

Cambridge AS & A Level · Business 9609 · Notes

Finance and accounting strategy A2

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Read first: [Analysis of published accounts](#), [Sources of finance](#), [Financial statements](#)

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What you need to know

By the end of this topic you should be able to:

1. **Use the financial statements when a strategy is being drawn up:** what the statement of profit or loss and the statement of financial position tell managers before, during and after a strategic choice.
2. **Describe what goes into a company's annual report,** and judge how useful each part is to the business itself and to other stakeholders.
3. **Judge how well a business is doing over time and compared with its competitors,** using its accounts and ratios.
4. **Explain how accounting data, including ratio results, shapes the strategy a business picks.**
5. **Show what a debt decision or an equity decision does to the ratios.**
6. **Show what a change in dividend strategy does to the ratios.**
7. **Show what business growth does to the ratios.**
8. **Show what other strategies do to the ratios** (for example cutting inventory, selling and leasing back property, factoring debts, cutting costs).
9. **Explain the limitations of published accounts and ratio analysis** as a basis for strategic decisions.

The syllabus lists the ratios this topic uses: current ratio, acid test ratio, gross profit margin, operating profit margin, return on capital employed (ROCE), trade receivables turnover, trade payables turnover, rate of inventory turnover, gearing, price/earnings ratio, dividend yield and dividend cover. Working each one out is taught step by step in [Analysis of published accounts](#). This note is about what happens next: reading the results as evidence, predicting how a decision will move them, and judging a strategy with them.

Understand it

Where accounting data fits into strategy

A strategy is a plan for where the business will be in several years and how it will get there: entering a new country, buying a rival, building a second factory, cutting the product range. Accounting data is used at three moments.

1. **Before choosing:** the latest accounts show what the business is good at and where it is weak. A shrinking gross margin, a pile of slow-selling inventory or loans that already take up most of capital employed all limit which strategies are realistic.
2. **While choosing:** managers draw up forecast accounts for each option ("what would next year's statement of financial position look like if we borrowed for this?") and compare the forecast ratios.
3. **After choosing:** next year's results are compared with the plan to see whether the strategy is working, and the plan is changed if not.

Each statement answers different strategic questions:

- **Statement of profit or loss:** which activities earn money, and is profit growing faster or slower than revenue? If cost of sales rises faster than revenue, a strategy built on price cuts would make things worse; if expenses are the problem, a restructure might help. The line "profit for the year" also shows how much could be kept back to pay for growth.
- **Statement of financial position:** what the business owns and how that is paid for. It shows whether there is spare cash or an unused building that could fund a project, and how much more the business can borrow before lenders become nervous.
- **Statement of cash flows** (also in the annual report): whether the profit is turning into cash. A business reporting good profits while its cash keeps falling cannot fund a strategy from inside.

The annual report

A company's annual report is the document it sends its shareholders after each financial year; a public limited company's report is open to anyone. Its main parts:

Part	What the reader learns from it
Chair's statement	A short overview of the year and the outlook, written by the chair of the board
Strategic (directors') report	The directors' description of the business model, the year's results, their plans and the main risks they see
Statement of profit or loss	Revenue, costs and profit for the year, with the previous year beside it
Statement of financial position	What the company owns and owes at the year end, and the owners' equity
Statement of cash flows	How cash came in and went out during the year
Notes to the accounts	The detail behind each total: the terms of loans, how inventory and assets were valued, any big one-off items
Auditor's report	An independent accountant's opinion on whether the accounts give a true and fair view
Governance and directors' pay; sustainability report	Who runs the company and what they are paid; its environmental and social record

How useful it is depends on who is reading:

Reader	What they look for
Directors and managers	Their own trends, to set targets and test strategies (though inside the business they have far more detailed figures than the report shows)
Shareholders and possible investors	Profit, dividends, the investment ratios and whether the directors' plans are believable
Banks and other lenders	Gearing, liquidity and whether profit is large enough to pay the interest comfortably
Suppliers	Liquidity, and how long the company already takes to pay its bills
Employees and trade unions	Profit and plans: job security, and whether a pay rise is affordable
Government and tax authorities	Profit, for tax; compliance with company law
Local community and pressure groups	The sustainability report and plans to expand or close sites
Competitors	Margins, growth plans and any weakness they could exploit

Its usefulness has limits. The narrative parts are written by the directors, who want the year to look good. The figures are already weeks or months old when they are published. Totals are grouped, so a reader cannot see which product or region made the profit. And a rival can read the report too, so a company says as little about its plans as the law allows.

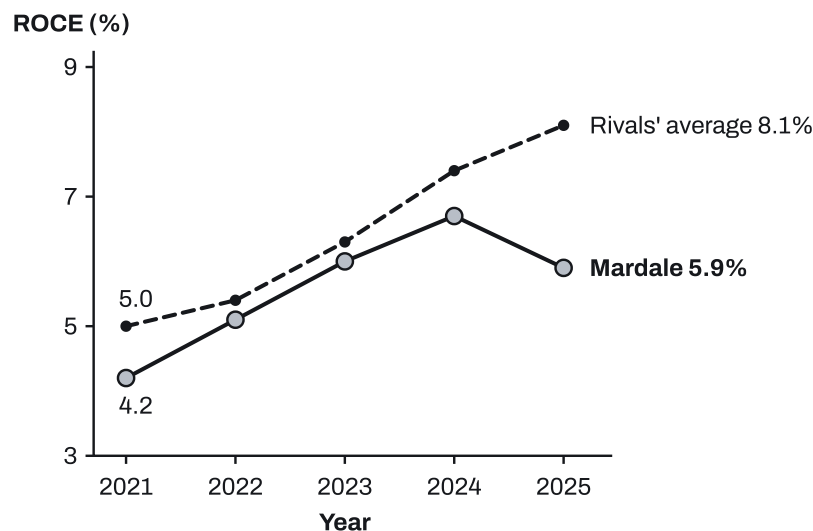
Judging performance over time and against competitors

A single ratio means little. It becomes useful when it is set beside something:

- **its own past (trend analysis):** is the ratio improving or getting worse, how fast, and since when? Three or more years show a trend; two years may show only a blip;
- **competitors or the industry average (inter-firm comparison):** what is normal differs widely between industries, so a business is best judged against firms that do the same thing.

