receivable in order to raise cash levels. Whilst this will have minimal effect on the actual working capital ratio, it will improve the firm's short-term financial situation.
 - Terrific Toys can obtain further assets via leases rather than purchasing with cash or borrowings. This will worsen the working capital ratio, but to a far smaller level than if cash or borrowings was used.

Question 2

- (a) The cash flow statement outlines the cash inflows and outflows of a company over a financial period. It hence reflects a firm's short-term solvency and liquidity. It is also used to prepare cash flow budgets which determine if the company will have sufficient working capital to meet future debt payments.
- (b) Either:
- A deteriorating level of cash sales from 132,000 to 112,000. This means that the company has a diminished ability to pay those who it owes money to.
 - A decreased level of payment from debtors. This means that the money it is owed is being repaid at a slowing rate and will hence reduce the level of cash the firm has on hand.
 - Increases costs of employing staff and paying for inputs. This further diminishes the company's cash levels.
- (c) Any two of:
- Discounts for early repayments of receivables. Providing an increased incentive for debtors who pay earlier will improve the 'payments from debtors' figure.
 - Changing credit terms: if the company reduces the amount of days within which it expects payment of debt, it will have a greater ability to predict when payments will be made in future.
 - Deferring payment of accounts payable as late as is feasible. This will increase the amount of cash on hand at any one time and minimise the firm's problems with paying employees and suppliers.

Question 3

- (a) ▫ Sharp's sales revenue has fallen significantly from 98,145 to 76,754.
 ▫ Its rent and electricity expenses have each almost doubled.
- (b) Fixed costs are those which do not vary with the level of a business's productive output. An example would be rent. Variable costs however are connected with the amount of output the firm produces. Electricity would be an example of a variable cost.

(c) Cost Control Strategy:

- Expense Minimisation: Sharp should try to minimise both its fixed and variable costs. Given that rent is higher yet revenue is lower, it should consider moving to premises which are cheaper to rent. It could reduce variable costs by trying to reduce electricity usage, especially when used by employees for non-essential purposes.
OR
- Cost Centres: The company should establish cost budgets for particular sectors or employees called 'cost centres' which will make them more accountable for the costs they incur and hence dissuade inefficient expenditure.

Revenue Control:

- Sales Objectives: The company should establish sales objectives which offer a clear target that is easily quantifiable. This will provide staff with a goal to strive for and maximise revenue.
OR
- Sales Mix: Sharp should change its sales mix so that it maximises revenue. This can be attained via either specialising in the products which it holds a competitive advantage in or diversifying the range significantly to reduce risk
OR
- Changing pricing policy: Raising prices may increase the firm's short terms cash levels. On the other hand, lowering prices will allow for greater market share and long-term income at the expense of short term cash inflows. Both should lead to improved cash revenues.