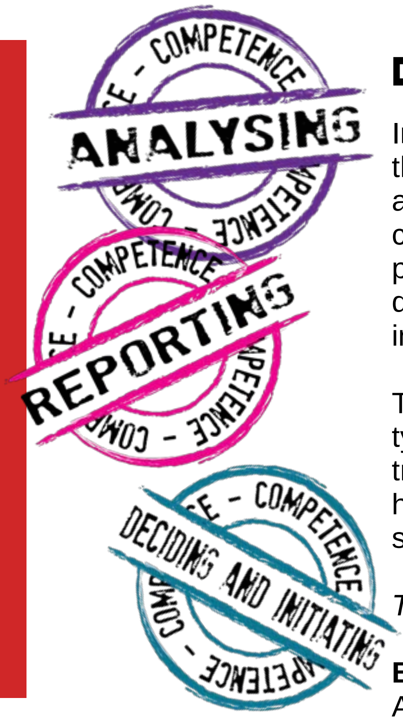
LEARNING ACTIVITY
‘Stamppot’
Ent-teach Unit 4 Financial Management



Description learning activity

In this example you can see all important aspects of financial management, also that it is important to closely monitor your financial statements. After this Learning activity you will understand the impact of small changes on the profitability of a company. Furthermore, they help you steer your business and alarm you in time if possible danger is ahead! Only if you put in the effort and have the discipline to draw up the overviews regularly. Furthermore, the figures give the entrepreneur an insight of how the profitability can improve with just one or two changes.

Take the example of a small Dutch roadside restaurant called Stamppot with a typical turnover of €750,000. The restaurant has chosen its name after a traditional Dutch winter dish, indeed called Stamppot. This means the restaurant has busy winter seasons and quiet summers. This is reflected in the income statement and cash flow statement.

Take a close look at income and cash flow statements in the annex 2.

Balance Statement
A balance sheet, also known as a "statement of financial position," reveals a company's assets, liabilities and owners' equity (net worth). The balance sheet, together with the income statement and cash flow statement, make up the cornerstone of any company's financial statements. If you are a shareholder of a company, it is important that you understand how the balance sheet is structured, how to analyze it and how to read it.

Please have a close look at the balance sheet in the annex 1.

Profitability
A forecast shows that the business will produce a gross profit of €465,000 (62%), and an operating profit before interest, depreciation and tax of around €142,000. The budget and cash flow statements reveal the business factors, which give the most chances for profit improvement.

Cash Flow
The cash flow forecast shows that the business requires cash to boost its business in quieter seasonal periods, but has surplus cash during peak trading periods. Knowing this allows the amount and timing of borrowings to be predicted with confidence. For a smart manager it should also lead to a questioning of strategies - to examine ways of offsetting the slow cash flow through sales or expense management, or a fresh marketing strategy. *The cash flow and Income statement can be found in annex 2.*

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Problem

Now we have examined the tables, we need to think of ways to improve the profitability of the restaurant. To see which improvements have the most potential, 4 'what if scenarios' will be applied.

What if?... Scenarios:
1. Average customer spend increased by 5% (equals less than €2 per customer)
2. Reduce Cost of Goods Sold by 5%
3. Increase customer head count by 1% (no change to average spend)
4. Reduce labour costs by 5%

Your assignment is now to find the most profitable scenario.

Tipp:

You need to **base** your scenarios on the total amount (not per months) and the operating profit. The operating profit is excluding the "other costs".

Use the Income Statement for your calculation of the scenarios.

Since you need to find the most profitable scenario, it would be good to have one current situation as a baseline (100%) and the other scenarios can be compared to this base (current situation) Meaning the operational profit (excl. "other costs") for the current situation is regarded as 100%.

Analysis

Take a look at the scenarios of improvement table (Annex 3)

This example shows that a 5% improvement in customer spending would yield a whopping 26% increase in operating profit. In this case, product pricing, and the amount each customer spends are high-leverage factors. Compare this with a 5% reduction in labour costs, which although significant, would only produce a 10% profit improvement.

At a basic level this suggests that an effort to boost customer-spending levels will yield bigger results than trying to reduce labour costs. But of course a closer examination may suggest that *both* improvements (or indeed neither of them) can be readily achieved.

Learning outcome (generalized)
After identifying the high-leverage factors, the next step is to examine each factor in more detail, and brainstorm ways to achieve the suggested results.

For example a 5% reduction in cost of goods sold, potentially yielding a 10% increase in operating profit, might be achieved by:

- changing the sales product mix, or
- re-negotiating terms with suppliers, or
- re-engineering inventory management,
-

or any combination of these and other actions.