Mardale Hotels' ROCE over five years shows why both are needed:

Year	2021	2022	2023	2024	2025
Mardale Hotels' ROCE (%)	4.2	5.1	6.0	6.7	5.9
Average ROCE of three rival hotel groups (%)	5.0	5.4	6.3	7.4	8.1



On its own trend, Mardale has done well: ROCE rose by 1.7 percentage points over the five years. Against its rivals it has done badly: it was 0.8 points behind in 2021 and 2.2 points behind in 2025, and it fell in 2025 while they kept rising. A strategy review would ask **why** (the ratio never says): older hotels needing repairs, weaker prices, higher wages? The answer decides the strategy: refurbish, sell the weakest hotels, or change the brand.

From ratio results to strategic choices

Ratios are symptoms; managers have to decide on the cure. Typical links:

What the ratio results show	Strategies they point towards	But check
Acid test far below the current ratio	Hold less inventory, order smaller batches, clear slow lines	Running out of stock loses sales
Trade receivables days far above the credit terms	Chase late payers, shorten credit, factor the debts	Customers may move to rivals that give credit
Gearing already high (above about 50%)	Pay for new projects with shares or retained profit; repay loans; sell idle assets	New shares dilute control
ROCE below the interest rate on loans	Do not borrow to expand; improve profit or shrink capital employed first	One poor year may not be a trend
Gross margin falling	Find cheaper suppliers, cut waste, raise prices or add value	Quality and price elasticity
Operating margin falling while gross margin holds	Cut overheads: rent, administration, marketing	Cuts may hurt future sales
Dividend cover high and rising	Room to raise dividends, or retained profit to fund growth	Profit is not cash: check liquidity
Low gearing, good liquidity, strong ROCE	An ambitious strategy such as a takeover can be afforded	The forecasts behind it

Debt or equity: the effect on the ratios

A company needing long-term finance for a big project mostly chooses between **debt** (a bank loan or debentures, repaid with interest) and **equity** (new shares, sold to existing owners in a rights issue or to new investors, possibly by becoming a plc). Both increase capital employed by the same amount, but they move the ratios in opposite directions.

Tarn Valley Quarries Ltd has issued share capital of 6.0 million dollars (12 million shares), reserves of 24.0 million dollars and non-current liabilities of 15.0 million dollars. It wants 10.0 million dollars for a new crushing plant.

(million dollars)	Now	Borrow 10.0 at 10%	Sell 2 million new shares at 5.00 dollars
Non-current liabilities	15.0	25.0	15.0
Capital employed	45.0	55.0	55.0
Gearing	33.3%	45.5%	27.3%
Extra interest each year	none	1.0	none
Existing owners' share of the votes	100%	100%	85.7%

Gearing is $15.0 \div 45.0 \times 100 = 33.3\%$ now. Borrowing puts the loan into both parts of the fraction: $25.0 \div 55.0 \times 100 = 45.5\%$. New shares only raise the bottom: $15.0 \div 55.0 \times 100 = 27.3\%$. The owners would keep $12 \div 14 \times 100 = 85.7\%$ of the shares.

What else changes:

- **Profit for the year and earnings per share.** The loan's interest comes off profit every year, whatever the plant earns. New shares add no interest, but every year's profit is then shared among 14 million shares instead of 12, so earnings per share are diluted. Which leaves the existing owners better off depends on how much the project earns compared with the interest; Example 3 weighs the same trade-off for a company that floats in order to repay loans.
- **Risk.** Interest and repayments are fixed. In a bad year a highly geared business can run short of cash, while a business funded by shares can simply pay a smaller dividend.
- **Control.** Lenders get no votes (though they may demand security or set conditions). New shareholders do.
- **Speed and cost.** A loan can be arranged in weeks. A share issue, and especially a flotation, takes months and costs a lot in fees.

Becoming a public limited company

A private limited company can only sell shares privately, to people the owners agree to, and its shareholders find it hard to sell their stakes. A **public limited company (plc)** can offer shares to the general public, usually through a listing on a stock exchange, where shares can then be bought and sold every day. Converting is

equity finance on the largest scale.

The steps: the company re-registers as a plc, publishes a **prospectus** (a detailed description of the company, its accounts, its plans and its risks, for investors to judge), and usually pays a bank to **underwrite** the issue (promise to buy any shares the public does not take). Legal, accounting, advertising and underwriting fees run into millions, and it takes months.

For the business and its shareholders:

- **Gains:** a large amount of permanent finance with no interest; gearing falls, so later borrowing becomes easier; existing shareholders can sell part of their stake on the market, often at a higher value than a private share would fetch; the listing raises the company's profile with customers and suppliers.
- **Costs and risks:** control is diluted, and if outsiders end up with over half the shares, they decide who runs the company, and a rival can buy shares and take it over; new shareholders may press for dividends and quick profit rather than long-term plans; the company must publish far more, which rivals read; the flotation itself is expensive, and if demand for the shares is weak the price, and so the money raised, is lower than hoped.
- **Keeping control:** the founders can float but keep more than half the shares between them, raising less money but staying in charge.

Limited liability is not a reason to become a plc: shareholders in a private limited company already have it. And "public" refers to who may buy the shares; a plc is still privately owned, not run by the government.

Dividend strategy and the ratios

Dividends are the share of profit the directors decide to pay out to shareholders in cash; the rest is retained and adds to reserves. Calloway Engineering plc made a profit for the year of 9.0 million dollars. It has 45 million shares, priced at 3.40 dollars. Three possible payouts:

Share of profit paid out	25%	55%	80%
Total dividends (million dollars)	2.25	4.95	7.20
Dividend per share (dollars)	0.05	0.11	0.16
Dividend yield	1.47%	3.24%	4.71%
Dividend cover (times)	4.0	1.82	1.25
Retained profit (million dollars)	6.75	4.05	1.80

For example, at 55%: dividends = $0.55 \times 9.0 = 4.95$, per share $4.95 \div 45 = 0.11$ dollars, yield $0.11 \div 3.40 \times 100 = 3.24\%$, cover $9.0 \div 4.95 = 1.82$ times, retained $9.0 - 4.95 = 4.05$ million dollars.

Paying out more raises the dividend yield and pleases shareholders who want income, which can support the share price and make a later share issue easier to sell. But cover falls (less safety if profit drops), less profit is retained, so reserves and capital employed grow more slowly and future projects need more borrowing

(gearing rises over time), and more cash leaves the business, which weakens liquidity. Paying out less does the opposite. The right choice depends on the business's cash, its investment plans and who its shareholders are: an owner with a majority of the shares may happily take less now for growth later.

