

Financial Aspects 1

Profit and Loss

Profit and loss account *for the year ended 31 August 2009*

	<i>Note</i>	Year ended 31 August 2009 £000	18 month period ended 31 August 2009 £000
Turnover from continuing operations	2	38,574	60,890
Cost of sales		(28,588)	(50,035)
Gross profit		9,986	10,855
Distribution costs		(904)	(1,773)
Administrative expenses		(6,158)	(9,086)
Operating profit/(loss) from continuing operations		2,924	(4)
Interest receivable	6	19	61
Interest payable	7	(281)	(1,056)
Profit/(loss) on ordinary activities before taxation	2-7	2,662	(999)
Tax on profit/(loss) on ordinary activities	8	(568)	705
Profit/(loss) on ordinary activities after taxation		2,094	(294)

The company has no recognised gains or losses other than those reported above and therefore no statement of total recognised gains and losses has been presented.

Balance Sheet

Balance sheet at 31 August 2009

	<i>Note</i>	2009 £000	2008 £000
Fixed assets			
Tangible assets	9	4,148	4,620
Current assets			
Stocks	10	2,848	3,698
Debtors	11	11,555	10,545
Creditors: amounts falling due within one year	12	14,403 (11,852)	14,243 (13,370)
Net current assets		2,551	873
Total assets less current liabilities		6,699	5,493
Creditors: amounts falling due after more than one year	13	(2,861)	(3,856)
Provisions for liabilities and charges	14	(107)	-
Net assets		3,731	1,637
Capital and reserves			
Called up share capital	15	70	70
Capital redemption reserve	16	30	30
Profit and loss account	16	3,631	1,537
Shareholder's funds		3,731	1,637

Balance Sheet

- A snapshot in time
- Lets the managers know how much money is available
- What can you tell from this sheet?

Balance Sheet

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Balance Sheet

- Debtors, companies that owe money have increased
- Creditors, companies that are owed money have decreased
- 2009 is a healthier year than 2008

But note the wording....

- Creditors: amounts falling due within one year
- Debtors: amounts falling dues after more than one year
- Money coming in now is critical to the business since this is the flow of cash that keeps it going
- Money due out a year from now is important but not so critical to cash flow
- But money due out a year from now can impact upon future strategies.....

P&L and Balance Sheet

- The P&L sheet tells the story of a period of time, typically 1 year but it can be less.
- The profit and loss account for a particular period will show the total revenue generated less the total expenditure before taxation.
- The difference between these two figures is called 'gross profit', which then becomes 'net profit' after taxation and interest are deducted.

P&L and Balance Sheet

- The balance sheet, however, is merely a snapshot of the business at a point in time
- Showing to that point in time the financial status of the business, including cash in out.

WORKING CAPITAL

- Working capital is a financial metric which represents the operating liquidity available to a business.
- Along with fixed assets such as plant and equipment, working capital is considered a part of operating capital.
- It is calculated as current assets minus current liabilities.

WORKING CAPITAL

- If current assets are less than current liabilities, a business has a working capital deficiency or deficit – in essence, there is less coming in than going out.

WORKING CAPITAL

- Net working capital is working capital minus cash (which is a current asset) and minus interest-bearing liabilities (ie short-term debt).

WORKING CAPITAL

- The formula for establishing working capital is
 - current assets (cash in the bank) less
 - current liabilities (payments due to be made from the business operating account).

Credit Terms

- Credit terms for different customers need to be taken into account, as one customer may not pay for 60 days, but another may pay in 14 days.
- Likewise, the business may choose not to pay their suppliers' invoices for 90 days, using "trade credit" to help fund the operation

Credit Terms

- For the typical logistics company credit terms are 14 or 30 days
- Initially, all new customers should be researched and checked for their credit rating history (a number of companies in the UK provide credit checking services such as Credit Safe and Risk Disk)

Credit Terms

- As with a personal credit rating that can be checked with Experian or Equifax, a company's credit score will be visible through the service providers mentioned above
- The credit report will contain details of the company's directors and the trading history of the business

Credit Terms

- The trading history will contain details of the company's accounts, full profit and loss accounts, together with the level of share capital and company worth
- Each of the credit companies will score the business based on this and issue an industry-standard credit rating for the business
- The credit manager can then choose whether to issue a standard credit limit advised by the credit companies or to take a different course of action

Credit Terms

- If the company issues a credit limit over the recommended amount, then they are taking on additional risk
- This could be a problem if their new customer has financial difficulties and cannot pay their bills.
- Usually, companies either issue the advised amount or go slightly under this until the customer has established a successful business relationship and demonstrated that they pay their invoices on time.
- Once a customer has proved that they can adhere to the credit terms set out by their supplier, this places the customer in a more favourable position to negotiate better credit terms.

Credit Terms

- An extension from 30 days to 60 or 90 days is quite possible.
- The term 'net monthly' means that if an invoice is raised in the middle of the month, the customer doesn't have to pay this until the end of the following month
- So depending on the time the invoice is raised the customer may gain up to two months credit.

Credit Terms

- Credit terms, however, should not be viewed as a process that constrains the business from acquiring new customers and slowing its growth.
- Credit terms are essential to ensure that the goods or services provided and invoiced are actually paid for by the customer, and the risk of very late or non-payment is reduced or minimised.

Credit Terms

- Credit terms can be an important strategic weapon
- A competitor might offer better credit terms
- The company then has to decide whether to match these and define the level of risk it is prepared to accept

Finance Task 1 - Groupwork

- Liaise with your finance team and establish how your business manages its cash flow, together with the relationships developed with suppliers and customers that make this happen.
- Find out:
 - The typical credit terms offered, ie 30 days, 60 days, more?
 - The terms offered to preferred customers
 - What considerations are made when assessing a customer credit score (this may be confidential for any one customer but general terms are what is sought here)
- Prepare a Powerpoint presentation for next week to be delivered as a group. The presentation will be the assessment for this part of the Finance element. The Powerpoint file should be uploaded into Moodle.

