Section IV – Sample Response 1

How can financial strategies affect the objectives of financial management? (2024)

NESA Directive verb:

'How' and 'why' questions require students to draw causal links between factors (*explain*).

Question deconstruction:

This question has two elements that are open for student selection; that is, they can choose to make causal links between ANY financial management strategy to ANY of the financial objectives. This makes the question quite accessible.

Response planning:

Students can select from the following strategies and objectives to draw causal links:

Cash Flow Management: • Cash flow statements • Distribution of payments, discounts for early payment, factoring Working Capital Management • Control of current assets – cash, receivables, inventories • Control of current liabilities – payables, loans, overdrafts • Strategies – leasing and sale and leaseback Profitability Management • Cost Controls – fixed and variable, cost centres, expense minimisation • Revenue Controls – marketing objectives Global Financial Management • Exchange rates, interest rates, methods of international payment, hedging and derivatives	Profitability Growth Efficiency Solvency Liquidity

Response Structure:

Students should select 3 clear links between strategies and objectives. These links can be the basis for structured paragraphs. There is no need to make causal links between EVERY strategy and EVERY objective – students should be selective based on how accessible the relationship is, their knowledge of their case studies and relevance.

Paragraphs can be structured with ONE objective – and making links to strategies. Or paragraphs can be structured with ONE strategy – and making links to objectives. The following student response uses the latter structure.

Language:

Note the causal language throughout the response (in order to, result in, lead to, because of this etc)

Section IV

Question 26

Criteria	Marks
• Demonstrates a comprehensive understanding of how financial strategies affect objectives of financial management • Applies relevant case study/studies and contemporary business issues • Presents a sustained, logical and cohesive response and communicates clearly using relevant business terminology and concepts	17–20
• Demonstrates a sound understanding of how financial strategies affect objectives of financial management • Uses relevant case study/studies and contemporary business issues • Presents a logical and cohesive response using relevant business terminology and concepts	13–16
• Demonstrates some understanding of how financial strategies affect objectives of financial management • Makes reference to case study/studies and contemporary business issues • Communicates using business terminology and concepts	9–12
• Describes some aspects of financial strategies and/or financial objectives • Makes limited reference to case study/studies and/or contemporary business issues • Communicates using some business terminology and/or concepts	5–8
• Makes limited reference to financial strategies and/or financial objectives • May identify case study/studies • Uses basic business terminology and/or concepts	1–4

Answers could include:

Objectives of financial management:
- Profitability, growth, efficiency, liquidity, solvency
- Short term and long term.

Financial management strategies:
- Cash flow management
  - cash flow statements
  - distribution of payments, discounts for early payment, factoring
- Working capital management
  - control of current assets – cash, receivables, inventories
  - control of current liabilities – payables, loans, overdrafts
  - strategies – leasing, sale and lease back
- Profitability management
  - cost controls – fixed and variable, cost centres, expense minimisation
  - revenue controls – marketing objectives

- Global financial management
  - exchange rates
  - interest rates
  - methods of international payment – payment in advance, letter of credit, clean payment, bill of exchange
  - hedging
  - derivatives.

Section III or Section IV Response

Question Number

Financial Management involves the monitoring and strategic use of a firm's financial resources to enable it to reach its goals. The five financial objectives - liquidity, solvency, growth, efficiency and profitability - are all interrelated, and therefore, the application of any financial management strategy will have implications for all of the objectives; some moreso than others. This response will explain how the leasing and sale and lease back strategies impact the solvency and profitability of McDonalds; show how Qantas' implementation of cost controls - specifically expense minimisation - has impacted their efficiency and profitability metrics; and demonstrate how Apple's cash management strategies boost their liquidity and their profitability.

