



Section 3.6

Activity 3.6.1

1.
 - a. Debtors days: $\$23\,422\text{m} / \$227\,969\text{m} \times 365 = 37$ days
 - b. Creditor days: $\$30\,282\text{m} / 160\,000\text{m} \times 365 = 69$ days
 - c. Stock turnover: $160\,849\text{m} / 22\,097\text{m} = 7.27$
 - d. Gearing: $34\,574\text{m} / 177\,555\text{m} = 19.47\%$
2. Comments on Total Oil's efficiency and gearing ratios:
 - Debtor days – it takes on average a debtor 37 days to pay
 - Creditor days – the business pays its creditors in 69 days on average
 - Stock turnover – the business sells its stock 7.27 times on average in a year
 - Gearing – 19.47% of the firm's long-term finance is borrowed.
3. A strategy Total Oil might use to improve efficiency could be to:
 - Increase stock turnover by reducing the amount of stock the business holds. The problem with this is that it might lead to stock out costs.
 - Cut the time period it allows debtors to have before they pay. The problem with this is it might lead to a fall in sales as some customers look for suppliers with better credit terms.

A strategy Total Oil might use to improve its gearing could be to:

- Pay back some long-term loans by selling new shares. The problem with this is that selling shares might reduce the control of existing shareholders
- Sell assets to pay off some long-term loans. The problem with this is that selling assets might reduce the business's ability to generate profits in the future.

Activity 3.6.2

1. Efficiency and gearing ratios for Union Market Wholesale and RFL Wholesale:

	Debtor days (days)	Creditor days (days)	Inventory turnover	Gearing (%)
Union Market	98	71	7.95	31.74
RFL	83	70	5	50

2. Comments on Union Market Wholesale and RFL Wholesale's efficiency and gearing:
 - RFL gets payment from debtors more quickly than Union Market Wholesale



- RFL pays creditors more slowly than Union Market Wholesale
- Union Market's stock turnover is faster than RFL
- Union Market's gearing ratio is lower than RFL.

3. The advantages to RFL of raising finance by selling stock include:

- Repayment is not needed
- No loss of control
- No interest payment.

The disadvantages to RFL of raising finance by selling stock:

- Stock out costs
- Selling \$73m of stock could be difficult to do quickly.

The advantages to RFL of raising finance by taking a bank loan:

- No loss of control
- Planned repayment and interest
- Can be raised quickly.

The disadvantages to RFL of raising finance by taking a bank loan:

- Interest payments
- Repayment
- May need to be secured.

Exam practice question

- a. Revenue is the income business receives from sales calculated as selling price x unit sold.
 - b. Inventories are the stock a business holds as raw materials, components, work in progress and finished goods.
- Karachi traders could measure efficiency by using day's sale in stock (stock / cost of goods sold x 365). This tells the business how quickly stock is sold.
- The values for the following ratios for Karachi Paper in 2013 and 2014 are:

	Debtor days (days)	Creditor days (days)	Inventory turnover	Gearing (%)
2013	77	137	2.78	46.15
2014	73	164	2.06	50

- On the basis of the ratios Karachi Papers might want to introduce strategies to deal with the following things:



- Debtor days is falling so the business is collecting from debtors more quickly. The problem with this is it might be losing sales because of more restrictive credit terms.
- Creditor days is rising, which means the business is paying more slowly so it keeps cash for longer. The problem with this is that it may incur penalty interest payments.
- Inventory turnover is falling, which means stock is being held for more time in the business and the firm incurs more holding costs. The benefit of holding more stock is that stock out costs are reduced
- Gearing ratio has increased which means the business may have more interest to pay and greater repayments. It may, however, have had more funds for investment.

Key concept question

Change might affect the way a business measures efficiency in the following ways:

- Ratios that are affected by a particular change decision should be used. If the change decision is to improve cash flow then reducing days' sales in debtors could be used.
- Ratio measures that show trends over time should be used to demonstrate whether a change decision is delivering effective change. Is the days' sales in debtor ratio falling to show cash flow might be improving?
- Non-monetary factors that are used to measure efficiency during a time of change, such as the views of managers and customers.

Culture might affect the way a business measures efficiency in the following ways:

- In a power culture ratios will be important for measuring the efficiency of workers
- In a task culture efficiency ratios can be used to measure the performance of different teams
- In a person culture individuals will look to measure their own efficiency.