Growth and the ratios

Growth tends to make several ratios look worse before it makes them better:

- **Liquidity.** Selling more means buying more materials and giving credit to more customers before their cash arrives. If growth outruns the working capital to support it, the business is **overtrading**: profitable on paper but short of cash, with falling current and acid test ratios and a growing overdraft.
- **Profitability.** New capacity adds to capital employed at once but takes time to earn, so ROCE often dips. Later, economies of scale can lift margins; but launch costs, discounts to win customers, and diseconomies of scale can push them down.
- **Gearing.** Up if growth is paid for with loans; down if with shares or retained profit.
- **Investment ratios.** Earnings per share may fall for a while, and dividends may be held back to pay for growth. Investors who expect higher profits later may still bid the share price up, raising the P/E ratio.
- **Takeovers.** Buying another company adds all its assets, debts and profits at once, so every ratio jumps. A takeover paid for with loans can push gearing very high; one paid for by issuing shares to the sellers dilutes the existing owners.

Other strategies and their effect on the ratios

Strategy	Main effect on the ratios	The catch
Just-in-time, smaller stocks	Inventory turnover rises; cash not spent on stock lifts the acid test	Reliable suppliers needed
Shorter credit for customers, chasing late payers	Receivables days fall; cash arrives sooner	Customers may go elsewhere
Debt factoring	Receivables become cash now, so cash is available to pay bills	The factor's fee cuts profit, and its cut lowers current assets slightly
Taking longer to pay suppliers	Payables days rise; cash stays in the business longer	Suppliers may stop giving credit or discounts
Sale and leaseback of property	Cash in now; used to repay loans, gearing falls	Rent lowers operating profit every year after
Replacing an overdraft with a long-term loan	Current liabilities fall, so both liquidity ratios rise	Gearing rises; interest still paid
Cutting costs (materials, staff, overheads)	Margins and ROCE rise if sales hold	Quality, morale and future sales may suffer
Raising prices	Margins rise if demand is price inelastic	Revenue falls if demand is elastic

Strategy	Main effect on the ratios	The catch
Cutting the dividend	More profit retained; more cash kept	Shareholders unhappy; share price may fall

Limits of accounts and ratios for strategic decisions

The general limits (accounts look backwards, window dressing, different accounting methods, no non-financial information) are covered in [Analysis of published accounts](#). For strategy, some matter especially:

- **A strategy is about the future; accounts describe the past.** A plan to enter a market the business has never served cannot be judged from its own past figures. Market research, forecasts and sales trials have to stand beside them.
- **Forecast accounts are only as good as their assumptions**, and they are often prepared by the managers who want the project approved. Testing "what if sales are 20% lower?" shows how fragile a plan is.
- **Comparisons with rivals can mislead:** rivals differ in size and product mix, value assets differently, and have different year ends.
- **What decides success is often not in the accounts:** whether staff have the skills a new strategy needs, how rivals will react, whether customers will trust the brand in a new product.
- **The economy can change the numbers:** a rise in interest rates turns an affordable loan into a heavy burden; a change in exchange rates or tax can wipe out a forecast profit.

Key facts and formulas

There is no formula list for this subject in the exam. "Learn it" means you must remember it.

Formula	Status
Capital employed = issued share capital + reserves + non-current liabilities	Learn it
Gearing = $\text{non-current liabilities} \div \text{capital employed} \times 100 (\%)$	Learn it
Forecast gearing after borrowing $L = (\text{non-current liabilities} + L) \div (\text{capital employed} + L) \times 100$	Learn it
Forecast gearing after raising S from new shares = $\text{non-current liabilities} \div (\text{capital employed} + S) \times 100$	Learn it
Existing owners' share after a share issue = $\text{existing shares} \div (\text{existing shares} + \text{new shares}) \times 100 (\%)$	Learn it
ROCE = $\text{operating profit} \div \text{capital employed} \times 100 (\%)$	Learn it

Formula	Status
Gross profit margin = $\text{gross profit} \div \text{revenue} \times 100$; operating profit margin = $\text{operating profit} \div \text{revenue} \times 100$ (%)	Learn it
Operating profit = revenue – cost of sales – expenses; profit for the year = operating profit – interest – tax	Learn it
Current ratio = $\text{current assets} \div \text{current liabilities}$; acid test ratio = $(\text{current assets} - \text{inventory}) \div \text{current liabilities}$ (both written $x : 1$)	Learn it
Trade receivables turnover = $\text{trade receivables} \div \text{credit sales} \times 365$; trade payables turnover = $\text{trade payables} \div \text{credit purchases} \times 365$ (days)	Learn it
Rate of inventory turnover = $\text{cost of sales} \div \text{average inventory}$ (times)	Learn it
Dividend per share = $\text{total dividends} \div \text{number of shares}$; dividend yield = $\text{dividend per share} \div \text{share price} \times 100$ (%)	Learn it
Dividend cover = $\text{profit for the year} \div \text{total dividends}$ (times)	Learn it
Earnings per share = $\text{profit for the year} \div \text{number of shares}$; P/E ratio = $\text{share price} \div \text{earnings per share}$	Learn it
Retained profit = $\text{profit for the year} - \text{dividends}$	Learn it
Value an offer puts on the whole company = $\text{price offered} \div \text{fraction of the shares bought}$	Learn it

How to do it

We have tagged 16 questions on this topic, from 2021 to 2025: 14 from Paper 3 and 2 Paper 4 essays. None of them mixes two of the types below, so the counts add up to 16. In 12 of the Paper 3 questions the written part comes after 1–4 mark ratio calculations (gearing in 8 of them), which are taught in **Analysis of published accounts**; the written part invites you to use those results, and they are marked on your own figures even if they were wrong.

