

# **COMPANY INTERNAL FINANCE**



## Countdown

All companies need money every day to run their business. But where does the money come from? Look at the diagram of the typical cash-flow cycle of a company below.

- 1 Find the three sources from which a company gets its money.
- 2 Work in pairs. Decide which of the items below bring a flow of cash into the company and which mean cash flows out. Mark each item 'In' or 'Out'.
  - a bank loans
  - salaries and rent
  - a bank overdraft
  - selling products to customers
  - owners' capital
  - taxes and dividend payments
  - interest payments on loans
  - buying stocks and raw materials
- 3 Use the information from 2 to complete 1–8 in the diagram below.
- 4 What happens to this cycle if a company sells a product today (1st July) on 90 days' credit?
  - 1 On what date does the company get paid?
  - 2 What kinds of problem can this create for a company?
  - 3 How can a company control its cash flow?

# THE CASH-FLOW CYCLE

**THE BANK**  
We get a loan and an \_\_\_\_\_<sup>1</sup> from the bank.

**THE BANK**  
We pay \_\_\_\_\_<sup>3</sup> to the bank on loans.

**OWNERS**  
The owners contribute \_\_\_\_\_<sup>2</sup>.

**OVERHEADS**  
We pay \_\_\_\_\_<sup>4</sup> to our employees.  
We pay \_\_\_\_\_<sup>5</sup> for our offices.

**SHAREHOLDERS AND TAXES**  
We pay \_\_\_\_\_<sup>6</sup> to shareholders.  
We pay \_\_\_\_\_<sup>7</sup> to the government.

**CASH**

**SALES**  
We sell products to customers.

**PURCHASES**  
We buy \_\_\_\_\_<sup>8</sup> and stock from our suppliers.

**GOODS**  
We produce goods.

**STOCKS**  
We hold stocks.



## Speaking

### Insisting on payment: the final reminder

- 1 When invoices are not paid on time, sometimes the company owed money will telephone, as well as write. In the dialogue below, Renate from PBS is calling Marius from Polstock Products about an unpaid invoice. Match the expressions (1-6) with their possible answers (a-f).

## Renate

1 Hello, this is Renate from PBS. I'm phoning about an unpaid invoice, reference: FG/584/310.

↓ Marius' reply e

2 We emailed you twice last week, but haven't received any reply.

↓ Marius' reply —

3 I see. How can we resolve this issue of the outstanding invoice?

↓ Marius' reply —

4 I appreciate your problem, but I'm afraid I must insist on payment in the next three days.

↓ Marius' reply —

5 Very well but if we don't receive payment by July 27, I'm afraid we'll have to pass this on to our legal department.

↓ Marius' reply —

6 We hope so too. So, I'll look forward to receiving your payment.

↓ Marius' reply —

## Marius

a Well, I'm afraid we cannot do anything until the network is working again.

b OK, I'll contact you again soon. Thank you for your call.

c Oh, I'm sure legal action won't be necessary.

d Sorry, we're having problems with our computer network at the moment so I haven't received any emails.

e Oh, hello. I was planning to phone you about that invoice.

f OK, let me talk to my boss and see what we can do.



## It's my job

The treasury department of a company is often a small team, but it plays an important role in making sure the company always has enough cash to pay its bills. Birgit joined the treasury department of a German company after doing an internship there.

- 1 Read the text. What does a treasury department do? What did Birgit learn from her internship?

## **Birgit Vanderbeke**

**Job** Treasury department assistant

**Location** Bavaria, Germany

**Company** Melstock: German dairy company

**What did you learn most from the internship?**

It was real work experience. My boss took me to all the meetings with the banks to discuss loans and credit terms and always asked my opinions of the negotiations after every meeting. He even forced me to do the calculations. I didn't know anything about negotiating loans but had to learn quickly. It was a surprise to find how different banks wanted different types of security as a guarantee for loans and how my boss would calculate the different advantages before making any decision.

**What sort of responsibilities do you have today?**

I'm the assistant to the director in the treasury department. Our main task is to manage the cash flow in the company. As we now have operations all over Eastern Europe, this is not so easy because we have over 150 different bank accounts in twelve countries. That means we have to move money around the company every day to meet the needs of different parts of the group. But as they all have different currencies we have to use a technique of hedging to protect the value of our money against movements in other currencies.

My main tasks now are to manage the working capital so that that we have the money to pay our suppliers, even if the customers don't pay us for 90 days. We use a system of factoring to get the cash we are owed immediately rather than wait for the customer to pay us.





## Reading

### Financing the company

Companies need different types of financing for different activities. They need *short-term* financing for daily operations, like paying their bills to suppliers, but they also need *medium* and *long-term financing*, for example, to buy properties, machinery or to expand into new markets.