McDonald's - Leasing and Sale + Leaseback

Leasing involves the contracted use of an asset, rather than the outright ownership of it. As a global business, interestingly, McDonald's derives a large percentage of its overall revenue from

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its vast real estate portfolio ($42 billion). McDonald's owns 50% of the land and 80% of the buildings where their franchisees operate. Therefore, McDonald's uses leasing as a method of gaining revenue from their franchisees - they are a corporate landlord. McDonald's operates as the lessor as a strategy, and this vast asset base of property (which appreciates in value) contributes significantly to their solvency position. Moreover, this leasing model boosts their profitability - the high-margin rental income is brought in with relatively low expenditure. The firm has engaged in some Sale and Leaseback activity - whereby they sell an asset to a different lessor, and then lease it back. This strategy unlocks capital for McDonald's for use ~~on~~ on capital expenditure. They also make profit from these lease agreements - the cost to lease the property being far lower than what they charge their franchisees. Finally, the funds raised from the asset sale, in the Sale + Leaseback strategy, are used in share buybacks. This reduces the number of shares in the public company, thus lifting the

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return on equity (profitability) per share. Leasing and Sale and Leaseback strategies have clearly affected the Solvency and Profitability objectives for McDonald's.

Qantas - Expense Minimisation

Cost controls are a profitability strategy and include cost centres and expense minimisation. Reducing costs is critical for all firms to maximise efficiency and profitability. Every dollar saved goes directly to the increase in the bottom line net profit. As a global airline, Qantas has significant expenses. Their application of a range of cost-saving measures has resulted in recent record profits in the 2023 financial year. Wages are a large expense for Qantas, and recent efforts to reduce their workforce - especially in 2014 and during Covid - has significantly reduced their expenses (but lifted public outcry). Additionally, by adding new fuel-efficient aircraft (such as the Boeing Dreamliner 747), the cost per flight has been reduced, resulting from fuel savings. Early retirement of older planes has also contributed to improved

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efficiency and profitability. By reducing the number of types of planes, Qantas also saves money on maintenance, spare parts and training costs involved in using a diverse fleet. Finally, and again, much to the detriment of Qantas' brand and reputation, the firm has engaged in outsourcing programs to lift efficiency and reduce costs. By utilising 3rd party businesses to manage aspects of Qantas' operations, the business secures improved services and reduces internal costs. These operational strategies are interdependent with the cost centre strategy of financial management – reducing expenses, lifting the objectives of efficiency and profitability. These strategies have lifted Qantas' performance incredibly in the post-Covid era, with the firm continuing to post record profits and returns for shareholders.

Apple – Cash Flow Management

Cash flow is vital to business success and is directly related to the financial objective of liquidity. Liquidity measures how easily a business can meet short-term obligations as they fall due. Cash flow management strategies include the use of a cash flow statement, distributing payments, offering incentives for early payment of accounts receiveable and factoring. Apple has enormous cash reserves - over $2 billion in liquid cash. The global stream of revenue flowing from its product sales continues to add to this stockpile of cash. Liquidity is not an issue. Apple uses this enormous reserve to fund its Research and Development projects and any capital expenditure (asset purchases). Apple uses this cash resource to add to its profitability. The firm has its own cash investment arm to manage where these funds are invested - mainly in high quality and safe bond issues. Therefore, the cash reserves act as another source of revenue and profit for Apple. Additionally, Apple uses highly advanced cash flow management tools across their global operation. This process creates projections for cash inflows (sales projections) and outflows (suppliers, asset

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purchases) which allows the finance team to predict cash shortages and surpluses over the short to medium term. In this way, the use of cash projections results in a more proactive management of Apple's cash reserves - perhaps requiring the sale of investments to enable large-scale purchases. Apple's cash flow management enables the firm to easily meet short-term obligations, directly impacting their liquidity. Their large cash reserves are not sitting idle - they have become a further source of revenue and profit for the firm - somewhat contributing to the profitability of Apple.

Financial management strategies - when implemented in global firms - have direct and complex implications for the 5 financial objectives. McDonald's creative use of leasing ensures its solvency position is very stable, but also increases its revenue and profit as a real estate owner. Qantas' application of expense minimisation strategies - directly related to operations - has clearly impacted positively their efficiency and

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profitability. Apple's cash flow management processes ensure the firm's liquid position is forecasted and maintained, and even uses liquid cash as a source of revenue and profit via investments. This response has clearly demonstrated the multiple ways that financial objectives can be affected by a range of financial strategies.

If you require more space to answer Question 25, you may ask for an extra writing booklet.

If you have used an extra writing booklet for Question 25, tick here. ☐

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