

ASSIGNMENT COVER SHEET

Name:	FELIX HANSON /STUDENT NUMBER: 2237SPCDL
Address:	HEAD, FINANCE AND CORPORATE AFFAIRS CERTIFIED AND CORPORATE CONSULTANTS POST OFFICE BOX NG 567 NUNGUA, ACCRA GHANA
Email Address:	certifiedcorporateconsultants@yahoo.co.uk OFFICE hansonfelix@ymail.com PERSONAL
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Tutor Name:	CLIVE FINDLAY cfindlay@brightonsbm.com
Assignment Name:	FINANCIAL AWARENESS
Student Services:	studentservices@brightonsbm.com.

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An organisation, Competition and the Business Environment in my opinion has three distinct aims. Firstly, to develop an understanding of the context in which firms operate. Secondly, to build a stock of knowledge about the different components of the Business Environment and to investigate how firms interpret the Business Environment as well as their role within it, since this will affect both how they deal with changes in it, and how they go about 'managing' it to achieve their strategic objectives. For instance, behind every environmentally-damaging project or company stands a financier and activists who are increasingly calling them to account. Ricardo Bayon looks at recent campaigns, and asks the banks for example on how they are responding to this unwelcome attention.

With the subprime mortgage crisis of 2007, whose effects continue to be felt throughout the capital markets, it is demonstrating to many Hotels, Holiday Camps and Guests House financial executives the downside of risk. Up to the point when Hospitality industries felt the impact of this crisis, finance-related risks such as credit risk, put risk, interest rate risk, basis risk, and failed auction risk were perhaps underappreciated by managers and board members alike. The importance of understanding risk on the Hospitality enterprises is well recognised. But not all senior industry financial leaders recognise the importance of fully understanding the organisation's financial risk position. Insufficient attention to overall financial risk, particularly in a challenging environment, can lead to strategic and financial decisions that greatly increase the day-to-day risk of operating the hotels and guest houses. To illustrate this point, consider the following scenario. A hotel in a rapidly growing region has positive business fundamentals, such as a good staff and good commercially security insured clients' volume. But competition from organisations eager to capture a piece of the growing market has increased during the past decade. To handle growth and solidify its long-term competitive position, the hotel has been steadily increasing capacity and investing in its facility, programmes, equipment, strategies, and staffing. Because this hotel has been borrowing and spending aggressively, its financial position is not particularly strong. The hotel may make a small profit, but its balance sheet has been weakened by its aggressive spending to defend its market position.

The leaders of such industries often are highly focused on what it takes to stay competitive and serve the community over the long run, and they too often are inattentive to the total amount of risk the organisation is taking as it tries to move to its desired strategic position. As a result, the organisation's risk position may be much greater than its financial position would warrant. Industry leaders may be borrowing more money than the business can really afford, and the type of borrowing, structured to lower the cost of capital, may be significantly increasing the total amount of financing risk. The leaders also may be making strategic decisions that lead to reduced profitability, or even operating losses. When an organisation in this high risk-leveraged condition encounters an unanticipated event risk, the financial harm will almost always be greater than expected. To ensure that their organisations are appropriately focused on risk, guest houses and Holiday Camp senior financial executives should raise the following questions:

- What risks should financial leaders address as part of their financial oversight responsibilities?
- What creates risk related to an organisation's financial performance?
- What might occur if risk is not properly understood or effectively managed?
- How much risk is too much risk and how much risk may not be enough?
- Can risk be managed to strategic advantage, and if so, how?

ARTIFICIAL COMPANY USED FOR THIS EXCERSISE
HOLIDAYRAMA LTD

Holidayrama is a holiday camp located in the city of Cape Coast and is wholly owned by Conglomeric plc a large and widely diversified company. The camp was added to the company's business portfolio during the early 2000s, a decade of holiday-camp euphoria. The success of Holidayrama was, to a large extent, due to the personal drive and business acumen of its founder and chairman, Bob Hamilton who retired from the company in 2006. Since Hamilton's retirement, the day-today management of the Holiday Resort has been the responsibility of 'Eric Donaldson who, until recent years, was able to produce a reasonable return on investment. However, over the past five years the camp experience pronounced decline in holiday-makers and is now operating at only 65% of capacity. Due to a combination of causes, Donaldson has just suffered a nervous breakdown and taken retirement, overdue anyway at the age of sixty-eight.

The burden of deciding what to do with Holidayrama now falls squarely on the shoulders of Linda Williamson, the group's Financial Director. She is aware of the decline in turnover but has only a very superficial knowledge of the business having relied much on Donaldson and the reports regularly received from his office. She is not sure whether the decline in business is an industrial problem (a decline in market demand), or is peculiar to Holidayrama (a decline in market share). Not knowing the cause for the decline, Linda is reluctant to make any strategic decision concerning the future of the camp without first finding out some facts. She recognises the need to carry out a strategic position audit, although the budget will not permit a large-scale stuffy. She therefore asks me, a Financial Management Consultant working at the office of the Certified and Corporate Consultants, to design and implement a low-cost investigation with the aim of yielding useful findings and recommendations. First, I decided to concentrate on examination of the financial position and performance of the company, and I have been able to obtain from the group's financial data- base files a summary of the company's accounts for the last three years. The information is given in Table 1.

Table 1.

Holidayrama Ltd- Summarised data: 2005 -2007

PROFIT STATEMENT	(£'000)		(£'000)		(£'000)	
	<u>2005</u>		<u>2006</u>		<u>2007</u>	
Sales	400		600		620	
Gross Profit	100		132		112	
Less: Expenses	36	72		76		
Depreciation	4	12		14		
Interest	-	28		14		
Corporation tax	30	70	10	122	-	104
Net Profit after taxation	<u>30</u>	<u>30</u>	<u>10</u>	<u>10</u>	<u>8</u>	
Dividend	24		12		-	
Retentions	<u>6</u>		<u>(2)</u>		<u>(8)</u>	

BALANCE SHEET	(£'000) <u>2005</u>	(£'000) <u>2006</u>	(£'000) <u>2007</u>
Fixed assets	200	500	700
Current assets			
Stock	120	180	200
Debtors	80	180	240
Bank	40	-	-
Current liabilities			
Overdraft	-	152	410
Creditors	50	220	146
Taxation	<u>30</u>	<u>10</u>	<u>-</u>
	80	382	556
Net assets			
Fixed Interest Capital	200	200	200
Ordinary share capital	160	158	150
	<u>360</u>	<u>358</u>	<u>350</u>
16% Loan	<u>-</u>	<u>120</u>	<u>380</u>
	<u>360</u>	<u>478</u>	<u>730</u>

During my investigation, I made time available to visit Hamilton who is now enjoying a very pleasurable and restful retirement in Somerset, although his enthusiasm in commercial terms was definite. "I told people for years but nobody was interested". Funds were short so directors turned their backs on me. What the camp needs, and has needed for a long time, is a new fun-pool. You're a yongerster; you know the sort, water-shuts, fountains, kinky shapes, driving-boards, etc. The campers would just love it. I know they would."

I decided to follow these ideas to put some numbers together and then test the financial sense of it. Putting the numbers together took longer than I anticipated however eventually I managed to arrive at figures that management was prepared to accept, for this first-stage justification anyway. These figures are given below;

Estimates:

Cost of pool	£620,000
Group's NPV break even target for Projects of this nature	6 years
Additional camp income (arising Because of pool)	£240,000 per annum (before inflation)
Income inflation	6% per annum after the year
Related inflation	£60,000 per annum (before inflation)
Cost inflation	8% per annum after the first year
Group's money required rate of return	18%

However, on reviewing the figures I decided that the sales figures I had used were too optimistic. I considered this matter carefully, going back over my research paper; and finally decided to build the following probability range into my model:

First year sales £	Probability
200,000	0.1
210,000	0.3
220,000	0.3
230,000	0.2
240,000	0.1

I was also concerned about my forecasts for inflation. I felt happier about my projection of sales inflation than about the figures used for cost inflation. In spite of some reservations from the managers I interviewed, I was reasonably confident from my analysis of the research material I had collected, that there was scope for profit improvement in Holidayrama. However, I decided before submitting my finding and recommendations to the finance director that I would go into meeting fully able to back up my arguments with ideas. With this aim I spent some time organising my material and carrying out some market research but without delving into depth. I was particularly interested in finding out the camp's obvious strengths, weakness, opportunities and threats, in both resource and market terms. I knew that knowledge of these positive and negative aspects would start ideas germinating in my mind about how best the fortunes of the camp could be turned around.

Below is a summarised reports and recommendations for the attention of Linda Williamson, that;

- (a) comments on the changes in the financial position of the company between 2005-2007;
- (b) shows the movement of working capital during the two years 2006 and 2007;
- (c) suggested remedial course of action should be considered

FINAL REPORTS AND RECOMMENDATION

To: Group Financial Director
From: Financial Management Consultant (Certified and Corporate Consultants)
Date: 17th August 2009
Reference: Memorandum BM 17/09 BF/AR/2

Holidayrama Ltd Strategic Appraisal

1. I have examined the company's accounts for the last 3 years. At Appendix A, you will find (a) source and application of working capital statement for 2006 and 2007. At Appendix B, you will find a financial appraisal of Holidayrama's performances for the three year period.