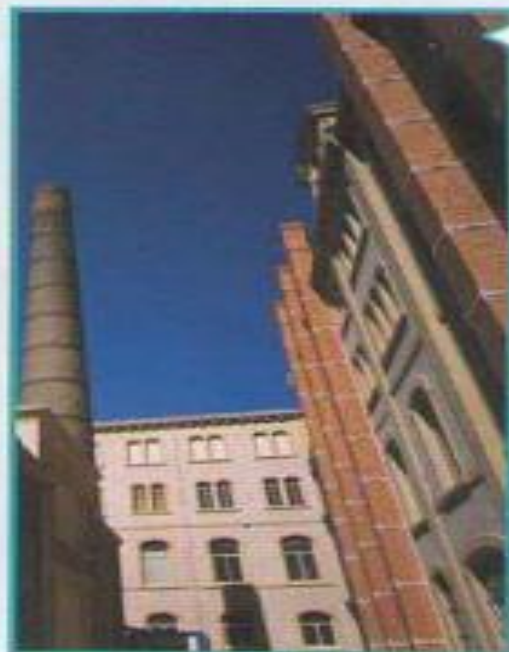
- 1 Look at these four different problems of company financing below. Decide which of the problems need short-term and which need long-term financing. Mark each company file S (short-term) or L (long-term).



**Plasnia** is a plastics company based in Brazil. It needs to invest heavily in new machinery. Its machines have to be replaced every three years because of new technology and this uses up a lot of its profits every year.



**Claw Valley** is a health food company. Its biggest customer (40% of sales) is a major supermarket, but the supermarket often takes 120 days before it pays its bills to the company.



**Schlink**, a German family company, owns its own engineering factory, but the building in a city centre is old and not adapted to modern production or truck delivery. The site is worth \$20m, but badly needs modernization and the company doesn't have the funds to do the work.

■ **Mitlink** is a software start-up company in Cambridge, Mass. which sells devices for mobile phones. Sales are expanding fast, but it often has problems paying its rent and even salaries at the end of each month because it is short of finance.



**2** Find out what kind of financing these companies could use. Look at the text and match the types of financing 1-7 with the explanations a-g given below on the website.

- 1 bank overdraft
- 2 trade credit finance
- 3 bank loans and term loans
- 4 property and machinery leasing
- 5 factoring of sales invoices
- 6 bonds / debentures
- 7 mortgages

- a** A system of borrowing in which you take out a loan by offering the guarantee of some asset, usually a building, as a security. This can be much cheaper than other forms of loan.
- b** If your company is owed cash by customers who take a long time to pay you, why not sell the debts to a bank in exchange for immediate payment? The bank will charge you a commission fee but it gives you immediate cash.
- c** A system by which a company borrows money from a bank for an agreed medium or long-term period and pays interest each year on the debt plus final repayment of the capital.
- d** An arrangement with a bank that allows you to spend more money than you have in your account for a short time to pay bills or expenses. Talk to your bank and arrange a 'facility' but remember this can be an expensive way of financing your business and is not a long-term solution.
- e** An arrangement between a company and a bank or specialist finance company in which the bank buys machinery, cars, trucks, etc. for the company and charges the company a regular fee to use this equipment. This saves you from making big long-term capital investments.
- f** A larger company can borrow money from the financial markets by issuing debt or 'paper' to the financial markets. It borrows the money from long-term investors and agrees to repay with interest over a given period. This can give real long-term stability to your company.
- g** Have you thought of negotiating with your suppliers to get short-term financing by buying on credit and paying 30/60 days after they deliver the goods? This is a common arrangement if you place regular orders with a supplier and they trust you.

## Professional skills

### Negotiating



- 1 What kind of things have you negotiated about in the last week – for example at home, with companies, or in shops? Make a list and explain to a partner what you did. Did you get what you wanted?

**2** Now read the advice on negotiating below. Do you agree with it?

What do you think of when people talk about negotiating? Buying a car and arguing over the price? Negotiating over the rent of your flat? Deciding with your friends which film to see tonight?

In fact, most people think first of price negotiations. This leads them to think there must be a winner and a loser in every negotiation. 'I will start by asking a really high price and then negotiate down. I know what my bottom line is, I won't sell for less than that.'

But is it the same in a business negotiation? Business research suggests that when companies negotiate with a supplier over a contract, both sides have to live with the results for years. If one side feels that it has got a bad deal, does that make for a successful commercial long term partnership? Probably not.

That is why management experts now believe that the best solution is to think of all professional negotiations as part of building a partnership. So, in a professional negotiation you should:

- set clear objectives about what you want to achieve
- focus on the issues and not on personalities
- try to understand the needs and fears of the other side
- not get emotional, be negative or blame people. It doesn't help.
- always prepare options in advance – you will never achieve everything you want.

