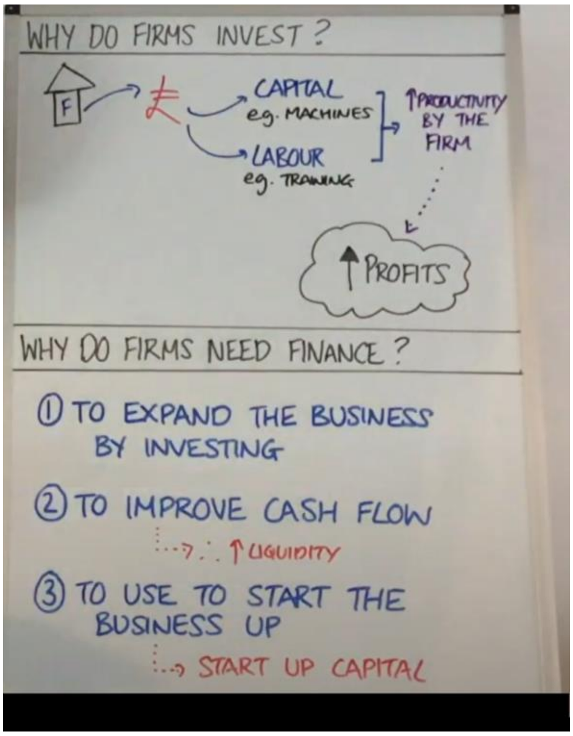
Investments and finance introduction



Firms will invest

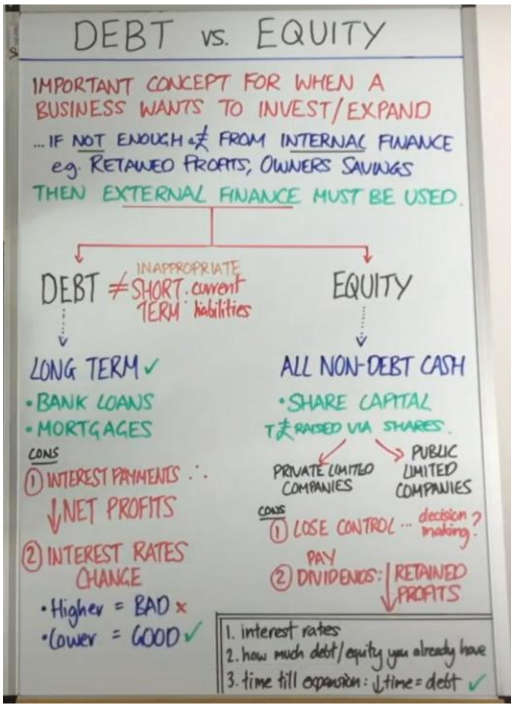
- Capital (machines)
- Get better labour skill force

These things will increase productivity of firm → increase profits

Why firms need finance

- Expand business by investing
- Improve cashflow → stop liquidity
- Use to start business up (start-up capital)

Debt vs Equity



Important when business wants to invest/expand if there isn't enough from internal finance → external finance needed

Debt (long term)

- Bank loans
- Mortgages
- **Disadvantages**
  - Interest payments → lower net profits
  - Interest rates change

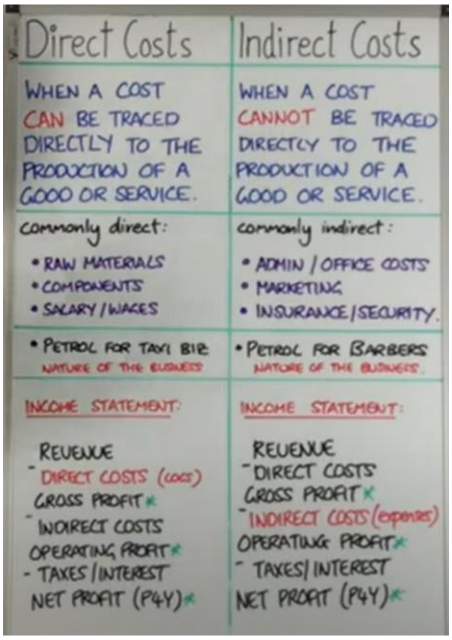
Equity (non-debt cash)

- Share capital
- **Disadvantages**
  - Lose control → less decision making
  - Pay dividends → lower retained profits

Which to use depends on

- Interest rates
- How much debt/equity you already have
- Time till expansion (less time → debt)