Overall Comments:

2. Liquidity. The company has insufficient liquid funds. They must be remedied.
3. Credit control. This is poor. Too much credit is being given and too much credit taken by the company. Stock Turnover is far too low.
4. Overtrading. In my opinion, the company is fast approaching an over-trading situation. This is born out by the analysis shown in Appendix B.
5. Fixed asset investment. There has been too much asset expansion, too quickly. The company's asset utilisation has steadily worsened with each new investment.
6. Gearing. The company is, at present, too highly geared. The loans are expensive to service, i.e., 16% before tax and the borrowed capital have not been invested wisely. The ROCE is currently 3.1%. Can these service a 16% loan? This is extremely difficult.
7. Sales mix. It appears from the falling profit margin that less profitable holiday packages are being sold. Are loss- leaders being used by managers and agents without permission?
8. Expenses. I would like to obtain a more detailed breakdown of this figure by cause. Only then can any useful comment be made.

Recommendations

9. Investment in fixed assets must be evaluated. I consider the acquisition of a fun-pool to be justified though, and I would like to discuss my ideas with you as soon as possible.
10. Additional long-term capital is required. This will probably have to be obtained from an issue of ordinary shares or from group support. In view of the trading results, a right issue may be the only source.
11. Credit control needs to be tightened up with an urgent review of our credit policy.
12. Depreciation policy needs to be investigated to ensure that it is adequate.
13. A reporting system, by market segment needs to be implemented in order to highlight strengths and weaknesses in the company. This should be on a frequent basis, say monthly.

Signed: FELIX HANSON (Head, Finance and Corporate Affairs)

Appendix A
Working capital statement: 2006 - 2007

		<u>2006</u>		<u>2007</u>
Sources of Income	£'000	£'000	£'000	£'000
Issue of 16% loan	120	260		
Retained profit (incl. appreciation)	10	130	6	266
 Application of funds				
Purchase of fixed assets		<u>312</u>		<u>214</u>
		(182)		52
 Increase/ decrease in working capital				
Increase in stock	60		20	
Increase in debtors	100		60	
Increase in tax provision	100		60	
Decrease in creditors	(170)		(44)	
Reduction in bank	(40)		-	
Change in overdraft	<u>(152)</u>		<u>6</u>	
		<u>(182)</u>		

Appendix B
Financial appraisal

1. **Profitability:** There are numerous measures of profitability. Each relates to the returns of the company to its sales, or equity. As a group, these measures will allow me to evaluate Holidayrama earnings with respect to a given level of sales, a certain level of assets, or the shareholder's investment. The industry statistics also allow useful inter-firm comparison. Below ratios are what I used for the purpose of this engagement.

	<u>2005</u>	<u>2006</u>	<u>2007</u>
Return on capital employed			
Profit before tax and interest	$\frac{60}{360} = 16.67\%$	$\frac{48}{478} = 10.04\%$	$\frac{22}{730} = 3.35\%$
Net Assets Employed (NAE)			

Profit margin: This margin represents what is often called the pure profits earned on each sale of £. The net profits are pure in the sense that they ignore all government charges (taxes, etc) and measure only the profits earned on the operations. It is debatable as to whether interest charges should be deducted, although in this case the profit after interest has been charged. Holidayrama's actual net profit margin is estimated to be far-far below the industry average. The ratios suggest that the company has relatively high administrative and marketing expenses and/or interest charges that need to be checked and controlled.

$\frac{\text{NPAIT} * 100}{\text{Sales}}$	$\frac{30}{400} = 7.5\%$	$\frac{10}{600} = 1.67\%$	$\frac{8}{620} = 1.29\%$
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Gross profit margin: This ratio indicates the percentage of each sale £ remaining after the company has paid for its goods. The higher the gross profit margin the better, and the lower the relative cost of goods sold. Of course, the opposite case is also true. Holidayrama's results are estimated industry average for the 2005 accounting year but kept on fallen in the subsequent years. There is however scope for improvement. Given a successful new product launch the cash revenue will be small and costs relatively high. The position will reverse as sales and deliveries build up, The Company will do well to achieve gross profit margin above the industry average in so short a time if my recommendations are considered.

	<u>2005</u>	<u>2006</u>	<u>2007</u>
$\frac{\text{Gross Profit} * 100}{\text{Sales}}$	$\frac{100}{400} = 25\%$	$\frac{132}{600} = 22\%$	$\frac{112}{620} = 18.06\%$

Return on equity: This ratio measures the return earned on the owners' (ordinary shareholders') investment using nominal values. Generally, the higher these returns, the better off are the owners in this case Holidayrama plc. The value could also have been derived by using the cash value of the shareholder's original equity holding. In these cases while ROI is a nominal ratio whose value depends heavily upon accounting conventions, ROE measures what happens in terms of the cash. This value seems to be quite good in the first year but recorded poor results in the second year and begun to pick-up again in the third year period.

	<u>2005</u>	<u>2006</u>	<u>2007</u>
$\frac{\text{NPAIT} * 100}{\text{Equity}}$	$\frac{30}{160} = 18.75\%$	$\frac{10}{158} = 6.32\%$	$\frac{8}{150} = 5.33\%$

Capital turnover

$\frac{\text{Sales}}{\text{NAE}}$	$\frac{400}{360} = 1.11:1$	$\frac{600}{478} = 1.26:1$	$\frac{620}{730} = 0.85:1$
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Overall Comments

- (a) ROCE has fallen drastically over the 3 years examined. This cannot continue and action must be taken to reverse the trend.
- (b) Profit margin has also fallen which means that less profit per £1 sales revenue is now being made. The cause of this will be determined in due course.
- (c) Capital turnover is decidedly unhealthy in a type of business which normally looks for high turnover on a moderate profit margin.

Analysis of profit margin

	<u>2005</u>	<u>2006</u>	<u>2007</u>
(Percentage of sales)	%	%	%
Expenses	9	12	12.26
Depreciation	1	2	2.26
Cost of sales (Balancing figure)	75	78	81.94

- (a) As sales and fixed asset investment have increased so expenses have become a larger burden on profits. This aspect must be further investigated.
- (b) Some reason must be found for the increase in cost of sales. Could it be the sale/ promotion of less-profitable holiday packages? Could purchasing economies be made? Be possible?
- (c) What is the company's depreciation policy?

Liquidity: Liquidity refers to the state of an assets nearness to cash. Nearness to cash has been defined in terms of the times and effort needed to sell an asset. Liquidity is vital to the financial health of Holidayrama. Too much liquidity is misuse of money and too little leads to severe cash problems. Among some of the key ratios under this include the following:

Current ratio

The current ratio provides a rough measure of the safety afforded to Holidayrama's short-term creditors. In the event of a technical liquidation because of its large holding company, current assets are more likely to yield a higher percentage of their assets book value than are fixed assets. However the current ratio or 'working capital ratio' is frequently misleading mainly because it does not provide information on timing, with reference to the matching of liabilities and cash inflows. Because of these Holidayrama might still face a sever shortage of cash even though it shows a sound estimated current ratio in the first year

	<u>2005</u>	<u>2006</u>	<u>2007</u>
Current Ratio	240:80	360:382	480:556
C Assets: C Liabilities	<u>3:1</u>	<u>0.94:1</u>	<u>0.79:1</u>

Quick ratio

One way of coping with the inadequacies of the current ratio is to consider the company's liquid assets in relation to its current liabilities. Liquid assets consist of cash and investments that can be realised without difficulty (near cash). Although in the case of Holidayrama, all receivables are considered as 'near cash' it is often practice to take only a percentage of these into the calculations, the estimated measure for the first year was in line with industry norms but this depleted in the subsequent years.

	<u>2005</u>	<u>2006</u>	<u>2007</u>
Liquid Ratio (Acid Test)	120:80	180:382	240:556
Liquid Assets: C Liabilities	<u>1.5:1</u>	<u>0.47:1</u>	<u>0.43:1</u>
Cash in current assets	16.7%	-	-

Comments

- (a) Liquidity is steadily worsening.
- (b) Current liabilities are inadequately covered by liquid assets.
- (c) Additional source of cash must be found immediately.

Debtor collection period

Account receivables or trade debtors are classified in a company's most liquid assets as they represent the major source of future cash receipts. However, these potential revenue is transferred into cash receipts only if the company's' customers pay their bills, thus it is extremely important to make sure that invoices are settled, and they are settled on time. One way of assessing the timing of these payments is to calculate the average age of the accounts receivable. At 73, 110 and 141 days, Holidayrama's estimated position compares poorly with the industry as a whole.

	<u>2005</u>	<u>2006</u>	<u>2007</u>
$\frac{\text{Debtors X 365}}{\text{Sales}}$	$\frac{80}{400} = 73$	$\frac{180}{600} = 110$	$\frac{240}{620} = 141$ (All in Days)

Creditors' period

A major item of current debt is the volume of credit contained in trade accounts payable, and as such represents funds. It is a poor financial strategy to increase this debt by not paying these accounts when they become due. One way of checking upon the status of a company's trade accounts is to calculate their average age. The age of an account payable is taken from the receipt of invoice or rather the computer input batch date until payment is made. It is noted that Holidayrama will take approximately two months to settle bills in the first year. This may not be a bad thing, but will require investigation into causing the effect on why in the subsequent years a record period of 4 to 6 months is recorded 2006 and 2007.