## Vocabulary

### Income statement / profit and loss account

Every year, by law, a public company has to present its audited financial results to its shareholders and publish them in the annual report. But to understand how much profit (or loss) a company has made we need to turn to the income statement or profit and loss account. The income statement is made up of three parts:

- 1 the trading performance
- 2 the operating performance
- 3 the distribution of profit.

- 1 Look at the income statement for NBS (a UK company) and write the titles 1–3 above in the correct sections a–c in the statement.
- 2 Look at the first part of the income statement (a) and find the accounting words they use to show you
  - 1 the money spent on raw materials and components for production
  - 2 the total sales last year
  - 3 the total sales minus the material costs.
- 3 Now in the second part (b) find the words for
  - 1 the tax paid on profit
  - 2 the fixed costs of running the business
  - 3 the profit made after deducting all the costs of running the business
  - 4 the final profit it made after paying tax
  - 5 the cost of paying interest on all the bank loans.
- 4 Now find the words in the third section (c) that show
  - 1 the money it kept for future investment
  - 2 the amount it paid shareholders based on each share they owned
  - 3 the amount of profit made for each share in the company.
- 5 Finally, see if you can work out the profit the company made: do the calculations.
  - 1 What was the gross profit?
  - 2 What was the operating profit?
  - 3 What is the profit after tax?
  - 4 Which of these figures do you think is most important in deciding how successful the company is?

### NBS Group Income statement for the year

	£ 000	
<b>a</b>		
revenue / turnover	6,067	
cost of sales	(1,601)*	
= GROSS PROFIT		
<b>b</b>		
overheads / expenses	(2,743)	
= OPERATING PROFIT		
net interest paid	(27)	
corporation tax	(283)	
= PROFIT AFTER TAX		
<b>c</b>		
dividends	324	
retained profit	1,089	
earnings per share	4.6 pence	

*this shows the total sales they made for the year*

*the cost of buying the materials they added to the stocks to produce the goods*

*the 'fixed costs' that they had to pay to run the business (wages, rent, etc.) independent of how much they produced*

*the money paid to the bank as interest on its loans*

*the money paid to the government as a tax on their profit*

*the money paid to shareholders from their profit as a return on their investment*

*the profit kept in the company to fund investment*

*the profit made for the year divided by the number of shares*

\* Figures in brackets are negative

## How do you know if a company is making a profit?



There are many different ways in which to look at the profits a company makes because accountants need to measure the efficiency of different activities in the business. So, if, for example, we want to find out how well a company is trading we need to look at the figures for total sales, the \_\_\_\_\_<sup>1</sup>, and then subtract from that the amount the company paid suppliers to purchase these goods, the \_\_\_\_\_<sup>2</sup>. This gives us a figure for the \_\_\_\_\_<sup>3</sup>.

However, a company also has many other permanent 'fixed' costs that are not affected by the sales volume. It has to pay for rent, salaries, and administration and these \_\_\_\_\_<sup>4</sup> have to be deducted to give us the \_\_\_\_\_<sup>5</sup>. It is this figure that most analysts focus on each quarter.

But to understand the risks of investing in the company the investor also needs to look at the outgoings from the company to pay the \_\_\_\_\_<sup>6</sup> on the bank loans and the level of \_\_\_\_\_<sup>7</sup> (the company tax paid to the government). Once these have been deducted we are left with a figure for \_\_\_\_\_<sup>8</sup>.

Finally, we need to look at what happens to the money the company earns. This money can be kept by the company as \_\_\_\_\_<sup>9</sup> to invest for the future. But the directors also have to consider what level of return to offer to the shareholders when they decide the level of \_\_\_\_\_<sup>10</sup> to pay out.

6 Now complete the following text from a finance handbook. Circle the correct answer A or B.

- |                      |                      |
|----------------------|----------------------|
| 1 A overheads        | B revenue            |
| 2 A fixed costs      | B cost of sales      |
| 3 A operating profit | B gross profit       |
| 4 A overheads        | B cost of sales      |
| 5 A operating profit | B retained profit    |
| 6 A overheads        | B interest           |
| 7 A corporation tax  | B administration tax |
| 8 A retained tax     | B profit after tax   |
| 9 A retained profit  | B dividends          |
| 10 A earnings        | B dividends          |

## Checklist

Assess your progress in this unit. Tick (✓) the statements which are true.

- I can understand the terms for cash flow of a company
- I can write a first reminder to a customer
- I can use conditionals
- I can call a customer to insist on final payment
- I can advise on financing decisions
- I can understand the accounting terms in an income statement

## Key words

### Nouns

cash flow  
cost of sales  
earnings  
excuse  
factoring  
fixed costs  
income statement /  
profit and loss account  
inflow  
operating profit  
outflow  
overheads  
reminder  
revenue  
stocks (of materials)  
target  
turnover  
working capital

### Verbs

appreciate  
delay  
insist (on)  
negotiate

### Adjective

outstanding

Look back through this unit. Find five more words or expressions that you think are useful.