Question type	Questions
Evaluate becoming a public limited company	4
Evaluate how to finance a project: loans or shares	3
Analyse or evaluate ways to improve liquidity	2
Evaluate ways to improve profitability or investor return	2
Recommend whether to accept a takeover or joint venture offer	2

Question type	Questions
Evaluate a dividend decision	1
Evaluate a finance and accounting strategy's impact on performance (Paper 4)	1
Advise which accounting data to use for a new strategy (Paper 4)	1

Written answers earn marks for four skills: **K** (knowledge of the terms and factors), **App** (application: using the case's own facts and figures), **An** (analysis: a chain of at least two linked causes and consequences) and **Eval** (evaluation: weighing the arguments and reaching a supported judgement). Since 2023 a Paper 3 12-mark question is worth 2 K, 2 App, 2 An and 6 Eval, and the top evaluation level (5–6) needs a judgement **in the case's context**; the 2021–2022 papers split it 2 K, 2 App, 4 An, 4 Eval. A Paper 3 8-mark "analyse" question is 2 K, 2 App, 4 An. A Paper 4 essay is 20 marks: up to 3 K, 2 App, 8 An, 7 Eval. Below, (K), (App), (An) and (Eval) after a sentence show which mark it earns; (1), (2)... in a calculation show the marks building up.

1. Evaluate becoming a public limited company (4 questions)

Paper 3, [12], after ratio calculations (gearing, ROCE, current ratio, margins). The question may ask whether the company should convert, or whether its **shareholders** would benefit from it.

1. **K**: what a plc is (shares offered to the public, usually on a stock exchange) and what converting involves (prospectus, underwriting, high costs); one or two consequences such as permanent finance with no interest, or dilution of control.
 2. **App**: the case's figures as evidence: gearing (often above 60% in these cases, so more loans are hard to get), ROCE or margins (would investors want the shares?), the size of the planned expansion, how many people own the company, the dividends paid so far.
 3. **An**: one developed chain, for example: gearing already high → banks see more lending as risky and charge more → share capital pays for the expansion with no interest bill → profit is not eaten by interest. Or: new shares sold to outsiders → founders' share of votes falls → below half, they can be outvoted or taken over → their aims for the business (family control, social aims) are at risk.
 4. **Eval**: weigh finance gained against control lost, **from the point of view of whoever the question names**. Say what it depends on: whether the founders can keep over 50%, how much investors will pay, the flotation cost, the alternatives (a loan, a private investor, retained profit), and what the owners want.
- **"Will the shareholders benefit?"** is not the same as "should the company convert?". In June 2023 many answers judged the company instead of its owners; in November 2021 few answers looked at the conversion from the owning family's point of view, and the report said doing so was necessary for the highest marks. Consider their income, the value and saleability of their shares, and their control.

2. Evaluate how to finance a project: loans or shares (3 questions)

Paper 3, [12]. A takeover, modernisation or trial needs money, and you judge whether to use long-term loans or a share issue, or whether the financial data given is enough to decide.

1. **K**: the sources (bank loan, new shares, venture capital, crowdfunding, retained profit, conversion to a plc) and what gearing and the investor ratios measure. If the project is a takeover, say what one is (buying a controlling stake in another business, a fast form of external growth).
 2. **App**: work out **forecast gearing** with the loan (the loan goes into both non-current liabilities and capital employed), compare the project's cost with the year's profit, and use the dividend yield and cover (would investors buy new shares?), retained profit (profit for the year minus dividends), and any interest rate news.
 3. **An**: loan → gearing and interest rise → profit for the year falls and risk rises if the project is slow; shares → no interest and lower gearing, but dilution and more dividends to pay; a strong dividend yield makes it more likely new shares will sell.
 4. **Eval**: the owners' attitude to risk and to control, how quickly the money is needed (a share issue is slow), the direction of interest rates, whether retained profit or crowdfunding could cover part, the business's objectives (a commitment to give away profit, for example), and the opportunity cost.
- **"Is the data enough to decide?"**: say what the figures do settle (for example that forecast gearing would pass 50%), what they leave out (future interest rates, the directors' view of risk, demand for the shares, whether retained profit has already been spent), then judge.
 - Keep to the question: it asks **how** to pay, not **whether** to go ahead (a mistake noted in June 2022).

3. Analyse or evaluate ways to improve liquidity (2 questions)

Paper 3, either [8] **"analyse two methods"** (2 K, 2 App, 4 An; no evaluation) or [12] **"evaluate methods"** (2 K, 2 App, 2 An, 6 Eval).

1. **K**: liquidity is the ability to pay debts due in the short term (not profit), measured by the current and acid test ratios; name the methods. In the 8-mark version, defining liquidity earns at most 1 of the 2 K marks.
 2. **App**: find the **cause** in the case's figures: a wide gap between the current ratio and the acid test points at inventory; receivables days well above the credit terms point at slow customers; paying suppliers on order; seasonal sales; a large dividend. In the 8-mark version only one App mark is given per method, so tie each method to a different case fact.
 3. **An**: complete the chain to cash and the ratio: "suppliers agree 45 days' credit → cash leaves weeks later → more cash on hand at any time → the acid test rises". A method with no link to cash is incomplete.
 4. **Eval** (12-mark only): who holds the bargaining power (will big customers accept shorter credit, will suppliers wait?), what each method costs (factoring fees, overdraft interest, lost discounts), how fast it works, and which one fixes the case's actual cause.
- In the 8-mark version only the best two methods count, so writing more wastes time.
 - Methods: less inventory or just-in-time, shorter credit or chasing late payers, debt factoring, delaying payments to suppliers, an overdraft (short term only), selling unused assets or sale and leaseback, cutting or delaying dividends, cutting overheads, moving to more cash sales. Becoming a plc is not a sensible answer: a flotation costs a lot of cash up front and is a way to fund long-term growth, not a cash shortage (March 2025 report).

4. Evaluate ways to improve profitability or investor return (2 questions)

Paper 3, [12].

- **Profitability:** K: profitability relates profit to revenue (margins) or to capital employed (ROCE); profit rises if revenue grows faster than costs, or costs fall without losing sales. Methods: raise prices or add value, cheaper materials or less waste, fewer indirect staff or lower promotion costs, higher productivity, more promotion of the highest-margin lines. App: which line of the case's accounts has worsened (cost of sales growing faster than revenue, a falling operating margin) and the case's business (premium materials, a generous pay policy, a social enterprise). Eval: what each method does to quality, staff and customers, price elasticity, and whether it fits the business's aims: a social enterprise may refuse to raise prices or use less sustainable materials.
- **Investor return:** K: investors gain through dividends and a rising share price (capital gain); measure it with dividend per share, dividend yield, dividend cover, earnings per share and the P/E ratio; the directors decide the dividend. App: the trend in the case's investor ratios and share price, and the plans in the case that could lift profit. An: a plan cuts unit costs → higher operating profit → more profit for the year to pay out and a higher share price. Eval: how long it takes and what it costs, whether the directors will actually pay out more rather than retain it, and whether a rising P/E means investors already expect the growth.

