Answer on question #41311 - Management - Other

For each of the following situations, explain what the most suitable source of finance is:

(i) A company with a cash flow problem that is having difficulty collecting its debts.

(ii) A successful sole trader wishing to expand quickly.

(iii) A private limited company wishing to modernize its fleet of cars.

Explanation:

In a market economy between enterprises constantly committed sales transactions regarding the purchase of tools and objects of labor, sales of products (works, services) with the funds. In addition, calculations are carried out with the budget, banks, insurance agencies various public organizations, charities directly with employees and other possible calculations arising between enterprises.

Cash flow is abstracted from its economic content of a series of numbers consisting of a sequence of received or paid money distributed in time. Underlying cash flow management is the concept of monetary circulation. Money is converted into inventories, receivables and cash back, closing the cycle of movement in working capital of the organization. When cash flow is reduced or completely overlaps, there is a phenomenon of insolvency. Lack of funds, the company can feel even if it formally remains profitable (eg, timing of payments violated the firm's clients. Cash flow is the difference between the benefits and costs of the subject of the economy (usually it is a company), expressed as the difference between the received and payments made. In general, the sum of retained earnings and depreciation saves for formation of the source of funds for the future renewal of fixed capital.

Financial well-being of the enterprise depends largely on cash flow, providing cover its liabilities. Lack minimally necessary supply of funds may indicate financial difficulties like it is note in our case. To analyze financial flows we must use the Statement of Cash Flows. The constituent part of the statement of cash flows is the intake and outflow of cash in the context of the current, investing and financing activities of the firm. Cash flow analysis can detect unbalanced cash flows, resulting in an imbalance, namely the excess outgoing cash flow of the incoming.

The evidence of Cash Flow problems is a late payment or non-payment of supplier invoices, direct debits being dishonored, late payment of taxes and employee superannuation, even worse being late payment of wages to staff.

The select method to control flow depends on the duration of the imbalance, that is, short or long term. If there was an imbalance in the short term, the most commonly used method «leads and lags». The essence of this method lies in the development of appropriate measures for additional fundraising, an increase in incoming cash flow and delay or reduces payments to businesses outgoing cash flow.

Increase of incoming cash flow of the enterprise in the short term can be achieved by:

1. Using prepaid for all or most of its products, which has increased demand;

2. Shortening providing commodity (commercial) loan products to buyers;

3. Increasing the size of price discounts to sales, which has high demand;

4. Using modern forms of refinancing outstanding receivables - accounting bills, factoring, forfeiting;

5. Individual work with each debtor to accelerate the receipt of funds;

6. Using short-term credits and loans.

In order to slow disbursement in the short-term in practice we apply the following activities:

- increase in terms of (in coordination with suppliers) commodity (commercial) credit;
- slowing own collection of payments ;
- restructuring of short-term debt by transferring them into long-term debt;
- postponement of payments to the budget and extra budgetary funds;
- decrease the amount of payments due to the improvement of internal and external financial policy of the company , aimed at cost savings.

The long-term increase of the incoming cash flow can be achieved by:

- increasing the size of equity;
- additional financial loans and advances;
- sale of the assets to increase the amount of funds in circulation ;
- sale of the property, primarily fixed assets, or renting them if they are not sufficiently efficient use;
- increase sales of goods or services;
- diversification activities.

Reduce the volume of outgoing cash flow in the long term can be due to:

- restrictions on the acquisition of fixed assets, which do not provide a significant increase in incoming cash flow over the long term;
- reductions in investment;
- reduce the cost of acquisition of tangible current assets;
- optimization of transport and storage costs;
- redundancies while increasing productivity;
- prevention and reduction of production costs.

Furthermore, in the management of cash flows of the enterprise is very important to ensure their balance over time. We can use two basic methods: alignment and synchronization.

Alignment cash flows aimed at regulating their volumes by separate periods that eliminates seasonal and cyclical fluctuations in the formation of the incoming and outgoing cash flows. Synchronization of cash flows of the enterprise (budgeting income and expenses) is aimed at providing a clear correlation between incoming and outgoing cash flows. As a result, regulation of cash flows of the enterprises is prerequisite to maximize the net cash flow.

The cash flow management requires more than just a financial fix. It requires a holistic approach that focuses on making a company's entire supply chain operate more efficiently. After all, the faster goods move from seller to buyer, the faster sellers can be paid.