	<u>2005</u>	<u>2006</u>	<u>2007</u>
$\frac{\text{Creditors X 365}}{\text{Purchases}}$	$\frac{50}{300} = 61$	$\frac{220}{468} = 152$	$\frac{264}{508} = 183$ (All in Days)

Stock Turnover Period

As can be seen in case of Holidayrama, stocks frequently represent a substantial proportion of current assets. The longer the company's funds are invested in stocks the smaller its eventually return. Thus, it is of great importance to keep track of the average age of stocks. With an estimated turnover of 54 days the position in Holidayrama warrants concern. The industry average at 36 days is shorter. The times which stocks turn over uses the same basic data and provides much the same information. Generally the higher the turnovers figure the better.

	<u>2005</u>	<u>2006</u>	<u>2007</u>
$\frac{\text{Stocks X 365}}{\text{Cost of Sales}}$	$\frac{120}{300} = 146$	$\frac{180}{468} = 140$	$\frac{200}{508} = 1144$ (All in Days)

Comments

- (a) Debtor are rising in value and taking longer to pay. This adversely affects liquidity
- (b) More credit is being taken from suppliers. This cannot continue indefinitely.
- (c) Stock turnover is far low bearing in mind the low profit margin.

Gearing: The debt position of Holidayrama indicates that there is amount of other people's money that is being used by it in generating its profit. Typically attention is placed on long-term debts, since these commit the company to pay interest over the long run and eventually repay the sums borrowed. Since long-term debts has prior claim present and prospective shareholder pay close attention to the degree of indebtedness and ability to repay debts. In general, the more debt a company uses, the greater its financial leverage, which is a term used to describe the increase of risk and return introduce through the due of fixed-cost financing. The more debt or financial leverage a company uses the greater will be its risk and return

Gearing ratio

This ratio sometime referred to as the debt:equity ratio indicates the relationship between the long-term funds provided by the loan group and those provided by the company's owners. The figure is only meaningful in light of the company's business and comparison with other organisations within the industry as useful. An industry average is a good benchmark but Holidayrama seems intend to use relatively high leverage and perhaps the implication behind this figure need closer examination.

	<u>2005</u>	<u>2006</u>	<u>2007</u>
<u>Long Term Loans</u>	200:160	320:158	580:150
<u>Ordinary Shares</u>	<u>1.25</u> (High)	<u>2.0</u> (High)	<u>3.87</u> (High)

Activities Activity ratios are used to measure the efficiency with which the company has been using assets to generate sales.

Total Asset Turnover Ratio

This indicates the efficiency with HOLIDAYRAMA is able to use all its (net) assets to generate £ sales. Generally, the higher a company's total net asset turnover the more efficiently it assets been used, the total net asset turnover is probably of greatest interest to management, since it indicates how financially efficient the company's operations have been. However other parties, such as creditors and prospective investors and present shareholders will also be interested in this measure.

	<u>2005</u>	<u>2006</u>	<u>2007</u>
Fixed Interest Capital	0:200	120:200	380:200
Ordinary Share capital	=N/A (Low)	=0.6:1 (Acceptable)	=1.9:1 (High)

Comments

- (a) In the three years examined, gearing has altered dramatically
- (b) The effect of the current 'high gearing' is already being felt by the shareholders, i.e., there was no dividend 2007.

- (c) Fixed assets utilisation has steadily declined and should be investigated further.
- (d) Stock and debtors have both increased. In this line of bawdiness, one looks for rapid stock turnover and a high proportion of cash sales. See credit control ratios for further information.

Working notes For Financial Justification of Fun-pool: (All original Assumptions Valid)

Note: the best way of justifying the proposed investment in the fun-pool would seem to require the use of the capital investment appraisal technique which uses discounted cash flow, and calculates a net present value for the length of the fun-pool's projected life using the group's money required rate of return as the discount rate factor. The only complication in the figures provided is the need to compound the effect of inflation over the years.

Capital		Discount				
Year	outlay	Income	Costs	Net flow	Rate@18%	present value
	£	£	£	£		£
0	(620,000)			(620,000)	1	(620,000)
1		240,400	60,000	180,000	0.85	153,000
2		254,000*	64,800**	189,600	0.72	136,512
3		269,664	69,984	199,680	0.61	121,805
4		285,844	75,583	210,261	0.52	109,336
5		302,994	81,629	221,365	0.44	97,400
6		321,174	88,160	233,014	0.37	86,215
						704,268
Net present value						84,268

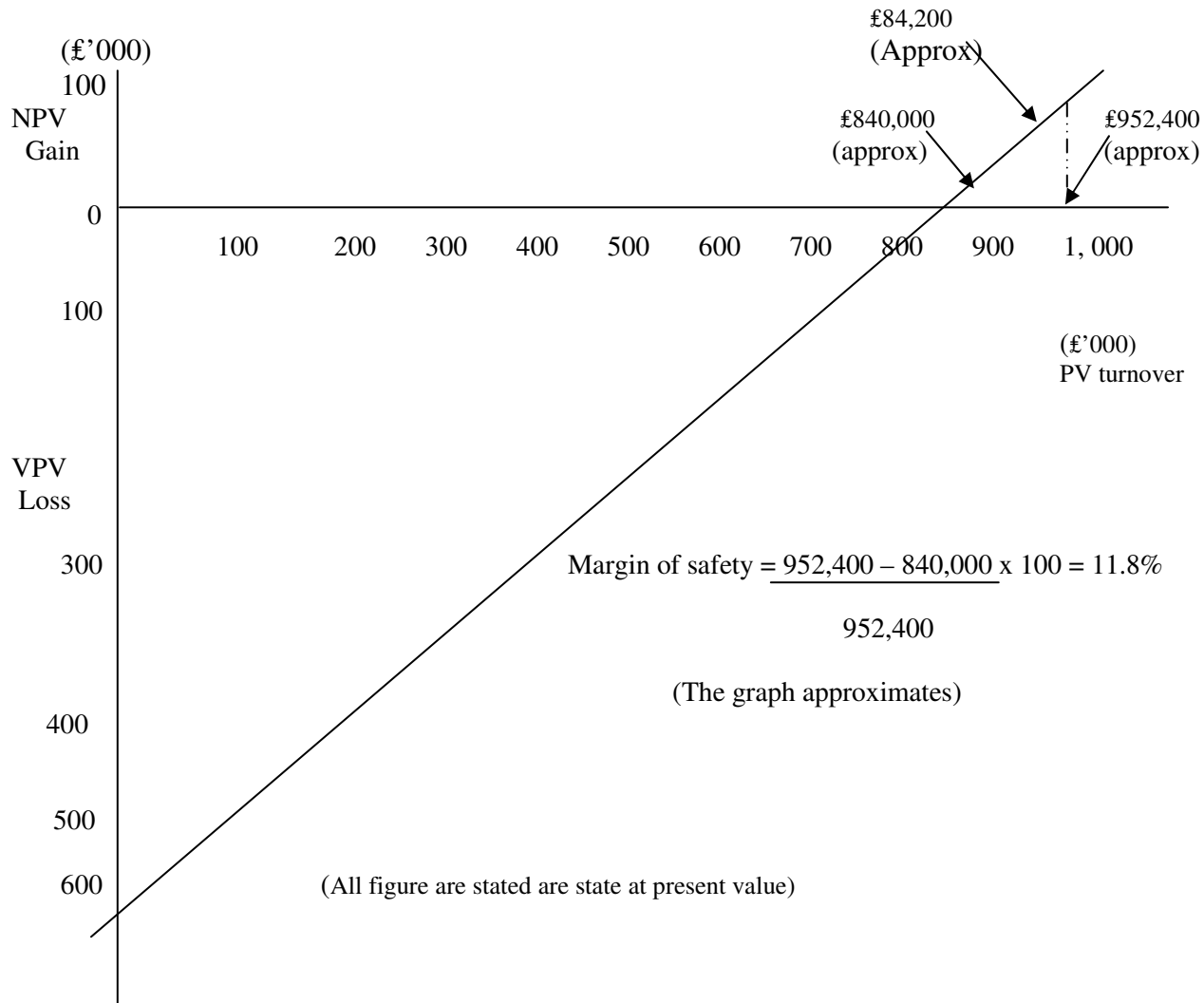
Conclusion: The fun-pool project returns a net present value of £84,268 and would therefore seem to be justified in financial terms. However, the usual provisions concerning Holidayrama's ability to fund the initial outlay of £620,000, and reliance on the forecast accuracy in the figures presented apply. Also the impact of the strategy on the company's gearing and associated financial risk needs to be considered.