As part of a deeper analysis it's instructive to break sales into categories, and then fully apportion all costs including overheads to see what the profit really is, category by category (or even item by item). The categories used will be specific to the business; for example they might be geographic, demographic, product-related, by selling channel, or some other segmentation, which makes sense.

This can be very revealing; sales items with high gross profit margins are not necessarily the most profitable overall. Using this information to make strategic or operational changes can lead to big profit improvements. This kind of information is almost never available from regular financial statements, and therefore is a frequently overlooked opportunity for improvement.

Testing decisions, the "what if?" analysis
Once specific improvement measures have been identified, it's a simple matter to re-run the budget forecasts to ensure that the proposed changes make sense, and that the cash flows of the business are safe.

Timeline

This Learning activity will take place after the students have completed the Market Analysis Units.

The activity will take approximately 2 hours, 30 minutes for reading and understanding the assignment (problem) and 30 minutes to draw up all the scenarios. Additionally, it may take up to and hour to discuss the outcomes, the further in-depth paragraphs (analyzing) and to make all students comprehend the necessary calculation steps.

Target audience

VET students who have completed the Financial Management Unit. The background (field of study) of the student is not a large factor.

Goal

Students learn how to apply their knowledge on analysing financial reports and making decisions based on scenarios.

Learning outcomes

Students will learn how to change factors in order to improve the profitability of a company. They can see first hand, which changes in have an influence on the profitability and thus gain knowledge in the interdependencies of financial related issues within a company.

Evaluation

Based on the outcomes of the scenarios, the students will chose a scenario with the highest profitability. In reality they could follow a strategic strategy, for instance to increase the price of a product service.

Technology

No particular technology is necessary for this learning activity, but a calculator.

Methods

- Verbal introduction by teacher, supported by the Unit content;
- Preparation by the students;
- Calculation of profitability by students
- Choice of scenario and justification of student (also study of the other provided topics of this unit)
- Summary by the teacher of the outcomes of the learning activity and relation to Unit theory (how to read and analyze financial statements).

Team

This learning activity can be led by a single teacher. It is only important for the students to understand the calculation process and to be analyze and evaluate financial statements in general by themselves. Furthermore, it is of importance, that the students are able to comprehend the scenarios as well as to create own scenarios if needed.

Annex 1
Balance sheet forecast

STAMPPOT RESTAURANT LTD

Balance sheet forecast

	Opening	jul-09	aug-09	sep-09	okt-09	nov-09	dec-09	jan-10	feb-10	mrt-10	apr-10	mei-10	jun-10
Current assets													
Bank	20.000	-	-	-	12.643	41.118	88.075	129.471	145.304	156.328	155.905	126.714	114.086
Inventories	25.000	25.000	29.750	34.500	39.250	44.000	44.000	39.250	34.500	29.750	25.000	25.000	29.750
	45.000	25.000	29.750	34.500	51.893	85.118	132.075	168.721	179.804	186.078	180.905	151.714	143.836
Non-current assets													
Plant & Equipment	107.000	107.000	107.000	107.000	107.000	107.000	107.000	107.000	107.000	107.000	107.000	107.000	107.000
Accumulated depreciation	-	-1.338	-2.675	-4.013	-5.350	-6.688	-8.025	-9.363	-10.700	-12.038	-13.375	-14.713	-16.050
	107.000	105.662	104.325	102.987	101.650	100.312	98.975	97.637	96.300	94.962	93.625	92.287	90.950
Total assets	**152.000**	**130.662**	**134.075**	**137.487**	**153.543**	**185.430**	**231.050**	**266.358**	**276.104**	**281.040**	**274.530**	**244.001**	**234.786**
Current Liabilities													
Bank	-	2.346	16.752	7.998	-	-	-	-	-	-	-	-	-
Accounts payable	27.000	12.097	16.925	27.879	41.339	50.237	56.977	52.930	41.980	30.723	19.460	17.116	16.761
Other creditors	10.000	10.154	4.852	6.332	8.774	9.841	15.044	20.724	18.030	21.124	23.060	7.810	7.884
Equipment loan	15.535	15.730	15.926	16.125	16.327	16.531	16.738	16.947	17.158	17.373	17.590	17.810	18.033
	52.535	40.327	54.455	58.334	66.440	76.609	88.759	90.601	77.168	69.220	60.110	42.736	42.678
Non-current liabilities	91.465	90.062	88.643	87.205	85.750	84.276	82.784	81.273	79.744	78.195	76.627	75.039	73.432
Total liabilities	**144.000**	**130.389**	**143.098**	**145.539**	**152.190**	**160.885**	**171.543**	**171.874**	**156.912**	**147.415**	**136.737**	**117.775**	**116.110**
Net assets	8.000	273	-9.023	-8.052	1.353	24.545	59.507	94.484	119.192	133.625	137.793	126.226	118.676
Equity & Reserves													
Capital & Reserves	8.000	8.000	8.000	8.000	8.000	8.000	8.000	8.000	8.000	8.000	8.000	8.000	8.000
Retained Earnings	-	-7.727	-17.023	-16.052	-6.647	16.545	51.507	86.484	111.192	125.625	129.793	118.226	110.676
	8.000	273	-9.023	-8.052	1.353	24.545	59.507	94.484	119.192	133.625	137.793	126.226	118.676