<u>Direct and indirect costs</u>



Direct costs = Cost can be traced directly to the production of a good/service

Common direct costs

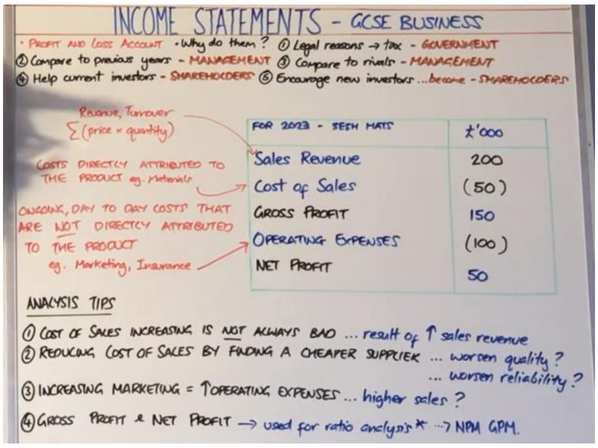
- Raw materials/components
- Salary/wages

Indirect costs = Cost cannot be traced directly to the production of a good/service

Common indirect costs

- Admin/office cots
- Marketing
- Insurance/security

Income statements



Why do income statements

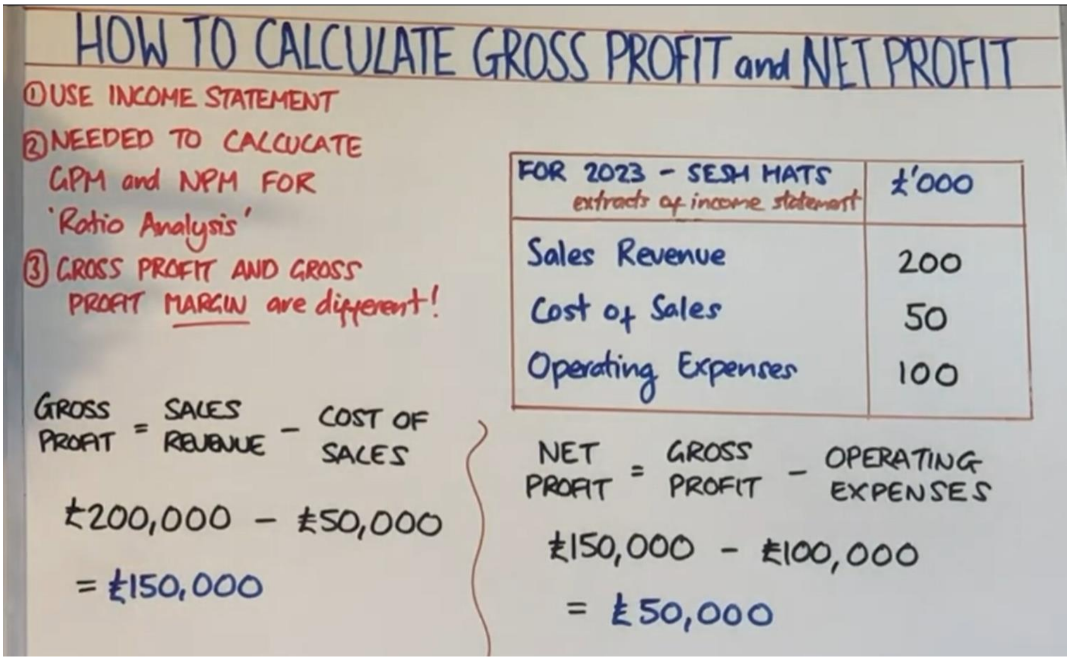
- Legal reasons (tax)
- Compare to previous years
- Compare to rivals
- Help current investors
- Encourage new investors