- (i) Using the original data provided, the fun-pool will achieve the Group's target 18% money return by achieving a positive cash flow of £ 84,000 over a period of 6 years.
- (ii) The target will not be achieved if the capital outlay on the fun-pool increase by more than 13%, 6% of its projected costs. Sensitivity to change is medium.
- (iii) The return will not be achieved if the first year's projected income drops by more than 8.8% and the income inflation rate remains constant at 6% per annum compounded for the duration of the 6 year life of the pool. Sensitivity to change is high.
- (iv) The target will be achieved if the projected costs in the first year does not increase by more than 34% and the cost inflation rate remain constant at 8% per annum compounded for the duration of the 6 year life of the pool. Sensitivity to change is low.
- (v) Taking estimated probabilities into account there is a 60% chance that the fun-pool's financial target will be achieved.

(vi) The fun-pool's financial target will be achieved if average cost inflation is below 22%. Sensitivity to change is low.

Each of the above statement considers a project aspect in isolation. All calculations are independent of the other calculations.

Fun-pool investment appraisal NPV breakeven profit-volume graph



The following strategies will help executives address the remaining questions and more effectively balance their organisations' financial and risk positions.

Understanding the Hotel's Financial Condition

This strategy informs all others. Thorough financial and credit analyses enable financial executives to identify their organisations' financial strengths and weaknesses. For instance, an organisation rated "AA," with an operating margin of 5 percent and 300 days cash on hand, will be able to take on more financing and business risk and will be better able to handle a certain amount of event risk than an organisation with a say "BB" rating, with a 1% percent operating margin, and fewer than 100 days cash on hand. If the latter organisation incurs strategic business risk or financing risk or both at the same time, the organisation's leaders should not be surprised at the depth of organisational financial pain when an unexpected event occurs. The point is that risk incurred should be related to the organisation's financial condition. If the hotel's financial position is mediocre, its leaders should be conservative about the risk taken. If the organisation's financial position is extremely strong, its leaders should recognise that incurring some risk may benefit the organisation.

A successful financial performance is a masterful balancing act, and the treasurer walks a financial tightrope to ensure success. Today's economy has tipped the scale away from aggressive revenue streams. Yet companies seek profitability comparable to the days of double-digit, top-line revenue growth. Adaptability in the business world means ever adjusting to the economic winds of change and staying grounded in strategies that sustain long-term success. Companies in recent globalisation stages adjust to macro business factors such as economic activity, interest rates, stock market valuations, and regulatory changes over which they have little control. Working capital performance is fundamental to a company's ability to adapt in a challenging economy, because it is both independent of macroeconomic factors and firmly within an organisation's control. This process of measuring performance often requires the use of statistical evidence to determine progress toward specific defined organisational objectives. In teams and organisations, there are various tools and measurements to determine how well it performs. Gamble, Strickland and Thompson (2007, p.99) provide a comprehensive method for measuring performance of organisations. How well each company performs is dependent on the strategic plan. Some of the measurements include basic financial ratios such as debt-to-equity ratio and if the levels are an issue with creditworthiness.

Setting organisational performance targets is a natural follow-up to the implementation of a performance measurement system. If an organisation were to decide to measure its performance against let's say the number of clients served in a year, then it would not be surprising if the organisation were to establish a target related to that measure. The organisation might set a target of, say, "service provided to 50,000 clients in 2008". This target together with, presumably, a number of others would become a basis for assessing the quality of the performance of the organisation as a whole, or of a unit within the organisation, or even of particular employees. The implication of setting a performance target is that failure to meet the target implies substandard performance unless a satisfactory explanation can be provided as to why the target was not met. Performance targeting has an important place in the organisational manager's toolkit. There is no reason to doubt that, when used properly, targeting can make a positive contribution to organisational performance. However, the assumption that organisations will indeed make proper use of performance targets is not always well founded. Designers of performance targeting schemes, if they wish to add value to their organisation's performance must bear in mind the limitations of performance targeting, and the potential of targeting schemes to cause significant and unintended perverse outcomes. Experience has shown that when targeting schemes are not carefully designed and implemented, they risk causing more harm than good to the organisation.

The intention behind the establishment of financial targets is to focus organisational attention on particular outputs and outcomes, and to align the behaviour of individuals with overall organisational goals and the expectations of stakeholders. However, as is the case with virtually every scheme designed to influence human behaviour, performance targeting systems are subject to the law of unintended consequences. In many cases, unintended behaviours induced by performance targets are perverse, leaving organisations and their stakeholders worse off than before the introduction of targets. A common manifestation of this is where individuals focus more on meeting targets themselves than on the products, services or benefits that their organisation is supposed to be delivering. Targets, if badly used, can cause organisations to focus on the trees rather than the forest.

The ostensible purpose of targets is to focus attention on things that matter most to the organisation, to its clients and to other stakeholders. Even so, many organisations introduce large numbers of targets that end up defeating this purpose by diffusing rather than focusing attention. The UK government originally introduced 366 government-wide performance targets in 1998, but found it necessary to reduce the number to 123 by 2002. In the United States (US), the state of Oregon was a pioneer in the creation of social and economic performance indicators and targets to assess progress toward the achievement of broad policy goals. Oregon's "Benchmarking" initiative was launched in 1989 with 158 indicators, or "benchmarks" and accompanying targets. By 1993, the number of benchmarks had increased to 272. The "keep it simple" rule applies with considerable force to performance targeting schemes. The larger and more complicated they are, the less likely it is that they will make a meaningful, positive contribution to organisational performance. It is not uncommon for organisations to set performance targets without first assessing the practicalities of implementing a system for performance monitoring. Targets may be set in the absence of adequate information about: (i) what constitutes a reasonable target figure; (ii) the availability and/or costs of obtaining data required to monitor performance in relation to targets; and (iii) the level of administrative effort (likely to be considerable) that may be required in order to support the performance monitoring system. The implication for designers of performance targeting schemes is that these practical issues must be assessed up front, at the time when performance targets are being selected

In a nutshell, financial environment within which organisations operate evaluates the soundness of the issues and decisions firms face every day. It is a balancing act. On one side, to remain competitive, Finance must focus on checks and controls to comply with legal, tax and accounting regulations and requirements. On the other side, it must be able to advise the business on future directions, performance and opportunities. But to do this successfully, Information feeds the process. The ability to consolidate results, report and analyse what happened, and shape what will happen is critical to the organisation as has been demonstrated by the Holidayrama example. As the custodian of shareholder value, Finance needs dynamic tools to balance compliance and performance, accounting and business structures, short term and long term, top-down vision and bottom-up reality. These tools let Finance:

- Close the books, consolidate results and report performance.
- Define, understand and lead company's decision-making for better performance management
- Set performance targets, align resource plans and **forecast business results** to meet or beat expectations.

The above decisions can be implemented well and move the business to the next level of growth, expansion and progress only when and if the business understands the dynamics of budgeting and budgetary processes. Below literature explains more on what can be done.

Running a department without understanding the budget process is like driving a car without knowing how to steer. Every manager needs a basic understanding of how to plan, use, and monitor adherence to a budget. Addressing the needs of the company's own budget process will help the financial processes and goals of the organisation as a whole. In this period, financial managers exhibit the concepts and techniques vital to the budget process, including forecasting revenue and expenses; choosing the best kind of budget strategy, and progressively measuring the success of the organisation's plan through the use of variance reports. This budget is a document that will translate plans into money, money that will need to be spent to get planned company's activities done (expenditure) and money that will need to be generated to cover the costs of getting the work done (income). It is an estimate, or informed guess, about what you will need in monetary terms to do the work of the organisation.

- The budget tells how much money the firm needs to carry out its activities.
- The budget forces organisations to be rigorous in thinking through the implications of its activity planning. There are times when the realities of the budgeting process force firms to rethink their action plans.
- Used properly, the budget tells institutions when it will need certain amounts of money to carry out business activities.
- The budget enables organisations to monitor their income and expenditure and identify any problems.
- The budget is a basis for financial accountability and transparency. When everyone can see how much should have been spent and received, they can ask informed questions about discrepancies.
- You cannot raise money from financial Institutions unless it is supported by a budget. Financial Institutions use the budget as a basis for deciding whether what companies are asking for is reasonable and well-planned.

1. Identifying the Infrastructure Supporting the Budgeting Process

Understanding the components that support the firm's budget plan is crucial for effective budgeting. From employees and knowledge to processes and technology, the finance manager must know how these components affect the business. Usually, you can begin by correctly assessing employees' skill levels and assign tasks and responsibilities accordingly. Employees who are trained and cross-trained in the appropriate tasks offer greater stability to the company and to items in the budget plan. Once the individuals have been assigned tasks and responsibilities, the next crucial step is providing the correct tools and processes for them to complete these successfully. Subsequently, by ensuring the budgeting process has been well documented and communicated, the tool will allow flexibility and control throughout the process. With the right resource allocation, knowledge transfer increases and dependability on key personnel decreases. Companies following this best practice are given more time to focus on the analysis of pertinent information rather than managing the process.