5. Recommend whether to accept a takeover or joint venture offer (2 questions)

Paper 3, [12] (2021–2022: 2 K, 2 App, 4 An, 4 Eval), using your ratio answers.

1. **K:** what the offer is. In a takeover, the buyer gains control by buying more than half of the shares. In a joint venture, two firms create a jointly owned project or business and share its costs, risks and profits, while each stays independent. Factors: finance, control, objectives, core competences, staff time.
2. **App:** does the business **need** the partner? High gearing, a low acid test and thin margins say its own profits cannot fund growth; low gearing and a high current ratio say it could manage alone. For a share purchase, work out the value placed on the whole company ($\text{price} \div \text{fraction bought}$) and compare it with net assets. For a joint venture, compare its forecast margin with the business's current margin.
3. **An:** who gets the money (in a share purchase the price goes to the **selling shareholders**, not into the company), what the partner brings (finance, customers, skills, economies of scale), what the owners give up (control, their roles, a share of future profit).
4. **Eval:** recommend, and say what it depends on: how much the owners value control, whether the price is fair, the partner's real motives and how it would finance the deal, whether the forecasts can be trusted, whether other partners exist, and whether selling less than half could bring the benefits without losing control.

6. Evaluate a dividend decision (1 question)

Paper 3, [12]: should the business raise its dividend?

1. **K:** shareholders provide the share capital; dividends are their reward for the risk; dividend cover and dividend per share measure the payout.

2. **App**: the case's dividend cover and its trend, profit and margin trends, the current ratio, plans that need retained profit (research, new markets), shareholders' mood, a planned flotation, who owns most of the shares.
3. **An**: higher dividend → shareholders content and new investors attracted → easier to sell shares at a good price later; against: higher dividend → less cash and retained profit → weaker liquidity and less money for growth.
4. **Eval**: can the business afford it in **cash**, not just in profit? Which matters more here, growth or shareholder income? What does the majority owner want? A judgement built on this case's numbers and plans reaches the top level; one that would fit any company stays in the middle.

7. Evaluate a finance and accounting strategy's impact on performance (Paper 4) (1 question)

Paper 4, [20]: a business has followed a financial policy for several years (for example no long-term borrowing, growth paid for from reserves, high dividends to one owner) and you judge what it has done to performance, using an appendix of accounts and ratios.

1. **K (up to 3)**: what a finance and accounting strategy is and the terms you will use (gearing, liquidity, reserves, dividends). Without a K mark, nothing else can be credited.
2. **App (2)**: case facts and figures, used **inside** a point of knowledge, analysis or evaluation.
3. **An (8)**: analyse each element of the strategy (4–6 marks), then the strategy as a whole (7–8 marks): a two-sided argument or several strands drawn together. For example: no loans → no interest and low gearing → survives bad years; but → growth limited to what reserves can pay for, and spending cash on expansion can leave the current ratio below 1.
4. **Eval (7)**: has the strategy worked, why, and how long can it last? What could change it: a new owner or chief executive, a recession, interest or exchange rates, the need to invest?

8. Advise which accounting data to use for a new strategy (Paper 4) (1 question)

Paper 4, [20]: a manager plans a new strategy (for example a new market) and you advise which accounting data would help.

1. **K**: naming a piece of data earns little; say **what it shows**. Choose from the statement of profit or loss, the statement of financial position, the liquidity, profitability, gearing and investment ratios, cash-flow forecasts, budgets, break-even and investment appraisal.
2. **App**: the strategy and the business: its ownership, size, how the move would be financed, the market (growth, competitors).
3. **An**: for each piece of data, how it helps this decision: liquidity → can the start-up costs be paid from cash? gearing → can it borrow? profitability → will the owners back it? And say which data matters less here, and why.
4. **Eval**: which data matters most, and its limits: past figures say little about a market the business has never been in, especially one dominated by large rivals, so add market research and forecasts.

Worked examples

Example 1

Aldermoor Bus Company Ltd runs local bus routes. Extracts from its accounts (million dollars):

At 31 March 2026	million dollars
Inventory (spare parts and fuel)	0.6
Trade receivables	0.4
Cash	1.6
Current liabilities	2.8
Issued share capital	5.0
Reserves	14.0
Non-current liabilities (bank loan at 8% interest)	16.0

Its operating profit for the year was 3.8 million dollars. The directors plan to sell the company's bus depot to a property investor for 6.0 million dollars, its value in the accounts, and rent it back for 0.5 million dollars a year. They would use 4.0 million dollars to repay part of the long-term loan and keep 2.0 million dollars as cash.

(a) Calculate Aldermoor's gearing ratio now and after the plan. **[4]**

(b) Calculate Aldermoor's acid test ratio now and after the plan. **[3]**

(c) Calculate the change in Aldermoor's yearly profit before tax caused by the plan, and explain what it shows. **[4]**

(a) Capital employed now = $5.0 + 14.0 + 16.0 = 35.0$ (1). Gearing = $16.0 \div 35.0 \times 100 = 45.71\%$ (2). After the plan, non-current liabilities are $16.0 - 4.0 = 12.0$ and capital employed $35.0 - 4.0 = 31.0$ (3). Gearing = $12.0 \div 31.0 \times 100 = 38.71\%$ (4).

(b) Now: current assets = $0.6 + 0.4 + 1.6 = 2.6$, so the acid test is $(2.6 - 0.6) \div 2.8 = 0.71 : 1$ (1). After: current assets = $2.6 + 2.0 = 4.6$ (2), acid test = $(4.6 - 0.6) \div 2.8 = 1.43 : 1$ (3).

(c) Interest saved on the loan repaid = $0.08 \times 4.0 = 0.32$ million dollars a year (1). The new rent is 0.5 million dollars a year (2), so profit before tax falls by $0.5 - 0.32 = 0.18$ million dollars a year (3), about 5% of the 3.8 million dollars of operating profit. The plan is not a way to raise profit: Aldermoor pays about 0.18 million dollars a year for lower gearing and twice the acid test, and it gives up a depot it can never use as security again, while the landlord may raise the rent at each review (4).