Analysis

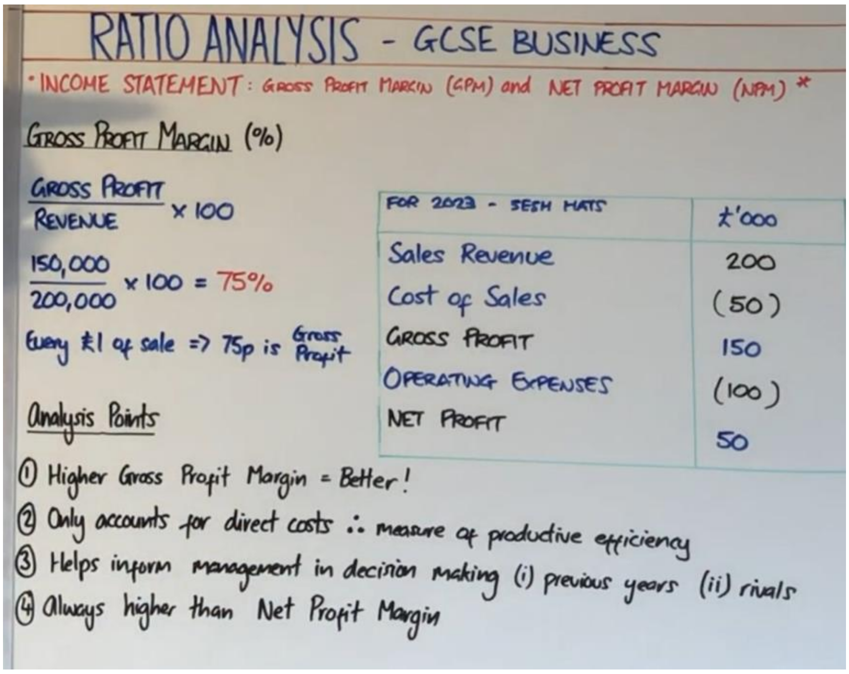
- Cost of sales → May be result of sales revenue increasing
- Reducing cost of sales by finding cheaper supplier → Worsen quality/reliability?

- Increasing marketing → increase operating expenses → higher sales?
- Gross profit and net profit → used for ratio analysis

Calculating gross profit and net profit

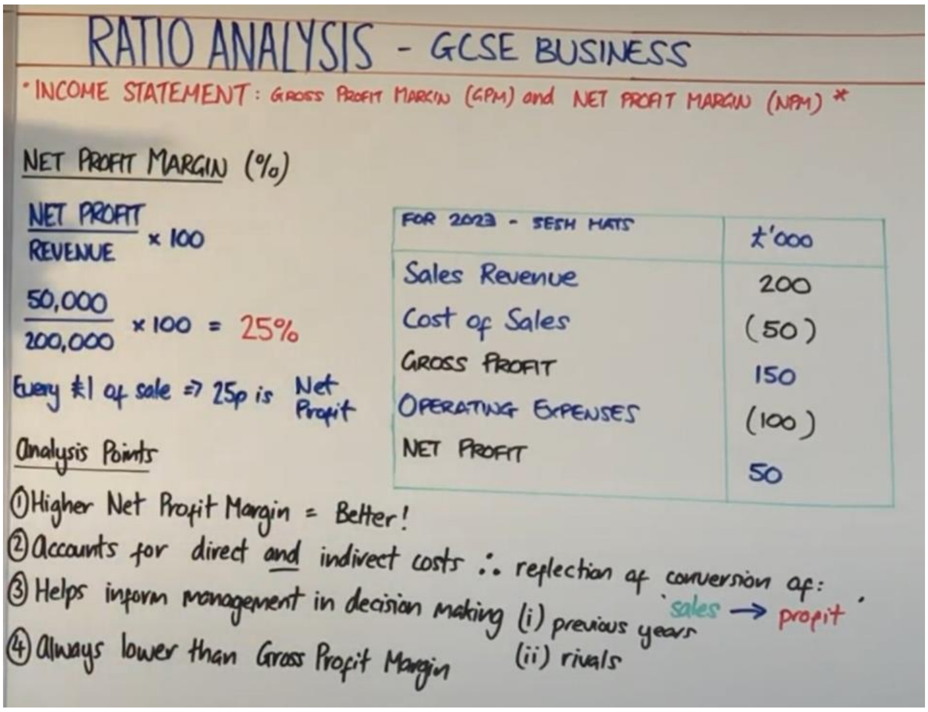


<u>Ratio analysis</u>



Analysis

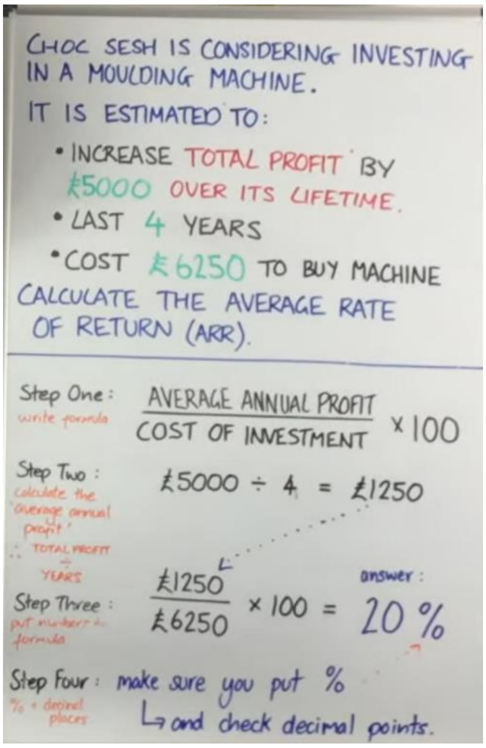
- Higher GPM = better
- Only accounts for direct costs → Measure of productive efficiency
- Helps inform management in decision making (previous years/rivals)