2. Defining a Budgeting Process

Budgeting processes are used to help ensure the flow between planning phases and identifying the most efficient procedures. Avoid the temptation to skip creating a well thought-out budgeting process. It is essential for laying the groundwork for a successful and efficient budget cycle. To begin, identify the project using tools such as a needs analysis and project management consultants. For an effective budget process, the following should be clearly defined:

With a comprehensive understanding of the budget, companies are able to make better, more informed decisions and can accurately recognise the true cost of products and services. An efficient budgeting process provides more time for analysis and improves the ability to react quickly to change.

3. Choosing a Dedicated Planning and Budgeting Software

Companies often seek software applications to increase the efficiency, accuracy, and consistency of the planning, budgeting, and reporting process. Today's applications make it easier to perform tasks that are difficult or impossible without the use of technology. As a best practice, invest in a package that not only becomes part of the Business Performance Management/Corporate Performance Management process but also automates the process and adds a Business Intelligence component to finance. Packages such as PROPHIX, Hyperion, Proclarity, and OutlookSoft offer this solution. Thoroughly research various options and choose software that best meets the company's needs. Speak to management consultants, attend user conferences, and review software life cycle models to understand all options. The key is to have a technology that works for the company and supports your current and future requirements.

4. Establishing and Defining the Correct Budget Level

Providing too much detail in the budget can be as inefficient as supplying too little. The time spent on focusing details that do not influence the plan can be better spent elsewhere. Only supply detail is significant to the budget. For example, is it necessary to plan a budget for paperclips or is a general budget for office expenses sufficient? Alternatively, perhaps a budget for total expenses is adequate. Financial Managers recognise that the budget does not need to reflect the actuals rather are meant to draw attention to significant variances so they can be investigated through actuals and by other means. With the correct level of detail in the budget, all accessible data is relevant. This decreases the time required for budgeting and reviewing. Ultimately, a successful budget plan provides enough detail for budgeting assumptions and decisions and still offers the flexibility to adjust business finances as needed.

5. Defining Key Performance Metrics (Indicators)

Key Performance Indicators (KPIs) are financial and non-financial metrics used to quantify objectives to reflect the strategic performance of an organisation. KPIs give a greater understanding of key business drivers, which ultimately allows for effective time and monetary investments. They gauge and help control the present state of the business. Depending on the industry, an organisation is operating in industry-specific. KPIs could be researched through industry trend reports or annual reports of peer companies. Every industry will have unique measurements for determining the financial health of an organisation. Examples of commonly used KPIs are revenue growth, earnings growth, debt reduction, and EBITDA margin. As a best practice, companies are advised to limit the KPIs to only those factors that are crucial to the organisation reaching its goals. They must reflect the organisation's goals, must be crucial to its success, and must be measurable. A good KPI includes the definition, the measurement (how the KPI is measured), and the target goal. Once KPIs have been defined, they must be clearly communicated across the organisation. With all departments relying on the same benchmarks, the company improves internal inefficiencies and clarifies goals.

6. Making Planning and Budgeting a Collaborative Process

To gain a greater understanding of the planning and budgeting processes involve resources across all levels of the organisation, have reviewers provide the direction, managers validate the details, and budgeters gather the information. For example, for a budget approval process model, executives need to decide on a business strategy, management needs to implement the plan, and budgeters need to provide the necessary data. A collaborative process offers greater accountability and a better execution of corporate strategy. To achieve this, implementers use managerial meetings, feedback forums, and surveys as tools.

7. Aligning Operating Tasks with Strategic Planning

It is important that day-to-day operations support the high-level corporate plan to ensure that planning efforts are cohesive throughout all departmental levels of the organisation. Many successful companies support this best practice by extending the corporate strategic plan from top management to the rest of the company. For example, once upper management sets strategic goals, Finance translates the goals into specific departmental plans, expense drivers, and linked incentives. Departmental managers subsequently use these specifics to operate the business. Tracking, measuring, and documenting are the next steps in maintaining the success of operations and strategic goals. With the alignment of operating tasks and the strategic plan, the detection and adjustment phase becomes more efficient, and companies gain the competitive advantage of achieving clear corporate objectives.

8. Align Resource Allocations with Objectives and Strategy

In every company, each function requires resources, some experiencing shortages and others in excess. To avoid wasted resources and misinformed decisions, identify, prioritise, and invest in projects that align with corporate strategy. By clearly defining strategies, risks, and opportunities, companies can better invest in projects that will produce desired outcomes. Before allocating resources, leading companies define objectives and strategies, and identify key performance metrics that align with the corporate plan. The use of (BI) Business Intelligence tools helps management identify risks and opportunities and allows for the proper allocation of resources to projects that support key objectives. Dash boarding, score carding, and what-if scenarios help monitor results, which is essential to the success of the allocation efforts. This practice focuses on corrective actions and investigation that allows companies to refine and improves processes. With a close alignment of resource allocations and objectives, productivity and accuracy increases, benefiting the overall health of the organisation.

9. Being Timely and Precise

Many companies struggle with time-consuming planning processes. Some planning cycles take up to six months, which results in irrelevant data by the time the plan, is operational. With a clear definition of KPIs, the project plan, and the timeline, planning cycles can be prepared within two months. For example, a company adhering to an agenda can complete the planning cycle in five weeks to:

Week 1: Define corporate and operational goals, as well as KPIs, and link to incentives

Week 2: Communicate planning process to company and accept feedback

Week 3: Complete first part of budget

Week 4: Complete second part of budget

Week 5: Finalise budget and communicate to departments

Because of a shorter cycle, data is kept up-to-date and relevant. By applying best practices and leveraging technology, leading companies have been able to create planning cycles quickly, allowing for sufficient time and resources to meet objectives.

10. Manage the Ever-Changing Market Conditions

Leading companies use planning processes that can quickly adapt to external conditions. This decreases the amount required for analysis and increases the merit of the data. Businesses perform more efficiently with the ability to respond to the business climate, to consolidate plan data, and to analyse information, all in a timely manner. Key practices to develop flexible processes include the use of monthly reforecasting, rolling forecasts, and what-if analyses.

11. Support the Project

Once the budget has been approved, support and maintenance is necessary to keep the project successful. Become a visible sponsor of the project by adhering to the plan and communicating ideas to the rest of the organisation. E-mails, newsletters, and open forums are a few methods used to share information. Providing a supportive and open environment also reduces the chance of failure. The following practices encourage such an environment:

- Create a feedback loop.
- Allow recover time.
- Implement a testing phase.
- Solve problems.

12. Implement Incentives

Many companies use incentives to encourage productivity and support. However, incentives are often tied to targets rather than the objectives. Meeting budget targets should be a secondary goal to meeting other measures. Allow department managers to produce their own goals and offer reward packages to those who meet them. By giving managers the responsibility, the importance of the company's planning process becomes relevant to all parts of the organisation. Objectives and operating strategies become better aligned. Executing such a practice is as simple as identifying the correct measures and encouraging achievements. When the planning process becomes part of the corporate culture, companies will excel in business management as well as financial management.

Appendix A – Budgeting Process: Reaching the TIPPING Point

The TIPPING Point is the completion of a budget process. Firms` budget adjustments and the balancing of budget data become exact point where advancing budgeting process can take place. By investing in information, infrastructure and by establishing a five-stage budgeting process, the organisation begin by Setting Goals & Objectives, Planning & Preparation, Manipulating Budget Data, Finalising Budget & Adjustments, Monitoring Results & Measuring Success, the TIPPING Point can be reached by investing in the firm`s information and creating a data repository to bring a superior return on all information. By forecasting your information, conducting What-if analysis, creating management-style reports, dash boarding, and performing sales analysis, a more accurate and concise forward-looking view of the business will be created. Below is the diagrammatical representation to the budgeting processes.