Annex 2
Income statement & Cash flow forecast

STAMPPOT RESTAURANT LTD

Income statement forecast

	jul-09	aug-09	sep-09	okt-09	nov-09	dec-09	jan-10	feb-10	mrt-10	apr-10	mei-10	jun-10	Total	%
Sales	23.438	23.437	46.875	70.312	93.750	117.188	117.188	93.750	70.312	46.875	23.438	23.437	750.000	100.0%
Direct Costs	8.906	8.906	17.813	26.719	35.625	44.531	44.531	35.625	26.719	17.812	8.907	8.906	285.000	38.0%
Gross profit	14.532	14.531	29.062	43.593	58.125	72.657	72.657	58.125	43.593	29.063	14.531	14.531	465.000	62.0%
Overheads	19.581	21.050	25.292	31.540	32.319	35.098	35.098	30.853	26.610	22.364	23.582	19.583	322.970	43.1%
Other Costs	1.338	1.337	1.338	1.337	1.338	1.337	1.338	1.337	1.338	1.337	1.338	1.337	16.050	2.1%
Operating profit	-6.387	-7.856	2.432	10.716	24.468	36.222	36.221	25.935	15.645	5.362	-10.389	-6.389	125.980	16.8%
Interest expense	1.340	1.440	1.461	1.311	1.276	1.260	1.244	1.227	1.212	1.194	1.178	1.161	15.304	2.0%
Net profit	-7.727	-9.296	971	9.405	23.192	34.962	34.977	24.708	14.433	4.168	-11.567	-7.550	110.676	14.8%
Cumulative	-7.727	-17.023	-16.052	-6.647	16.545	51.507	86.484	111.192	125.625	129.793	118.226	110.676	110.676	

Cash flow forecast

	jul-09	aug-09	sep-09	okt-09	nov-09	dec-09	jan-10	feb-10	mrt-10	apr-10	mei-10	jun-10	Total
Receipts													
Invoiced sales	25.782	25.781	51.563	77.343	103.125	128.907	128.907	103.125	77.343	51.563	25.782	25.781	825.002
	25.782	25.781	51.563	77.343	103.125	128.907	128.907	103.125	77.343	51.563	25.782	25.781	825.002
Payments													
Invoiced costs	13.026	9.652	10.559	13.476	18.899	19.756	22.379	22.253	19.337	16.119	12.895	14.670	193.021
Cost of goods sold	21.633	10.668	16.655	26.452	36.248	45.175	48.113	42.127	32.330	22.533	13.607	10.668	326.209
Wages	8.421	9.474	10.526	11.579	11.579	11.579	11.579	10.526	9.474	8.421	8.421	8.421	120.000
Loan payments	2.546	2.545	2.546	2.545	2.546	2.545	2.546	2.545	2.546	2.545	2.546	2.545	30.546
Overdraft interest	2	118	154	19	-	-	-	-	-	-	-	-	293
Group Tax	2.500	2.105	2.369	2.631	2.895	2.895	2.894	2.895	2.632	2.368	2.106	2.105	30.395
GST	-	5.625	-	-	2.483	-	-	6.946	-	-	15.398	-	30.452
	48.128	40.187	42.809	56.702	74.650	81.950	87.511	87.292	66.319	51.986	54.973	38.409	730.916
Net cash flow	**-22.346**	**-14.406**	**8.754**	**20.641**	**28.475**	**46.957**	**41.396**	**15.833**	**11.024**	**-423**	**-29.191**	**-12.628**	**94.086**
Opening bank	20.000	-2.346	-16.752	-7.998	12.643	41.118	88.075	129.471	145.304	156.328	155.905	126.714	20.000
Closing bank	-2.346	-16.752	-7.998	12.643	41.118	88.075	129.471	145.304	156.328	155.905	126.714	114.086	114.086