Example 2

Corbel Lab Supplies Ltd imports laboratory chemicals and equipment and sells them to university and hospital laboratories, which it allows 90 days to pay. This year Corbel paid its shareholders dividends of 0.9 million dollars, up from 0.5 million dollars last year, while its overdraft rose sharply.

	2026	2025
Current ratio	1.04:1	1.11:1
Acid test ratio	0.78:1	0.83:1
Trade receivables turnover	118 days	97 days

Analyse two methods Corbel could use to improve its liquidity. [8]

Liquidity is Corbel's ability to pay the bills that fall due in the next few months, such as its overdraft and its tax, from cash and from assets that soon become cash (K).

Method 1: debt factoring (K). Corbel's customers take 118 days to pay, 28 days beyond the 90 it allows and 21 days longer than last year (App). A factor would pay Corbel most of the value of each invoice as soon as it is issued, and then collect the money from the laboratories itself. Cash that now arrives nearly four months after a sale would arrive within days, so Corbel would need far less of its overdraft and could pay what it owes when it falls due (An).

Method 2: hold back the dividend (K). Corbel raised its dividends from 0.5 to 0.9 million dollars in the same year that its overdraft rose sharply; its acid test is only a little below its current ratio, so stock is not the cause (only about a quarter of current assets is inventory) and part of the cash shortage is cash paid out to its owners (App). Keeping next year's dividend at last year's 0.5 million dollars would keep $0.9 - 0.5 = 0.4$ million dollars more cash in the business. That cash could reduce the overdraft and pay suppliers and tax on time, so Corbel would rely less on the bank's goodwill and its liquidity would improve (An).

The marks: 2 K (liquidity and the two methods), 2 App (one case fact per method), 4 An (a developed chain for each method, ending in better liquidity). No evaluation is needed when the command word is "analyse".

Example 3

Haverly Skincare Ltd makes natural skincare products and sells them to pharmacies and online; three pharmacy chains buy most of its output. Its 8 million shares are owned by Nadia Haverly (4.6 million), her brother Tom (1.8 million) and Lindqvist Ventures (1.6 million), an investor that helped start the business and now wants to sell its stake. Haverly's capital employed is 25.0 million dollars, of which 16.0 million dollars is long-term loans at 9% interest, costing 1.44 million dollars a year. Over the last five years its operating profit has varied between 2.9 and 5.6 million dollars; last year it was 5.0 million dollars.

The directors propose converting Haverly to a public limited company. It would sell 4 million new shares to the public at about 2.75 dollars each, and Lindqvist would sell its 1.6 million shares in the same offer. After fees of 1.0 million dollars, the money from the new shares would repay 10.0 million dollars of the loans.

The directors say that converting to a plc is in the best interests of Haverly's current shareholders. Evaluate this view. [12]

A public limited company can offer its shares to the public, usually on a stock exchange, after publishing a prospectus, and the issue is normally underwritten (K). Share capital is never repaid and carries no interest, but every new shareholder gets votes and a share of each year's profit (K).

For the view. Haverly's gearing is $16.0 \div 25.0 \times 100 = 64\%$, so interest takes a large, fixed bite of profit whatever kind of year it has (App). The new shares raise $4 \times 2.75 = 11.0$ million dollars, 10.0 after fees. Repaying 10.0 million dollars of loans cuts gearing to $6.0 \div 25.0 \times 100 = 24\%$ (capital employed stays at 25.0, since equity rises by as much as the loans fall) and yearly interest from 1.44 to $0.09 \times 6.0 = 0.54$ million dollars (App). With 0.90 million dollars less interest to pay, more of a weak year's profit is left after the bank is paid, so the business is far less likely to run short of cash or have to cut the dividend, and it could borrow again later if it needed to (An). In Haverly's worst recent year, with operating profit of 2.9 million dollars, the current shareholders' profit before tax would be $2.9 - 1.44 = 1.46$ million dollars as things stand, but two-thirds of $2.9 - 0.54 = 2.36$, which is 1.57 million dollars, after floating, since they would own 8 of the 12 million shares (App). The listing also helps the shareholders as owners of an asset. Lindqvist's minority stake in a private company is hard to sell; in the offer it receives $1.6 \times 2.75 = 4.4$ million dollars, money that goes to Lindqvist, not to Haverly. Nadia and Tom's 6.4 million shares gain a market value of $6.4 \times 2.75 = 17.6$ million dollars and could be sold on any trading day.

Against the view. The original shareholders would own $8 \div 12 = 66.7\%$ of the company, so they give up a third of **all** future profit in exchange for lower interest. In an ordinary year, like last year's 5.0 million dollars of operating profit, their profit before tax would be $5.0 - 1.44 = 3.56$ million dollars as things stand, but two-thirds of $5.0 - 0.54 = 4.46$, which is 2.97 million dollars, after floating: about 0.59 million dollars a year less (tax is charged at the same rate either way, so the comparison holds after tax too) (Eval). The two choices pay them the same when operating profit is 3.24 million dollars; in any year above that, keeping the loans leaves them better off (Eval). The fees of 1.0 million dollars, a fifth of last year's operating profit, are lost whatever happens, and if investors pay only 2.40 dollars a share, the new shares raise 9.6 million dollars, just 8.6 after fees (Eval). Control shifts too. Nadia and Tom together fall from $6.4 \div 8 \times 100 = 80\%$ to $6.4 \div 12 \times 100 = 53.3\%$: still a majority, but a narrow one, and Nadia on her own falls from $4.6 \div 8 \times 100 = 57.5\%$ to $4.6 \div 12 \times 100 = 38.3\%$, so she can no longer decide anything without Tom. New shareholders will expect regular dividends, and as a plc Haverly must publish far more about its plans (Eval).

Judgement. The view is right for Lindqvist but overstated for Nadia and Tom (Eval). For Lindqvist, the offer is the simplest way out of a private company at a market price. For Nadia and Tom it is insurance: they pay about 0.59 million dollars a year in an ordinary year, and gain only in years when operating profit falls below 3.24 million dollars, which has happened, since its worst recent year was 2.9 million dollars (Eval). Unlike most flotations, it leaves the family in control, but only while the siblings agree: if Tom sold just 0.5 million shares, the family's stake would fall to $5.9 \div 12 \times 100 = 49.2\%$ and Haverly could become a takeover target (Eval). So the flotation is in their interest if they expect Haverly's profit to stay as uneven as it has been, or interest rates to be higher when the loans are renewed, and value a saleable stake; if they expect profit to stay near 5.0 million dollars, they would do better to keep Haverly private, find Lindqvist a private buyer for its stake, and

repay the loans gradually from retained profit (Eval). Because a skincare brand's sales can swing with fashion and with the three pharmacy chains that buy most of its output, the safer route is defensible, but the directors cannot call it best for every current shareholder (Eval).

