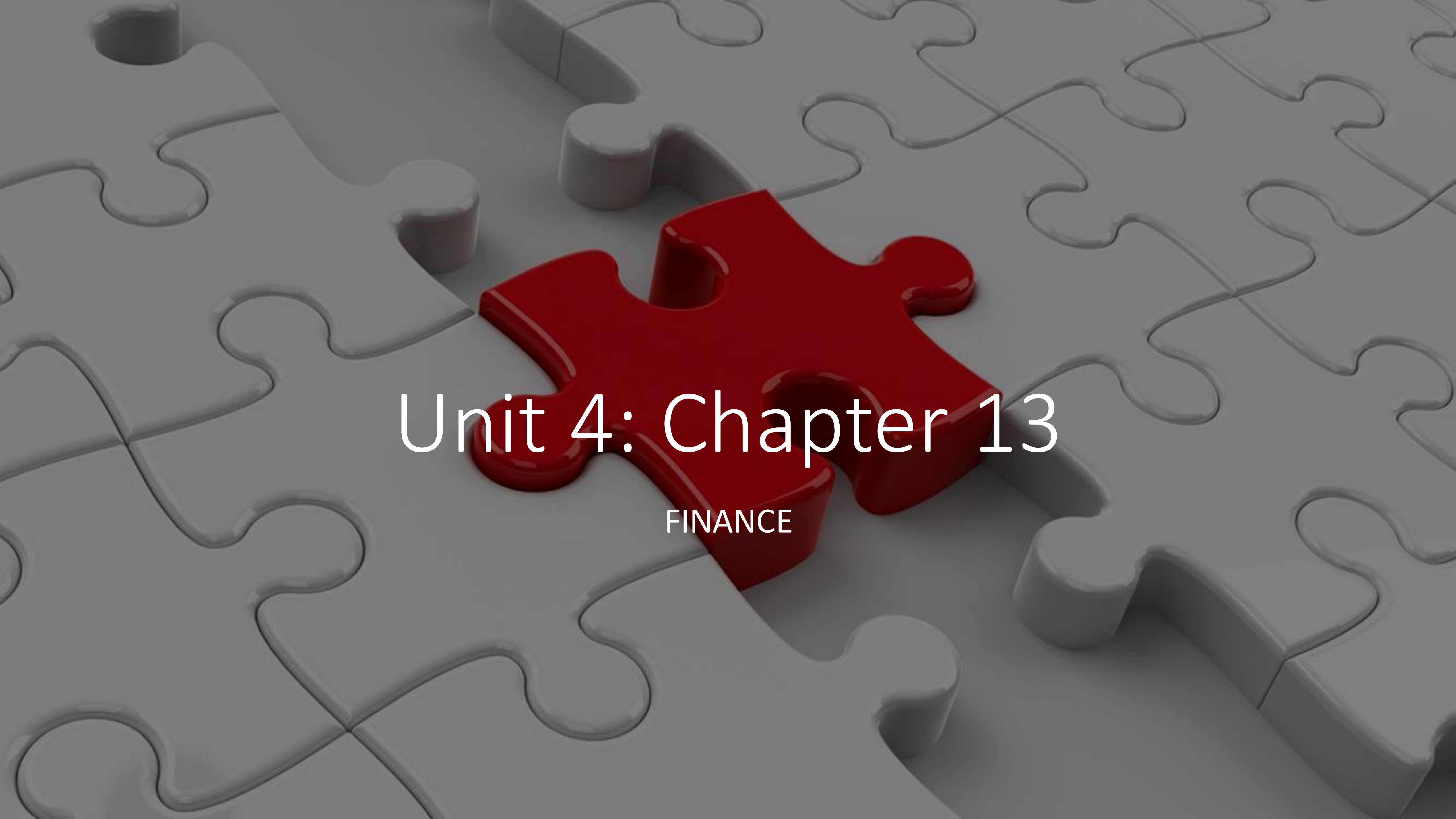

Unit 4: Chapter 13

FINANCE

Learning Outcomes from this chapter

On completion, you should be able to:

- Explain the reasons for preparing a cash flow for a business and a budget for a household
- Calculate a cash flow forecast
- Analyse a cash flow forecast and make recommendations
- Outline methods of dealing with cash flow forecast and house budget problems
- Explain the different sources of finance available to a business and a household
- Apply the different sources of finance to different purposes
- Explain the factors to consider when choosing between different sources of finance
- List the services offered by a current account

Benefits of a cash flow forecast for a business

Improve financial control	Take corrective action in advance of a problem
Access finance	Apply for loans, show ability to repay, attract investors
Highlight cash deficits	Predict cash shortages to adjust spending or arrange finance
Highlight cash surpluses	Predict cash surpluses to plan saving or spending

Actions that can be taken to address deficits

Arrange short-term finance	Arrange bank overdraft, plan to accrue expenses
Adjust receipts	Change marketing mix (e.g. new advertising campaign)
Adjust payments	Postpone, reduce, delay or spread any planned payments
Seek advice	Household (credit union/bank), business (accountant/advisor)

Short-term finance

Finance available for a period of up to one year, repaid within 12 months and used for working capital needs

Uses: Paying bills (phone, electricity, gas), wages, buying stock

Bank overdraft	Negotiate a limit below zero in your current account.
Accrued expenses	Delay paying bills for a period to free money for other uses.
Credit card	Pay now, get a bill later (high interest if unpaid).
Trade credit	Receive goods now, pay supplier later (typically 30 days).
Factoring of debts	Sell your debtors to a debt collector for an upfront payment.

Medium-term finance

Finance available for a period of between one and five years	
Uses: Machinery, computers, delivery vehicles with a life span of over one year and under five years	
Lease	Rent an asset (never owning it) so no initial payment is needed.
Hire purchase	Buy an asset over time, ownership only transfers after final payment is made.
Medium-term loan	Take a loan for between one and five years; repay in regular, equal instalments that include interest.

Long-term finance

Finance available to fund the long-term running of the business or household (over five years)	
Uses: Fund long-term expansion/growth (new store, warehouse, long-term machinery)	
Reserves	Profits left over from trading are reinvested; retained earnings
Government grant	Money provided to a business for a purpose; does not have to be repaid
Long-term loan debenture	Repayable in regular monthly instalments plus interest to a bank; interest repaid regularly, and initial principle repaid at the end
Share capital	Share capital raised by selling shares to investors (shareholders)

Factors when choosing between different sources of finance

Cost	Compare expense measured by APR, extra fees/charges
Purpose	Match source to use (e.g. overdraft for short-term use, such as paying bills)
Amount	Reserves may be limited in size: a long-term loan may be needed
Control	Equity capital gives voting rights away: could lose control of an important asset which is used as collateral
Collateral	Assets may be required to access a loan (assets used as security)

What affects the ability to qualify for a loan?

Collateral	Value of the security available that can be repossessed if loan cannot be repaid
Capacity	Ability to repay: cash flow forecast (business), budget (household)
Character	Creditworthiness, reputation, credit rating (trustworthiness of borrower)
Purpose	Size of loan will increase risk; will purpose actually increase revenue?

Business versus household finances

Similarities	**Differences**
Both need to plan for the future to help control their finances: cash flow forecast (business), budget (household).	Businesses have access to more sources of finance (e.g. debentures, trade credit).
Both need to keep accurate records and file important documents; this helps when applying for a bank loan.	Businesses usually deal with much greater amounts of money (e.g. debentures).
Both need to match the purpose of the finance to the length of the finance (e.g. bank overdraft for short-term needs).	Businesses need to include additional expenditure (e.g. VAT and PRSI, which they collect and give to Revenue).