EXECUTIVE SUMMARY

Student: Ali Prasla (UTEID: anp2429) Section: 3:30 PM TTH

**Statement of Problem:**

Jones Electrical Distribution, a profitable company, has experienced a shortage of cash. In order to meet the Company’s current liabilities, Jones maxed out his line of credit with a local bank. After securing an additional line of credit with Southern Bank, Jones must decide the payment schedule for his suppliers. There are two possible options: he pays the suppliers within 10 days of receipt, earning a 2% discount on his purchases or he waits until later to secure the cash. Taking the first option will require additional short term financing.

**Discussion:**

Ideally, Jones would have enough cash on hand to meet his obligations. However, this is infeasible due to his Company’s operational cycle. Therefore, a trade-off exists between additional interest expense of the short term loan and money saved by discount. As shown in Exhibit A and using Cost of Goods sold as a proxy for supplying costs, the benefit of the discount is approximately $40,000. Then, a pro-forma balance sheet and income statement was constructed (Exhibit B and C). The income statement in particular (constructed later using the financing demand) shows a significant increase in net income, about $38,000 with the discount.

Using historical trends and common sized ratios, the constructed balance sheet has the largest difference in the Accounts Payable row. This difference comes from Exhibit D, where the difference of $122,9

40 in financing demand is shown between the Discounted and Non-Discounted options. Fortunately for Jones, the financing demand was lower than the financing available (Exhibit E) through the Southern Bank Deal. There was no need to use the mortgage or issue more equity.

When evaluating a financial, it is important to look at the short and long term effects of this financing. The short term effects are, of course, an increase in net income. However, the long term impacts are minimal for this financing deal. There is no long term debt and a highly liquid capital structure. The Company is only subject to certain debt covenants, which are not a worry, because of the Company’s strong financial situation.

Yet, this agreement is less than ideal in the long term. As the Company grows, the convent restrictions are going to become more and more constraining. But the solution is adequate to solve today’s problem.

**Recommendation:**

Jones should borrow about $210,000 from Southern Bank to pay for the discount from the suppliers. This increases net income without poising too much liability or operational restrictions on the Company.