Solving cash flow problems requires the attention not only if the CFO but also of the logistics manager, the purchasing department, operations, the tech personal and even the CEO. And while working with a bank to open a line of credit or amending an existing financial instrument can certainly help, the only real way to address a cash flow problem is to take a holistic, long-term view of the issue.

As methods to improve cash flow should provide the following. Holding company the customer credit checks. Perform credit checks on all new and non-cash customers. This process can immediately reduce bad debt, since company will stop offering credit to customers who haven't proved they deserve it. Offering term discounts to encourage customers to pay on time, consider offering term discounts. Next is to ask customers to pay by cash or credit card. Rather than sell on term payments, sell on cash or credit card payments. Once company got the cash in hand, deposit the funds immediately.

Today's business environment pretty much mandates that small companies go global. But conducting business with trading partners overseas can be risky. Credit insurance can help mitigate the risks by protecting the value of company's receivables. Credit insurance can be used on a case with new customers whose payment Histories Company's unfamiliar with.

In conclusion, to be successful at cash flow management is to make sure all three flows of commerce--goods, information and funds--are working together to accelerate the movement of money through your supply chain

(ii) A successful sole trader wishing to expand quickly.

The sole trader has multiple options for extending his finances and preventing dilution of ownership while continuing to fulfill his financial needs. It should be note the sole trader carry unlimited personal liability for any losses and he is personally liable for any business related obligations such as debts. The sole trader may utilize his personal capital, retained profits, sale of assets, sale and lease back, loans or credit lines from banks and hire purchase. However, the sole trader must understand that an expanding business will have to eventually agree to dilute ownership since these strategies are only delay tactics.

To determine the most appropriate source of funding is necessary to review the types of business financing, analysis of their advantages and disadvantages.

It is customary to distinguish between internal and external sources of small business financing. Internal sources for a sole trader include savings, retained profits and the sale of assets. These are long term in so far as this money is usually only available on a one off basis eg life time savings. So therefore there must be a long term benefit such as new buildings or machinery. New partners can also be brought into the business although this will dilute ownership i.e the existing owner(s) will lose some ownership and control. Internal sources also include sale of stock. This is short term in that sale of goods already produced should provide a stream of finance that can be used to pay wages and buy more supplies.

Now we consider the external sources of finance. For a sole trader or partnership these will include bank loans, secured loans (mortgages), leasing, venture capital and government grants. These are long term and are used for expanding the business through the purchase of assets. Loans from banks incur interest charges and can be expensive. However, this may be offset by the additional profits that this finance generates. Loans have the advantage that we are ownership of the business is not being diluted (the owners retain control). However, banks can place conditions on loans and often require the business plan, cash flow and break-even forecasts. The sole trader can approach a bank or a financial institution to apply for a loan. This could include a business loan, a credit line, credit cards, trade credit and a mortgage. Trade credit and credit cards are preferred by sole traders as these will usually not require a mortgage of the business assets. Trade credit is mostly secured against the accounts receivable and the work in progress of the sole trader.

For a sole trader external sources of finance also include overdraft, trade credit, short term loans and debt factoring. These are short term and are used for paying overtime wages, bills and supplies.

When a sole trader is short of personal capital and retained earnings and there's a need to further investment in the business, he may decide to sell some of his assets. This could be a property registered in the name of the business. The sole trader may rent an office and use the sale proceeds to expand his business. If the sole trader does not have any other assets to sell, he may decide to sell an asset or a property and lease it back from the buyer. This helps him to retain the same business address and continue business as normal while raising capital for expansion.

Funding to small businesses is the most relevant in our time. It is known that the main financial sources for small businesses' own funds or capital employed (due to banks, other organizations or individuals).

The main sources of financing for small businesses serve not only their own funds entrepreneurs, but, and of course, profit, which was obtained as a result of business activities. There is often the equity sorely lacking. Moreover, the lack of finance can be felt both at the stage of business creation, and in the course of its development.

Small business is experiencing a constant need for additional financial resources, as for opening new businesses, and for the development of existing ones. A suitable source of credit for business only contributes to the formation and increases its share in the economy as a separate region and the whole country.

Having considered the possible sources of funding for a sole trader business growth and development, we can infer what the most appropriate way of financing. It should be noted that there are a plurality of rapid growth factors that predict the need to obtain the desired result. The sole traders usually have very little money. In this regard, the risk of failure is very high in the market. Therefore, as a sole trader, we must have an objective assessment of the market, supply, demand, trends, and many other factors that need to be considered in the business. The safest way to start business and development this own personal savings and any money that we might have received from leaving previous job e.g. redundancy pay, because in this case we don’t need to return, monies, and not have to pay interest for their use. Businessman only need to do and provide a report on the expenditure target, he received funds in terms of the financial support.

