Solutions

Marking: **M1** a correct method, **A1** the correct answer, **B1** an independent mark.

Each answer shows the steps, then the **result**.

2.1

(current assets − inventories) ÷ current liabilities; inventories may be hard to sell quickly for cash, so the ratio gives a stricter test of liquidity

2.2

profitability: the ability to make profit from sales or capital; liquidity: the ability to pay short-term debts as they fall due

2.3

$160\,000 \div 400\,000 \times 100 = \mathbf{40}\%$; $48\,000 \div 400\,000 \times 100 = \mathbf{12}\%$

2.4

$90\,000 \div 60\,000 = \mathbf{1.5}$ (or 1.5 : 1); within the range often seen as healthy: it can cover its short-term debts

2.5

(a) capital employed $= 300\,000 + 450\,000 = 750\,000$; gearing $= 300\,000 \div 750\,000 \times 100 =$ **40**%; (b) $50\,000 \div 365\,000 \times 365 =$ **50** days

3.1

award up to [10]: profitability fell: gross profit margin 45% to 38% and profit margin 15% to 9%; possible causes: higher supplier costs or price cuts / rising expenses; liquidity fell: current ratio 1.6 to 1.1, acid-test 1.0 to 0.6, the gap shows much cash tied up in stock; strategies: sell slow charger stock at a discount: improves cash, but lowers margins further; negotiate better supplier prices or switch suppliers: improves GPM, but may affect quality; cut expenses (marketing, rent); delay payments to suppliers / collect debts faster; better stock control to avoid over-buying; judgement: liquidity is the urgent problem (acid-test 0.6), so clear the stock first

3.2

gearing above 50% means the firm is highly dependent on long-term loans; interest payments are a fixed burden; rising interest rates raise costs; lenders may refuse further loans; shareholders face more risk; falling ROCE means less profit to cover interest; strategy, e.g. issue new shares / use retained profit to repay loans / sell unused assets; evaluated: e.g. new shares lower gearing but dilute ownership and control

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