The marks: 2 K for a plc and what new shares give their owners; 2 App for gearing and interest before and after, and the owners' income in a bad year; 2 An for the chain from lower fixed interest to safer income; 6 Eval for the cost in an ordinary year, the break-even profit, the fees and share price, the family's narrower control, and a judgement that separates Lindqvist from Nadia and Tom and rests on how uneven Haverly's profit is.

Example 4

Brannock Dairies Ltd is owned by two siblings. In 2022 they began buying small local dairies, paying for each one with long-term bank loans at variable interest rates, and kept dividends low so that most profit stayed in the business. It has bought three dairies so far. Two supermarket chains buy 55% of its output. Over 2023–2025 the central bank raised its interest rate from 2.5% to 4.5%, and Brannock now pays about 5.5% on its loans.

	2022	2023	2024	2025
Revenue (million dollars)	46	61	78	93
Operating profit margin (%)	4.8	4.2	3.6	3.1
ROCE (%)	8.3	7.4	6.6	6.0
Gearing (%)	34	49	61	66
Current ratio	1.42:1	1.28:1	1.03:1	0.86:1
Dividend cover (times)	5.0	6.2	7.5	8.0

Evaluate the impact of Brannock's finance and accounting strategy on its performance between 2022 and 2025. [20]

Brannock's finance and accounting strategy has two parts: growth by takeover paid for with debt, which raises gearing (the share of long-term finance that is borrowed), and a low dividend payout, which keeps profit in the business as reserves (K). Both affect profitability, liquidity and risk, which the ratios measure (K).

Growth has worked. Revenue has roughly doubled, from 46 to 93 million dollars (App). Buying existing dairies brought customers and capacity at once, much faster than building them, and with more volume Brannock should be able to negotiate better prices from farmers and use its tankers more fully (An). Operating profit has risen from $46 \times 0.048 = 2.21$ to $93 \times 0.031 = 2.88$ million dollars, an increase of about 31% (App).

But profitability has fallen at every step. Profit has grown far more slowly than revenue: the operating margin fell from 4.8% to 3.1%, and ROCE from 8.3% to 6.0% (An). Each dairy bought adds to capital employed at once, while joining up the businesses (different equipment, systems and contracts) takes time, and supermarkets buying over half its milk can resist price rises, so the extra revenue is earned at a lower margin (An).

The debt is becoming a burden. From the ratios, capital employed in 2025 was about $2.88 \div 0.060 = 48$ million dollars, so loans were about 66% of that, roughly 31.7 million dollars, against about 9 million dollars in 2022. At 5.5%, interest is about 1.74 million dollars a year, about three-fifths of operating profit (An). ROCE has fallen from 8.3% to 6.0% while the cost of borrowing has risen to about 5.5%: even at today's rate, capital earned 2.8 percentage points more than loans cost in 2022, but by 2025 the gap is only 0.5 points, so further loan-financed takeovers would add risk while adding very little for the owners (An). Because the loans are at variable rates, the rate rises since 2023 have pushed the interest bill up just as margins fell (An).

Liquidity has weakened despite low dividends. Dividend cover has risen from 5.0 to 8.0 times, so the owners take little cash out, yet the current ratio has fallen from 1.42:1 to 0.86:1 (App). Cash generated has probably gone into the deposits and integration costs of each new dairy and into rising interest, so the business now has fewer current assets than current liabilities and depends on its suppliers and bank waiting to be paid (An). The low payout has helped: without it, Brannock would have had to borrow even more (An).

Judgement. The strategy has achieved its aim of rapid growth, and keeping dividends low was sensible, but its financial side has run its course (Eval). With gearing at 66%, ROCE barely above the 5.5% cost of its loans and a current ratio below 1, another debt-financed takeover would put the business at serious risk: a further rise in interest rates, or one supermarket moving its orders to a rival dairy, could leave Brannock unable to meet its interest and pay its farmers (Eval). How long the strategy can last depends mainly on interest rates and on whether the three dairies can be run more efficiently together, lifting the margin back towards its 2022 level (Eval). Brannock should pause buying dairies, use retained profit to repay part of its loans, and if it wants further growth, the siblings should consider bringing in equity, for example a minority share for an investor, accepting some loss of control in exchange for lower risk (Eval).

The marks: K for the strategy and the ratio terms; 2 App for the case figures used in the argument; An at the top level because each part of the strategy (debt-financed takeovers, low dividends) is analysed and then the strategy is judged as a whole, with both sides; Eval for a judgement on how far it has worked, how long it can last and what it depends on, built on Brannock's own figures and situation.

Common mistakes

- **Thinking a plc belongs to the government.** The November 2021, March 2022 and June 2023 reports all found answers treating a public limited company as state-owned or state-backed; in June 2023 those answers scored nothing. "Public" means the public can buy its shares.
- **Giving benefits every company already has.** In March 2022 answers praised a plc for limited liability, which private limited companies have too. Give gains that only a listing brings: much more share capital, and shares that are easy to sell.
- **Judging the business when the question asks about the owners.** In June 2023 the key requirement was whether **shareholders** would benefit, and many answers missed it; the November 2021 report said that judging a conversion from the owning family's point of view was necessary for the highest marks, and in March 2021 the strongest answers focused on what mattered most to the founders and owners. Read who the question is about.
- **Getting the flow of money wrong in a share sale.** In March 2021 many candidates thought the price a buyer pays for existing shares goes to the business. It goes to the shareholders who sell.