Risk

Risk Impact

- *Risk = probability of event x cost of event*

Or

- *Risk = probability of event x likelihood of event*

Identify Threats:

- **Human** - from individuals or organizations, illness, death, etc.
- **Operational** - from disruption to supplies and operations, loss of access to essential assets, failures in distribution, etc.
- **Reputational** - from loss of business partner or employee confidence, or damage to reputation in the market.
- **Procedural** - from failures of accountability, internal systems and controls, organization, fraud, etc.
- **Project** - risks of cost over-runs, jobs taking too long, of insufficient product or service quality, etc.
- **Financial** - from business failure, stock market, interest rates, unemployment, etc.
- **Technical** - from advances in technology, technical failure, etc.
- **Natural** - threats from weather, natural disaster, accident, disease, etc.
- **Political** - from changes in tax regimes, public opinion, government policy, foreign influence, etc.
- **Others** - Porter's Five Forces analysis may help you identify other risks.

Porter's 5 Forces

Porter's Five Forces

Threat of New Entry:

- Time and cost of entry
- Specialist knowledge
- Economies of scale
- Cost advantages
- Technology protection
- Barriers to entry
- etc.

Threat of
New
Entry

Competitive Rivalry:

- Number of competitors
- Quality differences
- Other differences
- Switching costs
- Customer loyalty
- Costs of leaving market
- etc.

Supplier
Power

Competitive
Rivalry

Buyer
Power

Supplier Power:

- Number of suppliers
- Size of suppliers
- Uniqueness of service
- Your ability to substitute
- Cost of changing
- etc.

Threat of Substitution:

- Substitute performance
- Cost of change

Threat of
Substitution

Buyer Power:

- Number of customers
- Size of each order
- Differences between competitors
- Price sensitivity
- Ability to substitute
- Cost of changing
- etc.

Strategies for dealing with risks

- *risk avoidance*
 - for example, where costs outweigh benefits, you may decide to refuse a contract;
- *risk reduction*
 - for example, regular reviews can reduce the likelihood of an end-product being unacceptable;
- *risk protection*
 - for example, taking out insurance against particular eventualities;
- *risk management*
 - for example, making use of written agreements in areas of potential disagreement;
- *risk transfer*
 - passing the responsibility for a difficult task to another organisation with more experience in that field.

Risk Impact Grid

Severity	5	5	10	15	20	25
	4	4	8	12	16	20
	3	3	6	9	12	15
	2	2	4	6	8	10
	1	1	2	3	4	5
		1	2	3	4	5
		Likelihood				

High

Medium

Low

Risk Rating

Risk Event Probability	Interpretation	Rating
> 0 - <= 0.05	Extremely sure not to occur	Low
> 0.05 - <= 0.15	Almost sure not to occur	Low
> 0.15 - <= 0.25	Not likely to occur	Low
> 0.25 - <= 0.35	Not very likely to occur	Low
> 0.35 - <= 0.45	Somewhat less than an even chance	Medium
> 0.45 - <= 0.55	An even chance to occur	Medium
> 0.55 - <= 0.65	Somewhat greater than an even chance	Medium
> 0.65 - <= 0.75	Likely to occur	High
> 0.75 - <= 0.85	Very likely to occur	High
> 0.85 - <= 0.95	Almost sure to occur	High
> 0.95 - < 1	Extremely sure to occur	High

Probability Table

Severity/Impact	1.00	.00	.05	.10	.15	.20	.25	.30	.35	.40	.45	.50	.55	.60	1.00
	.95	.00	.05	.10	.14	.19	.24	.29	.33	.38	.43	.48	.52	.57	.95
	.85	.00	.04	.09	.13	.17	.21	.26	.30	.34	.38	.43	.47	.51	.85
	.75	.00	.04	.08	.11	.15	.19	.23	.26	.30	.34	.38	.41	.45	.75
	.65	.00	.03	.07	.10	.13	.16	.20	.23	.26	.29	.33	.36	.39	.65
	.55	.00	.03	.06	.08	.11	.14	.17	.19	.22	.25	.28	.30	.33	.55
	.45	.00	.02	.05	.07	.09	.11	.14	.16	.18	.20	.23	.25	.27	.45
	.35	.00	.02	.04	.05	.07	.09	.11	.12	.14	.16	.18	.19	.21	.35
	.25	.00	.01	.03	.04	.05	.06	.08	.09	.10	.11	.13	.14	.15	.25
	.15	.00	.01	.02	.02	.03	.04	.05	.05	.06	.07	.08	.08	.09	.15
	.05	.00	.00	.01	.01	.01	.01	.02	.02	.02	.02	.03	.03	.03	.05
	.00	.00	.00	.00	.00	.00	.00	.00	.00	.00	.00	.00	.00	.00	.00
		.00	.05	.10	.15	.20	.25	.30	.35	.40	.45	.50	.55	.60	1.00
Likelihood															

Risk Impact Grid

IMPACT	Extreme					
	Very High					
	Medium					
	Low					
	Negligible					
		Rare	Unlikely	Possible	Likely	Almost Certain

LIKELIHOOD

Groupwork

- Identify an event that poses a number of risks to your company
- Estimate the probability of Likelihood of each risk happening and the Severity of the impact if it does
- Draw your conclusions together by averaging the probabilities and estimate the overall impact of the event