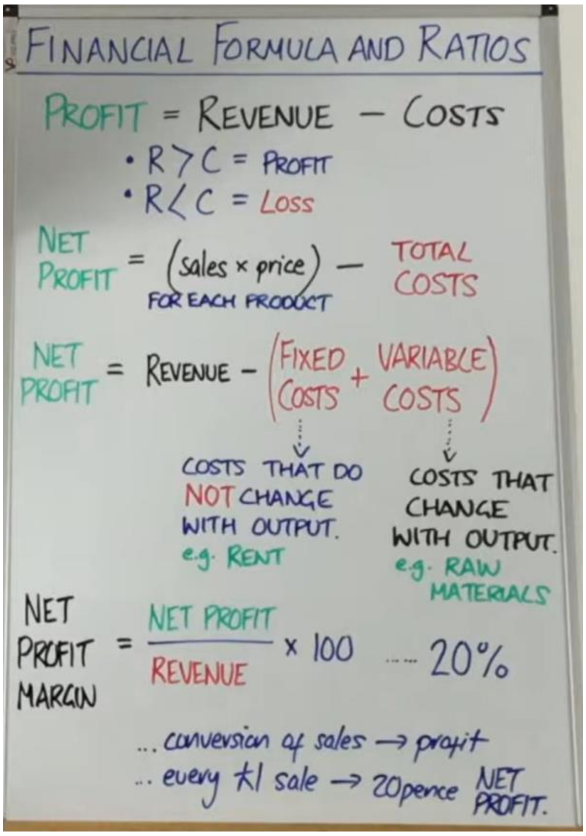
Analysis

- Higher NPM = better
- Accounts for direct and indirect costs
- Helps inform management in decision making (previous years/rivals)

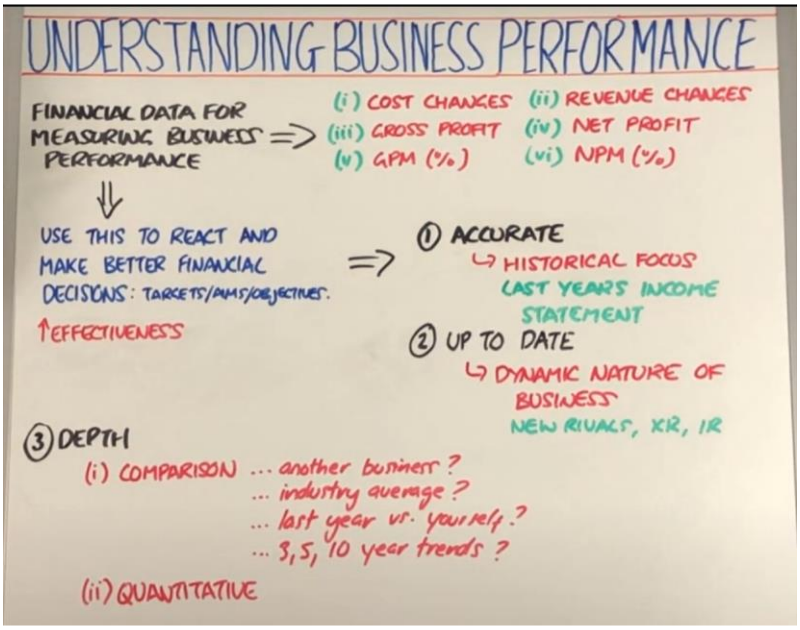
<u>Average Rate of return (ARR)</u>



Financial formulas



Understand business performance



Use financial data to react and make better financial decisions (targets/aims/objectives) → increase effectiveness

- Accurate
  - Last years income statement
- Up to date
  - Dynamic nature of business (things change)
- Depth
  - Comparison (on its own my not be enough)
  - Quantitative

Types of profit

Gross profit

- Pricing decisions
- Production efficiency

- Control excess production costs

Operating profit

- Operating expenses
- Operating performance
- Can control excess operating costs

Net profit

- Overall profitability
- Shows you conversion of sales → profit

Retained profit