Budget Preparation Activities

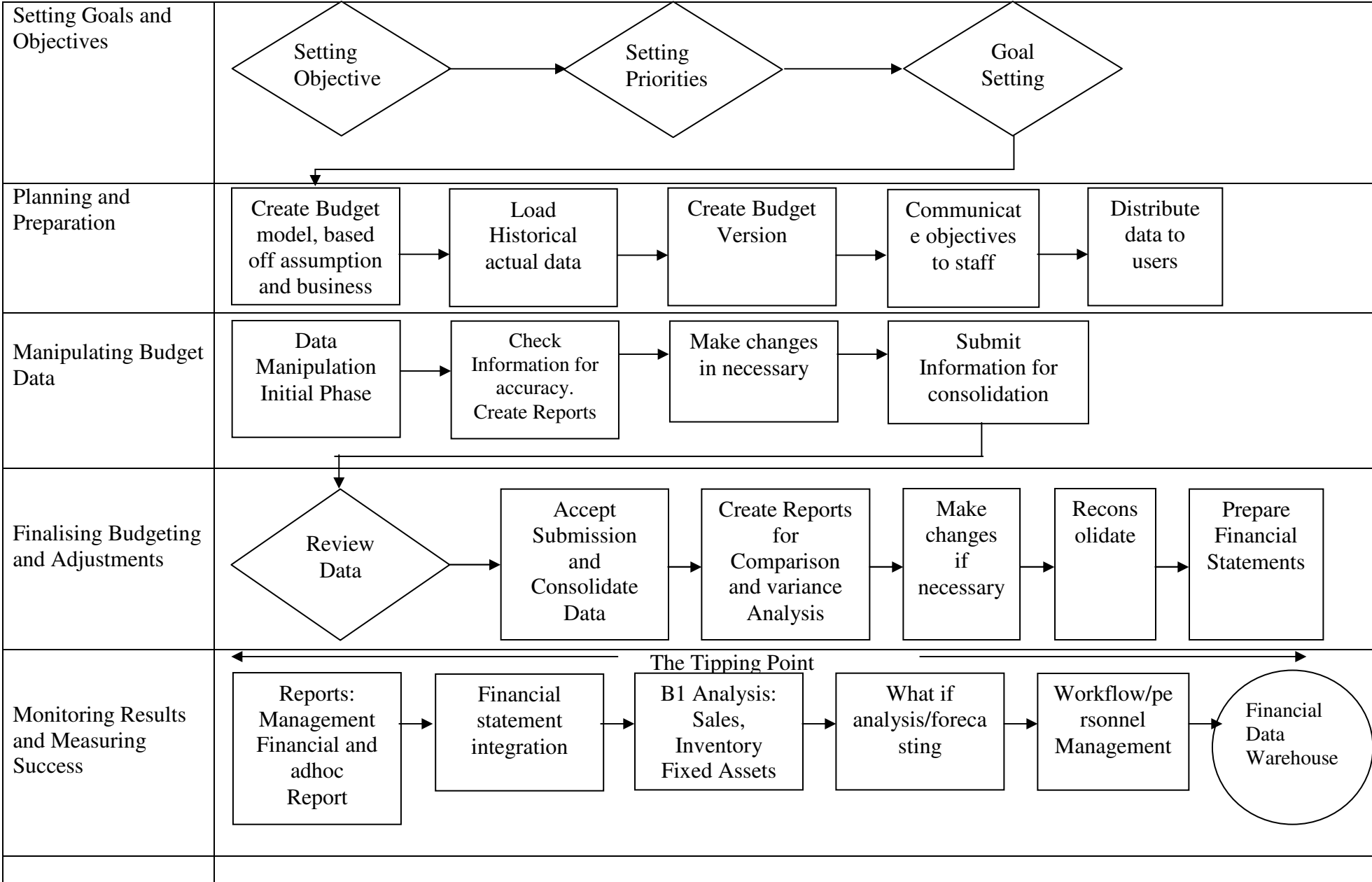
- recognise the value of adhering to an effective budgeting process in business.
- match budget process activities with examples.
- complete the preliminary activities to establish budget objectives for a hypothetical department.

The Budgeting Process

- recognise the benefits of using a methodical budget process.
- match two budget approaches with advantages and disadvantages.
- implement the most favorable budget approach for a given business scenario.
- complete procedures to prepare a departmental budget that supports hypothetical company financial goals.
- match budget components with examples and identify elements used to forecast revenue and expense.
- forecast profit or loss given hypothetical company budget components.

Monitoring Adherence to Budgets

- recognise the importance of monitoring adherence to budgets.
- identify the principles of effective variance report use.
- improve monitoring of budget adherence by using variance reports in a hypothetical business scenario.
- match techniques for addressing revenue variances with examples.
- apply appropriate techniques for addressing revenue variances to hypothetical business situations.



Large enterprises like the Holidayrama Ltd are like aircraft carriers powerful and potent, but slow. To gain agility and reduce risk, companies are turning to Decision Management and business rules management solutions, especially during this radically different and rapidly changing economic environment. Decision Management explains what it takes to create business transformation and keep companies in business despite difficult and dynamic markets. It also presents detailed information on the factors an enterprise must address in implementing or improving the business rules management system. **Financial analysis** therefore assesses the viability, stability and profitability of a business, sub-business or project. It must be performed by corporate professionals who prepare reports using ratios that make use of information taken from financial statements and other reports. These reports are usually presented to top management as one of their bases in making business decisions. Based on these reports, management may:

- Continue or discontinue its main operation or part of its business; or purchase certain materials in the manufacture of its product;
- Acquire or rent/lease certain machineries and equipment in the production of its goods;
- Issue stocks or negotiate for a bank loan to increase its working capital;
- Make decisions regarding investing or lending capital;
- Other decisions that allow management to make an informed selection on various alternatives in the conduct of its business.

As Kristy and Diamond noted, a company's over-all financial health can be assessed by examining three major factors: its liquidity, leverage, and profitability. All three of these factors are internal measures that are largely within the control of a company's management. It is important to note, however, that they may also be affected by other conditions such as overall trends in the economy that are beyond management's control. The factors which have already been linked to the Holidayrama Company are discussed briefly below:

Liquidity: Liquidity refers to a company's ability to pay its current bills and expenses. In other words, liquidity relates to the availability of cash and other assets to cover accounts payable, short-term debt, and other liabilities. All small businesses require a certain degree of liquidity in order to pay their bills on time, though start-up and very young companies are often not very liquid. In mature companies, low levels of liquidity can indicate poor management or a need for additional capital. Of course, any company's liquidity may vary due to seasonality, the timing of sales, and the state of the economy. As with the example of Holidayrama, Companies tend to run into problems with liquidity because cash outflows are not flexible, while income is often uncertain. "Creditors expect their money when promised, just as employees expect regular paychecks. However, the cash being generated does not follow a set schedule. Sales of inventory vary, as do collections from customers," Kristy and Diamond explained. "Because of this difference between cash generation and cash payments, businesses must maintain a certain ratio of current assets to current liabilities in order to ensure adequate liquidity."

Leverage: Leverage refers to the proportion of a company's capital that has been contributed by investors as compared to creditors. In other words, leverage is the extent to which a company has depended upon borrowing to finance its operations. A company that has a high proportion of debt in relation to its equity would be considered highly leveraged. Leverage is an important aspect of financial analysis because it is reviewed closely by both bankers and investors. A high leverage ratio may increase a company's exposure to risk and business downturns, but along with this higher risk also comes the potential for higher returns.

Profitability: Profitability refers to management's performance in using the resources of a business. Many measures of profitability involve calculating the financial return that the company earns on the money that has been invested. As James O. Gill stated in his book *Financial Basics of Small Business Success*, most entrepreneurs decide to start their own businesses in order to earn a better return on their money than would be available through a bank or other low-risk investments. If profitability measures demonstrate that this is not occurring particularly once a small business has moved beyond the start-up phase then the entrepreneur should consider selling the business and reinvesting his or her money elsewhere. However, it is important to note that many factors can influence profitability measures, including changes in price, volume, or expenses, as well as the purchase of assets or the borrowing of money as evidenced by Holidayrama analysis above.

"Measuring the liquidity, leverage, and profitability of a company is not a matter of how many dollars or pounds in assets, liabilities, and equity it has, but of the proportions in which such items occur in relation to one another," Kristy and Diamond wrote. "We analyse a company, therefore, by looking at ratios rather than just dollar amounts." Financial ratios are determined by dividing one number by another, and are usually expressed as a percentage. They enable business owners to examine the relationships between seemingly unrelated items and thus gain useful information for decision-making. "They are simple to calculate, easy to use, and provide a wealth of information that cannot be gotten anywhere else," Gill noted. But, he added, "Ratios are aids to judgment and cannot take the place of experience. They will not replace good management, but they will make a good manager better. They help to pinpoint areas that need investigation and assist in developing an operating strategy for the future."

Virtually any financial statistics can be compared using a ratio. In fact, Kristy and Diamond claimed that there are over 150 recognised financial ratios that can be computed in a financial analysis. In reality, determining which ratios to compute depends on the type of business, the age of the business, the point in the business cycle, and any specific information sought. For example, if a small business depends on a large number of fixed assets, ratios that measure how efficiently these assets are being used may be the most significant. There are a few general ratios that can be very useful in an overall financial analysis. However, to assess a company's liquidity, Kristy and Diamond recommend using the current, quick, and liquidity ratios. The current ratio can be defined as $\text{Current Assets} / \text{Current Liabilities}$. It measures the ability of an entity to pay its near-term obligations. Though the ideal current ratio depends to some extent on the type of business, a general rule of thumb is that it should be at least 2:1. A lower current ratio means that the company may not be able to pay its bills on time, while a higher ratio means that the company has money in cash or safe investments that could be put to better use in the business. The quick ratio, also known as the "acid test," can be defined as $\text{Quick Assets (cash, marketable securities, and receivables)} / \text{Current Liabilities}$. This ratio provides a stricter definition of the company's ability to make payments on current obligations. Ideally, this ratio should be 1:1. If it is higher, the company may keep too much cash on hand or have a poor collection programme for accounts receivable. If it is lower, it may indicate that the company relies too heavily on inventory to meet its obligations. The liquidity ratio, also known as the cash ratio, can be defined as $\text{Cash} / \text{Current Liabilities}$. This measure eliminates all current assets except cash from the calculation of liquidity. Ideally, the ratio should be approximately .4:1.

To measure a company's leverage, Kristy and Diamond recommend using the debt/equity ratio. Defined as $\text{Debt} / \text{Owners' Equity}$, this ratio indicates the relative mix of the company's investor-supplied capital. A company is generally considered safer if it has a low debt to equity ratio that is, a higher proportion of owner-supplied capital though a very low ratio can indicate excessive caution. In general, debt should be between 50 and 80 percent of equity.

