Exercise walk-through

Finance and accounting strategy ▪ 10.4

eXercise

You must be able to

- explain how financial data supports a strategic decision
- describe the financial questions managers ask before a major spend
- analyse and evaluate the role of financial information in strategy

Method — Using finance to choose a strategy

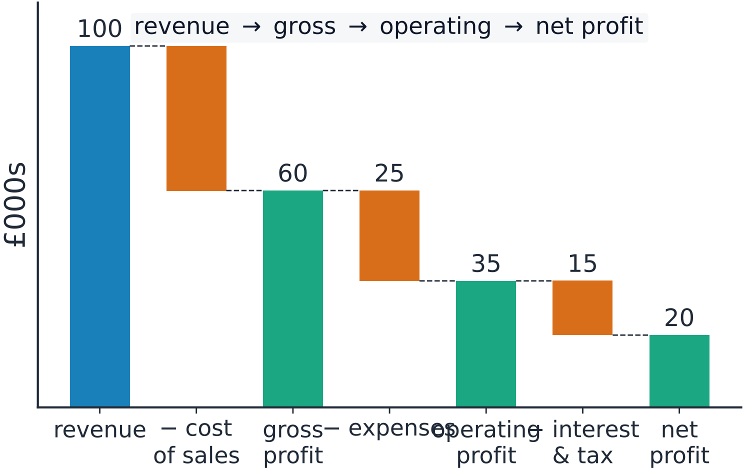
Before a big decision, managers ask:

- **Can we afford it?** (cash flow, existing debt and gearing)
- **How will it affect profit and return?** (ROCE, ARR, NPV)
- **What is the risk?** (payback, the effect on liquidity)

Financial data must still be weighed with the market, the staff and the firm's objectives.

Answer shapes: AO1 + AO2 + AO3 (reasoning chain) + AO4 (a supported judgement *in context*).

Method — Using finance to choose a strategy



Method — Using finance to choose a strategy

Financial data and ratios let managers judge a strategy before committing

Practice 2.1 ▪ 2 marks

State two financial questions managers ask before a major investment.

Solution 2.1

Method: Using finance to choose a strategy

Worked steps

any two of: can we afford it (cash/gearing)?; how will it affect profit and return?; what is the payback/risk?; how will it affect liquidity? $(1 + 1)$.

Practice 2.2 ▪ 2 marks

Define the term *gearing*.

Solution 2.2

Worked steps

the proportion of a firm's long-term capital that comes from borrowing rather than from owners (2 for a clear definition; 1 for a partial idea).

Practice 2.3 ▪ 2 marks

State one non-financial factor managers should also consider in a strategic decision.

Solution 2.3

Method: Using finance to choose a strategy

Worked steps

any one of: the market and competition; staff morale and skills; the firm's objectives; ethics or the environment (2 for a developed point; 1 for a basic one).

Exam-style 3.1 ▪ 3 marks

Explain one reason why financial data is useful in making a strategic decision.

Solution 3.1

Method: Using finance to choose a strategy

Worked steps

[3] **AO1** 1 — give a reason (it measures cost, profit, return and risk objectively). **AO2** up to 2 — develop it, e.g. comparing the NPV of two projects shows which adds more value → managers choose the better one → resources are used well (2 developed / 1 limited).

Exam-style 3.2 ▪ 8 marks

Analyse two financial factors a business should consider before a major investment.

Solution 3.2

Method: Using finance to choose a strategy

Worked steps

[8] For **each** of two factors: **AO1** 1 + **AO2** 1 + **AO3** up to 2. Example chains — *gearing/affordability*: a heavily borrowed firm → high interest risk → it may delay or fund the project with equity instead. *Return (NPV/ARR)*: a project with a positive NPV → adds value over its life → worth investing in if cash allows. Maximum 4 per factor, 8 total.

Exam-style 3.3 ▪ 12 marks

'Financial data is the most important factor in any strategic decision.' Evaluate this view.

Solution 3.3

Method: Using finance to choose a strategy

Worked steps

[12] **AO1** 2 / **AO2** 2 / **AO3** 2 / **AO4** up to 6. **For:** financial data is objective, measures cost, return and risk, and underpins affordability. **Against:** numbers use estimates and past data, and ignore the market, competition, staff and ethics; a profitable-looking plan can still fail for non-money reasons. Judgement: financial data is essential but rarely sufficient alone — the best decisions weigh it against market and human factors and the firm's objectives; its importance depends on the type of decision.