Student 1: Low Excellence

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6 Jack Fowler runs a free-range chicken farm in Canterbury called Eggs Galore. The farm's bank recently approved a $100,000 mortgage to expand the business by buying a hectare of land next to his property. At the end of January Jack received an unexpected invoice from the district council of $15,000 for a land use fee. A lateness penalty will be added if the invoice is not paid by the end of February. Jack had not factored this cost into his cash flow forecast so must find ways to cope with this variation.

As seen in the farm's original cash flow forecast the closing bank balance in February was projected to be $6,590 so paying the $15,000 fee would create a deficit for February of $8,410. Unless he makes some adjustments to avoid this deficit Jack would need to arrange an overdraft with the bank of, say a rounded amount of $9,000, and would need to pay 1 interest on this as well as an overdraft establishment fee. If an overdraft wasn't arranged automatic payments and direct credits of Eggs Galore would not be paid by the bank. This would cause problems. For example, if he could not pay the supplier of chicken feed or maintain the level of farm hygiene the health and productivity of his chickens could suffer, and this could reduce sales, customer satisfaction and the good reputation of Eggs Galore. The farm's credit rating could also be affected.

An overdraft can be short-term such as for only a few months, but the interest rate can be high and is calculated on the daily balance. Rather than arranging an overdraft to avoid the 2 predicted negative bank balance, Jack could also consider applying to the bank to add the $9,000 to the mortgage recently taken out to buy the land next door. If the bank approved this increase in the mortgage the interest rate would be lower than for an overdraft, but Jack 7 would be paying off the $9,000 over a longer time making it a more expensive option.

I recommend that Jack avoid taking on further debt. He has only recently contracted for a further $100,000 and hasn't had time to demonstrate a good history of repaying the principal and/or interest on the due dates. It is not an appropriate time to incur further debt and interest for the sake of $15,000. There are other ways to solve the problem of the unexpected land fee invoice.

Although the $15,000 land use fee has not been budgeted for, Jack only needs to find solutions that will avoid the projected deficit of $8,410 at the end of February. However, I am 1 going to make adjustments that will enable Eggs Galore to finish February with $890 in the bank just in case sales do not reach the levels Jack has forecasted.

Jack should attempt to contribute a further $9,000 capital into his business. This would 2 increase Egg Galore's cash inflows in February to $76,700. The benefit of using his own funds is that the business will not be incurring further debt and further interest. It also means that Jack's equity in his business is larger, relative to the amount of debt the business has. If 3 he needs to apply for business finance in the future it will show that Jack had faith in his business by investing more of his own funds.

A personal disadvantage of contributing further capital is that Jack may have been saving for something, such as an asset or a holiday, which would need to be put on hold. He would also lose the chance to earn interest on the $9,000. Because Eggs Galore is Jack's only source of income it should be more important to him that the business is a success. Once the enlarged farm is operating successfully and profit increases Jack could return the funds to his personal account by taking an additional $9,000 as drawings.

I have recommended that Jack invest further capital rather than reduce his monthly drawings because his personal budget would be based on his current level of income and his $3000 drawings per month is not an excessive amount anyway. If Jack doesn't have a spare $9,000 in his bank account it might be easier for him to add this amount to any personal mortgage or loan, rather than go three months without any income.

I also suggest that Jack reduces the amount Eggs Galore spends on advertising in the months of February and March, providing he has not signed a contract that commits him to spend $200 with the Courier which is a free weekly paper and $500 with the Guardian which is sold to readers. As Eggs Galore will still be advertising the newspapers are unlikely to hold them to the size of the monthly ads already booked. If he can reduce these to $100 and $300 he would save $600 in advertising in February. 2

The cheaper advertisements would be less prominent however Eggs Galore would still have exposure in the newspapers. If Jack is concerned about the advertising not being as effective as it currently is, he could also make use of free social media promotion, e.g. he could establish a Facebook page for Eggs Galore. Jack should monitor whether his sales appear to be affected by the smaller ads. It could be that he will be able to continue to place less expensive ads into the future so that the cost of advertising is permanently reduced. 4

I have recommended responses that will not affect business productivity. I could not reduce the equipment lease expense or mortgage and interest repayments because legal contracts apply to these. Reducing operating expenses could affect the output of eggs and therefore reduce sales. I also could not reduce employee wages as this would go against their employment agreements. 5

The two responses I have recommended should ensure that Eggs Galore can finish each month in the six-month timeframe with funds in the bank account.