Summarizing the analysis should highlight the main components of rapid business growth for a sole trader, entering the market with a "product " that will be in high demand (the uniqueness of the business, perhaps innovative), a quality business plan for the long term, there is sufficient equity or trade loans and credit cards as they generally do not require collateral business assets. Commercial loans are mainly secured receivables and work in progress sole trader.

(iii) A private limited company wishing to modernize its fleet of cars

There are firms that are owned by individuals in the form of shares but the firm is a legal entity in its own right. This means that if a firm owned by shareholders goes bankrupt then the shareholders, as they are separate to the business, do not go bankrupt personally although they might lose the value of their shares. This is known as limited liability. One of the types of incorporated firms is private limited company (ltd). These tend to be small firms that are locally based. Shares can only be sold privately by invitation from the board of directors. This enables the firm to control who can own shares in the business. Hence, this is a popular form for family run businesses.

We have deal with Private limited company. Limited companies attain their finances from myriad sources and what is ideal for one company might not work for another. In deciding on where to source finances, a limited company has to carry out a careful analysis of its needs. When the business is expanding and shows signs of profitability, earned profits are re-invested into the business instead of distributing them among shareholders. Company assets not critical to the business could be disposed of and the earnings could be used to finance company operations.

In the previous section, we discussed existing funding sources and found out that they are internal external. We indicate for our company the kind of possible sources of funding and in the context of our problem, we choose the most suitable way of finance.

Internal sources in long-term period include share capital and sale of assets. In short-term period it is only sale of stock. External sources in long-term period include government grants, bank Loans, Debentures (plc's only), and venture capital (short term only).

It should also identify advantages and disadvantages.

The benefits of the Private Limited Company should include the following:

1. Shareholders are only limited by the value of the shares they hold.

2. Shareholders jointly bear the business' risks together.

3. As a separate legal entity (an imaginary person), the company can sue and be sued in its own name.

4. The company enjoys some privacy as its books of accounts are not made public.

5. The death or withdrawal of a shareholder does not bring the business to an end.

6. The private limited company has more sources of capital compared to the sole proprietorship and partnership forms of business organizations. This is because it has a higher limit of fifty people who can co-own the business and make financial contributions, compared to the limit of twenty people in the partnership and one person in the sole proprietorship.

7. A greater number of shareholders means a greater pool of knowledge, ideas, skills, abilities and expertise. This is an advantage to the private limited company compared to the sole proprietorship and the partnership.

8. Growth and expansion can be achieved since there are more sources of capital.

The disadvantages of the Private Limited Company should include the following.

1. There are delays in decision making, and putting into action the decisions made. This is because issues are first discussed by the board of directors who are responsible for the day to day operations and accountable to the shareholders.

2. Disagreements between or among members of the company, if not properly handled, can bring the company to an end.

3. The starting up and running of a private limited company requires huge capital.

4. A shareholder cannot transfer his shares without the approval of other shareholders of the company.

5.Profits are not distributed according to work efforts put into the business by members. This means that members who have more shares, but do not work hard like others towards achieving the company's goals may earn more dividends.

Based on the above information, the following conclusions can be made about what funding should use to modernize fleet of cars. In case when the business is expanding and shows signs of profitability, earned profits are reinvested into the business instead of distributing them among shareholders. The business could be disposed of and the earnings could be used to finance company operations like as to modernize fleet of cars.

If our company has a good reputation in the market but their own funds insufficient to implement modernization, in this case, possible variants of using venture-capital. The venture-capital is able to inject huge amounts of money into a company but - as when new shares are issued - they play a controlling role in the management of the business and could require a seat on the company's board. On the plus side, providers of venture capital bring with them years of expertise in business management and will ultimately help strengthen the company. Most venture-capital houses, however, will only work with well-established companies.

However, in our case, if the company has not enough equity to implement modernization, perhaps the most suitable source of funding can be a long-term or medium-term bank loan depending on the objective assessment of the costs for the modernization. Banks provide a ready external source of finance for limited companies. It can be at either a fixed or variable interest rate. A business may have to provide collateral or security for the loan. The company therefore needs to carefully assess its cash-flow situation before deciding on this matter.

Summarizing it should be said that in this situation the choice in each funding sources depends on many factors, which take into account possible only with careful analysis calculation of the company, market assessment, and others. In general, it can only make a prediction about what method of financing to choose in a given situation.