Finally, to measure a company's level of profitability, Kristy and Diamond recommend using the return on equity (ROE) ratio, which can be defined as Net Income / Owners' Equity. This ratio indicates how well the company is utilising its equity investment. ROE is considered to be one of the best indicators of profitability. It is also a good figure to compare against competitors or an industry average. Experts suggest that companies usually need at least 10-14 percent ROE in order to fund future growth. If this ratio is too low, it can indicate poor management performance or a highly conservative business approach. On the other hand, a high ROE can mean that management is doing a good job, or that the firm is undercapitalised.

In conclusion, financial analysis can be an important tool to business owners and managers to measure their progress toward reaching company goals, as well as toward competing with larger companies within an industry. When performed regularly over time, financial analysis can also help small businesses recognise and adapt to trends affecting their operations. It is also important for small business owners to understand and use financial analysis because it provides one of the main measures of a company's success from the perspective of bankers, investors, and outside analysts. As inferred in the financial statements of Holidayrama Ltd, Financial analysts often compare financial ratios of solvency, profitability and growth of the business in:

- **Past Performance** - Across historical time periods for the same firm at say, the last 3 years of operation.
- **Future Performance** - Using historical figures and certain mathematical and statistical techniques, including present and future values, this extrapolation method is the main source of errors in financial analysis as past statistics can be poor predictors of future prospects.
- **Comparative Performance** - Comparison between similar firms.

Comparing financial ratios are merely one way of conducting financial analysis. Financial ratios face several theoretical challenges such as:

- They say little about the firm's prospects in an absolute sense. Their insights about relative performance require a reference point from other time periods or similar firms.
- One ratio holds little meaning. As indicators, ratios can be logically interpreted in at least two ways. One can partially overcome this problem by combining several related ratios to paint a more comprehensive picture of the firm's performance.
- Seasonal factors may prevent year-end values from being representative. A ratio's values may be distorted as account balances change from the beginning to the end of an accounting period. Use average values for such accounts whenever possible.
- Financial ratios are no more objective than the accounting methods employed. Changes in accounting policies or choices can yield drastically different ratio values.
- They fail to account for exogenous factors like investor behaviour that are not based upon economic fundamentals of the firm or the general economy fundamental analysis.

The two main sources of data for financial analysis are a company's balance sheet and income statement. The balance sheet outlines the financial and physical resources that a company has available for business activities in the future. It is important to note, however, that the balance sheet only lists these resources, and makes no judgment about how well they will be used by management. For this reason, the balance sheet is more useful in analysing a company's current financial position than its expected performance.

The main elements of the balance sheet are assets and liabilities. Assets generally include both current assets as cash or equivalents that will be converted to cash within one year, such as accounts receivable, inventory, and prepaid expenses and noncurrent assets as assets that are held for more than one year and are used in running the business, including fixed assets like property, plant, and equipment; long-term investments; and intangible assets like patents, copyrights, and goodwill. Both the total amount of assets and the makeup of asset accounts are of interest to financial analysts. The balance sheet also includes two categories of liabilities, current liabilities as debts that will come due within one year, such as accounts payable, short-term loans, and taxes and long-term debts as debts that are due more than one year from the date of the statement. Liabilities are important to financial analysts because businesses have same obligation to pay their bills regularly as individuals, while business income tends to be less certain. Long-term liabilities are less important to analysts, since they lack the urgency of short-term debts, though their presence does indicate that a company is strong enough to be allowed to borrow money. The balance sheet also commonly includes stock-holders' equity accounts, which detail the permanent capital of the business. The total equity usually consists of two parts, the money that has been invested by shareholders, and the money that has been retained from profits and reinvested in the business. Generally, the more equity that is held by a business, the better the ability of the business to borrow additional funds.

In contrast to the balance sheet, the income statement provides information about a company's performance over a certain period of time. Although it does not reveal much about the company's current financial condition, it does provide indications of its future viability. The main elements of the income statement are revenues earned; expenses incurred, and net profit or loss. Revenues consist mainly of sales, though financial analysts may also note the inclusion of royalties, interest, and extraordinary items. Likewise, operating expenses usually consist primarily of the cost of goods sold, but can also include some unusual items. Net income is the "bottom line" of the income statement. This figure is the main indicator of a company's accomplishments over the statement period.

Financial analysis is an aspect of the overall business finance function that involves examining historical data to gain information about the current and future financial health of a company. Financial analysis can be applied in a wide variety of situations to give business managers the information they need to make critical decisions. "The inability to understand and deal with financial data is a severe handicap in the corporate world," Alan S. Donnahoe wrote in his book *What Every Manager Should Know about Financial Analysis*. "In a very real sense, finance is the language of business. Goals are set and performance is measured in financial terms. Plants are built, equipment ordered, and new projects undertaken based on clear investment return criteria. Financial analysis is required in every such case."

In any case, the finance function in business organisations involves evaluating economic trends, setting financial policy, and creating long-range plans for business activities. It also involves applying a system of internal controls for the handling of cash, the recognition of sales, the disbursement of expenses, the valuation of inventory, and the approval of capital expenditures. In addition, the finance function reports on these internal control systems through the preparation of financial statements, such as income statements, balance sheets, and cash flow statements. Finally, finance involves analysing the data contained in financial statements in order to provide valuable information for management decisions. In this way, financial analysis is only one part of the overall function of finance, but a very important one. "The mathematical tools produce data, not explanations; information, not interpretation; measurement, not meaning," according to James E. Kristy and Susan Z. Diamond in their book *Finance without Fear*. "To these tools you must add judgment, which develops slowly mostly out of experience."

After computing Financial Statements and arriving at ratios, companies may have been intensely creative in generating solutions to a problem, and rigorous in selection of the best one available. However, this solution may still not be worth implementing, as the business may invest a lot of time and money in solving a problem that is not worthy of this effort. An alternative tool for addressing such difficult challenges in real life company situation is the use of Cost Benefit Analysis. Cost Benefit Analysis or CBA is a relatively simple and widely used technique for deciding whether to make a change. As its name suggests, companies simply add up the value of the benefits of a course of action, and subtract the costs associated with it. Costs are either one-off, or may be ongoing. Benefits are most often received over time. We build this effect of time into our analysis by calculating a payback period as evidenced in the calculations of Holidayrama Company Ltd explained earlier. This is the time it takes for the benefits of a change to repay its costs. Many companies look for payback on projects over a specified period of time e.g. three years.

Cost-benefit analysis is carried out using only financial costs and financial benefits. For example, a simple cost benefit ratio for a road scheme would measure the cost of building the road, and subtract this from the economic benefit of improving transport links. It would not measure either the cost of environmental damage or the benefit of quicker and easier travel to work. A more sophisticated approach to building a cost benefit models is to try to put a financial value on intangible costs and benefits. This can be highly subjective, for example, a historic water meadow worth £25,000, or is it worth £500,000 because of its environmental importance? What is the value of stress-free travel to work in the morning? These are all questions that people have to answer, and answers that people have to defend. The version of the cost benefit approach we explain here is necessarily simple. Where large sums of money are involved for example, in financial market transactions, project evaluation can become an extremely complex and sophisticated art. The fundamentals of this are explained in Principles of Corporate Finance by Richard Brealey and Stewart Myers.

Example: A sales director is deciding whether to implement a new computer-based contact management and sales processing system. His department has only a few computers, and his salespeople are not computer literate. He is aware that computerised sales forces are able to contact more customers and give a higher quality of reliability and service to those customers. They are more able to meet commitments, and can work more efficiently with fulfillment and delivery staff. His financial cost/benefit analysis is shown below:

Costs: New computer equipment:

- 10 network-ready PCs with supporting software @ £2,450 each
 - 1 server @ £3,500
 - 3 printers @ £1,200 each
 - Cabling & Installation @ £4,600
 - Sales Support Software @ £15,000
- Training costs:
- Computer introduction - 8 people @ £400 each
 - Keyboard skills - 8 people @ £400 each
 - Sales Support System - 12 people @ £700 each

Other costs:

- Lost time: 40 man days @ £200 / day
- Lost sales through disruption: estimate: £20,000
- Lost sales through inefficiency during first months: estimate: £20,000

Total cost: £114,000

Benefits:

- Tripling of mail shot capacity: estimate: £40,000 / year
- Ability to sustain telesales campaigns: estimate: £20,000 / year
- Improved efficiency and reliability of follow-up: estimate: £50,000 / year
- Improved customer service and retention: estimate: £30,000 / year
- Improved accuracy of customer information: estimate: £10,000 / year
- More ability to manage sales effort: £30,000 / year

Total Benefit: £180,000/year

Payback time: $\frac{£114,000}{£180,000} = 0.63$ of a year = approx. 8 months

Tip: The payback time is often known as the break even point. Sometimes this is more important than the overall benefit a project can deliver, for example because the organisation has had to borrow to fund a new piece of machinery. The break even point can be found graphically by plotting costs and income on a graph of output quantity against £. Break even occurs at the point the two lines crosses as demonstrated in the financial analysis of Holidayrama Ltd in chapter 13 above. Inevitably the estimates of the benefit given by the new system are quite subjective. Despite this, the Sales Director is very likely to introduce it, given the short payback time. Cost/Benefit Analysis is a powerful, widely used and relatively easy tool for deciding whether to make a change.