- **Ignoring your own calculations.** In June 2022 (Paper 31) many joint-venture answers never used the ratios just calculated. Quote them in the argument and say what they mean for the decision.
- **Repeating figures without explaining them.** In March 2023 answers that only said "gearing has increased" earned nothing for it; the mark needs what the change means, for example that further borrowing will be harder. The same report saw candidates read rises as falls because the latest year was in the left-hand column.
- **Answering a different decision, or misjudging the source.** In June 2022 (Paper 33) some answers discussed whether to run the project when the question asked how to pay for it, and some thought a share issue raises money quickly.
- **Confusing liquidity with profit.** In March 2025 some candidates thought liquidity was about profit, and some suggested floating the company to cure a cash shortage. Liquidity is about having cash for short-term bills; a flotation is slow and costly.
- **Stopping a liquidity chain too early.** The March 2022 report (Paper 2) noted answers such as "sell a machine" or "sell inventory" with no link to cash. Say how cash comes in, and which ratio improves: selling stock for cash lifts the acid test but not the current ratio.
- **Spending the time on analysis instead of evaluation.** In June 2023 analysis often took up more than half of 12-mark answers although it was worth only 2 marks; half the marks are for evaluation, so half the answer should weigh and judge.

How to get the marks

- **Command words.** *Analyse*: two developed chains, no judgement needed. *Evaluate* or *Assess*: both sides and a supported judgement for this business. *Recommend ... justify* or *Advise*: a clear decision for the person named, with reasons and what it depends on.
- **Use the earlier calculations as evidence.** Quote a ratio inside an argument ("gearing would reach 70%, so a bank would see further lending as very risky"). Copying a figure out without using it earns no application. Your own figures are accepted even if a calculation was wrong.
- **Forecast the ratio the decision changes.** The marks reward working out what a loan, a share issue or a dividend change would do: forecast gearing, the owners' share after an issue, retained profit after a dividend, the value an offer places on the company.
- **Chains of at least two links.** Decision → what it does to cash, profit, risk or control → what that means for the business or its owners.
- **Context in the judgement.** The top evaluation level needs a judgement that could only be about this business: its owners, its figures, its plans. A conclusion that would fit any company is capped at the middle level.
- **Say what the judgement depends on:** the owners' attitude to control and risk, interest rates, how soon the money is needed, how reliable the forecasts are, whether investors will buy the shares.
- **Paper 4 essays** need knowledge first (without it, nothing else scores), application inside the argument, analysis of each part of the strategy and then the whole, and a judgement on how long the strategy can last.

Quick check

1. A company has non-current liabilities of 19.5 million dollars and shareholders' equity of 19.5 million dollars. It needs 6.5 million dollars. Calculate its gearing now, after borrowing the 6.5 million dollars, and after raising it by selling new shares.
2. A buyer offers 9.1 million dollars for 70% of the shares in a private company whose net assets are 8.6 million dollars. Calculate the value the offer places on the whole company and how far above net assets it is. Who receives the 9.1 million dollars?
3. A company has 60 million shares, a share price of 1.50 dollars and a profit for the year of 7.2 million dollars. To win back investors after a fall in its share price, it raises its total dividend from 1.2 to 5.4 million dollars. Calculate the dividend per share, dividend yield, dividend cover and retained profit before and after the rise.
4. A business has current assets of 3.2 million dollars (inventory 1.1), current liabilities of 2.5 million dollars (including an overdraft of 1.0), non-current liabilities of 2.4 million dollars and shareholders' equity of 11.6 million dollars. It replaces the overdraft with a five-year bank loan. Calculate its current ratio, acid test ratio and gearing before and after.
5. Explain two limitations of comparing a business's published accounts with a rival's when judging whether its strategy is working. **[4]**

Answers

- Now: capital employed = $19.5 + 19.5 = 39.0$, gearing = $19.5 \div 39.0 \times 100 = 50\%$. Loan: $26.0 \div 45.5 \times 100 = 57.14\%$. Shares: $19.5 \div 45.5 \times 100 = 42.86\%$. The company is already at the 50% line that lenders treat as high; the loan takes it well past that, while shares bring it below but dilute the owners.
- Value of the whole company = $9.1 \div 0.7 = 13.0$ million dollars, which is $13.0 - 8.6 = 4.4$ million dollars above net assets: a large premium, perhaps for the brand, customers or skills. The money goes to the shareholders who sell, not to the company; they give up control and keep 30% of the shares.
- Before: dividend per share = $1.2 \div 60 = 0.02$ dollars, yield = $0.02 \div 1.50 \times 100 = 1.33\%$; cover = $7.2 \div 1.2 = 6$ times; retained = $7.2 - 1.2 = 6.0$ million dollars. After: dividend per share = $5.4 \div 60 = 0.09$ dollars, yield = $0.09 \div 1.50 \times 100 = 6\%$; cover = $7.2 \div 5.4 = 1.33$ times; retained = $7.2 - 5.4 = 1.8$ million dollars. Investors who want income now get a yield four and a half times as high, which may lift the share price, but 4.2 million dollars less profit is kept for growth, more cash leaves the business, and if profit fell by a quarter the whole year's profit would go on the dividend.
- Before: current ratio = $3.2 \div 2.5 = 1.28 : 1$; acid test = $(3.2 - 1.1) \div 2.5 = 0.84 : 1$; gearing = $2.4 \div 14.0 \times 100 = 17.14\%$. After: current liabilities = 1.5, so current ratio = $3.2 \div 1.5 = 2.13 : 1$ and acid test = $2.1 \div 1.5 = 1.4 : 1$; gearing = $3.4 \div 15.0 \times 100 = 22.67\%$. Liquidity looks much better and the bank can no longer demand the money at short notice, but gearing rises and interest is still paid.
- The two businesses may use different accounting methods, for example valuing inventory or depreciating assets differently (1), so the same performance can produce different ROCE or margins, and a gap may reflect accounting choices rather than a better strategy (2). They may differ in size, product mix or year end (1): a rival selling more premium products, or reporting after its busy season, will show different ratios for reasons that have nothing to do with how well either strategy works (2). Other valid points: the rival's accounts are grouped totals, so the reasons behind its figures are hidden; they are already months old.

Past questions to try

- **9609/32/F/M/21 Q2**: gearing, profit margin and acid test, then whether the founders should sell a majority stake to a larger firm.
- **9609/31/M/J/22 Q4**: ROCE, gearing and dividend cover, then whether to accept a joint venture offer.
- **9609/33/O/N/23 Q4**: gearing, then whether the financial data is enough to choose how to pay for a modernisation.
- **9609/42/O/N/24 Q2**: a Paper 4 essay advising which accounting data to use when planning a move into a new market.