To use the tool, firstly work out how much the change will cost to make. Then calculate the benefit you will gain from it. Where costs or benefits are paid or received over time, work out the time it will take for the benefits to repay the costs. Cost/Benefit Analysis can be carried out using only financial costs and financial benefits. Companies may, however, decide to include intangible items within the analysis. As you must estimate a value for these, this inevitably brings an element of subjectivity into the process. Larger projects are evaluated using formal finance/capital budgeting, which takes into account many of the complexities involved with financial Decision Making. Of course, these are high level technical languages that employees and other stake holders might find difficult to understand. By so doing a strategy will always be necessary for the Financial Manager to employ so that companies new changes, policies and mission could be communicated to its audience without much problems.

Consolidating the key financial information on a single page is a great tool for communicating some of the most important data about the company in a quickly-grasped snapshot. Because of this, it is not only good for companies' board, but their employees as well. Presenting the data this way makes it much easier for an audience to understand the financial health of the company without pouring over the complete set of financial statements. It also gives the business chance to make clear to its audience what it believes are and the highest priority financial metrics for the company at any time. This way, the Financial Manager Learns what does and does not need to be said and how to “walk through” critical information with non-financial audiences. Also learn how to obtain better information from accountants and financial experts to improve the communication efforts.

Objectives and Highlights

1. Sifting the chaff, what does and does not need to be communicated
2. Lighting the path, relating to the audience
3. Pointing out the potholes, emphasise the critical data
4. Walking together, establishing ongoing communication helpful to all
5. Report card of activity and status
6. Provide credibility and Stimulate thought or action
7. Ask questions your audience will likely ask of you
8. Define terms in common language
9. Determine your communication goals
10. Thorough knowledge of raw information
11. Understand audience
12. Agree on motive approaches and provide material ahead of presentations

Critical Concept

- Relating to the audience
- Sales people want SALES data
- Cash managers want cash, not accruals
- Stockholders want EPS, etc.
- Executives want Bigger picture and bottom line

What Financial Manager must not do:

- Using accounting to explain accounting
- Failing to explain relevance
- Overuse or improper use of technical terms
-

Better mousetraps: The Financial Manager must use

- Charts, graphs and diagrams to reach the non financial audience
- Overviews, even for audited reports
- Plain and clear language
- Use examples audience can relate to
- Refer to products (sales of cars, etc.)
- Use the terminology of the company's audience

Financial Analyst need to know how to communicate with various managers and even employees to get a better sense of the company as it exists among the workers. Financial analysts can require years of data to create a thorough report on a company. The analyst will also need to create trend lines showing how all of the major ratios interact with one another over time. With companies becoming more and more transparent about their business to their employees, further obstacles to delivering the information have to be overcome. Firstly, with complex financial information, many employees may not have the business literacy to fully understand it. Below is a summary of Jim Cole's five-point process to help overcome this issue.

Planning – understand the financial data, the intent of your communication effort, the employee expectations of it and the audience's perspective.

Play a game of “Stump the Expert” – quiz yourself, the communication expert, to make sure everything you are saying will be understood by the audience.

Differentiate between “need-to-know” and “noise” – senior leaders often want to disclose too much, which can lead to communication becoming “noise.” Try to communicate an idea rather than a number or a type of ratio.

Whose bottom line is it? – remember, not everyone has the same concept of the “bottom line,” so concentrate on what your audience wants from the information.

Match metaphors to audience – remember the professional and personal perspective of the audience, and use key words and phrases to make communication easier to understand.

Developed by: Jim Cole, Director of Development, Masonic Home of Virginia

“Learning Maps were the single most impactful tactic we have ever employed to communicate our business strategy and financial ratios to our employees and engage them in working towards its key objectives,” says Rodenbough. “Visual learning is a way to connect with people who can not just absorb a report filled with facts and numbers.” The team chose an innovative approach to kick-start the process of communicating this change to employees: live, tangible Learning Maps to provide people with a basic understanding of the challenges that the company faces and explain to them why certain choices had been made. Communicating about the business to employees presents a range of challenges, even with the greatest amount of planning and research. Key to this is how you effectively cascade material in a way that will create a clear line of sight at every level. In a large multinational, how you strike the right balance between global and local strategy to corporate business priorities are vital issues.

British Petroleum (BP) used a toolkit approach to overcome this challenge. How to make messages interesting, compelling, and convey a clear direction for action is essentially the ultimate aim of strategy communication. Before introducing the hexagonal toolkit to the managers who would be using it, BP focused on the critical task of engaging them in the content of the new strategy. Once they had built up the required appetite for the strategy, the toolkits were introduced as a means of translating it to the wider audience. Jacqui Hitt, a consultant on this project, says: “We needed leaders to understand the full detail of the background to change. Once that was established, the tiles were just the next piece of the puzzle, an aid for them to distil all that content into an easy and practical format. It was not just the tiles but it was about building the momentum behind them.”

Switching gears for a brief moment, people in every industry talk about team building and working as a team, but few understand how to create the experience of team building or how to develop an effective team. It is here that leaders must take on the significant task of developing the design, while at the same time, using their teams to strengthen the depth of the organisations leadership bench. As individuals work to achieve Personal Proficiency for their role in the organisation, leadership must begin the rotation process to ensure that each person in the system also achieves an increased level of Professional Mastery at each job task. When the rotation begins to show positive organisational behaviours from the people within the different areas and departments, this too will result the beginnings of a dynamic team being formed on behalf of the organisation. In Financial Management, the task will require collaboration of the Accounts Department, Cost and Management Accounting Department, The Budget and sometimes the Treasury sections of the organisation before a financial decision are arrived at. Usually the lead consult will be the Director of Finance who will invite submissions of figures and statistical data from the various departments under his/her watch through a properly convene meetings in order to arrive at financial figures which should assist the firm in attaining its short term, medium and long term goals. When making financial decisions, the whole team's energy and drive is focused on reaping what the organisation is aiming to achieve in the longer term and there is a clear understanding of how the team will achieve this goal in the short, medium and long term. Here, each team member must have clearly defined responsibilities for team issues as well as their own functional role or specialism, and these team roles are assigned based on their strengths and preferred behaviours for working within a team. For example, a team member within the sales function may take on responsibility for liaising with customer service on behalf of the whole sales team as they enjoy networking with others and are good at building strong working relationships.

Although the leader of the team clearly holds the vital leadership role, in a high performing team, team members complete some tasks that a traditional leader holds, for example, chairing the monthly team meeting to ascertain total turnover before forwarding them to the Accounts Department. Team members also accept far more responsibility for resolving issues on behalf of the team when there is a sense of shared leadership and ownership for the business. That is to say, within high performing teams, foundations are not only in place for team members at all levels within the organisation to ask questions and provide feedback on how the organisation is performing, but also simple methodology for team members to share ideas and propose potential solutions to growing the business or increasing the effectiveness of the organisation's systems and processes. Whatever system used for this, the key is to ensure that there is a quick method for providing feedback to the team member after submitting their question, feedback, idea or suggestion from the field of work. An "open door" policy along with regular team meetings and feedback sessions with senior managers will support this approach. Leaders of high performance teams recognise utilisation of team members' talents and ensure they are aware of all the team member's talents inside and outside work and continuously look for ways to utilise these to benefit the organisation and its people.

High performing teams schedule and spend time frequently reviewing their team objectives to ensure they are on track to achieve their goals within the original time frame set. By doing this they are also able to effectively manage any difficulties that arise and plan additional resource to achieve the goal. In this type of environment, team members are very clear on their responsibility to deliver results whilst feeling supported by other team members when challenges and issues arise. Time is also set aside to review the effectiveness of each goal or project to ensure sufficient learning is acquired and applied for future goals and projects. By so doing, the responsibilities of team leader must be clear as enumerated below:

- Assign clear tasks to each member and regularly review and monitor progress of work
- Ensure that the team meets deadlines through discussions and agree on the timetable for major activities with the team
- Motivate team members by resolving conflicts
- Give guidance when needed and help members to overcome barriers
- Regularly assess team performance using a checklist

Skills you need to be a good leader

- involving members in decision-making provides personal encouragement
- recognising and rewarding good performance build on members confidence to use their own initiative
- By inspiring members with a vision for success, it ensures good two-way communication

Leaders have a clear sense of where they want to go and how they intend to get there. They see the big picture, and then create a strategic plan for achieving their goals. In demonstrating how team leading skills are required when implementing financially-based decisions, the financial manager seeks to:

- Strengthen teamwork and group dynamics
- Build cross-functional decision-making capabilities
- Distinguish task leadership from compliance to task
- Operate effectively in high-stress environments
- Create trust among team members during budgeting and forecasting
- Discover the impact of clear, concise communication and
- The power of accountability and personal responsibility to all team members of the team

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