FISCAL STRATEGY TOOLS

10 TOOLS OF FISCAL STRATEGY: Fiscal policy is one tool a government has to achieve its economic and social objectives. The operation of fiscal policy is governed by the Public Finance Act 1989 (PFA).

The Act requires the Government to outline its fiscal policy intentions in the annual Fiscal Strategy Report(FSR). The FSR sets out the Government's long-term fiscal objectives relating to expenses, revenue, the operating balance, debt and net worth over a period of at least 10 years.

The Fiscal Strategy Model (FSM) projects the financial performance and the financial position of the government over a medium-term horizon and is normally published with the latest Economic and Fiscal Update.

Note: Previously these medium-term projections were done by the Long Term Fiscal Model (LTFM) however the LTFM is now used solely for longer-term projections (minimum of 40 years).

Fiscal Strategy Model Projections
The principal purpose of the FSM is to produce the post-forecast fiscal projections. The Budget Economic and Fiscal Update 2014 updated version of the FSM is published here on the Treasury's website.

The projections:

- begin from the end of the five-year forecasts in Economic and Fiscal Updates (EFUs) and normally cover a period of ten years beyond that
- are strongly influenced by the EFU forecasts
- are consistent with the Government's approach to fiscal management in that new initiatives are modelled through assumed operating and capital allowances
- grow operating and capital allowances from their end-of-forecast levels at prescribed rates, as no decisions on the size of these spending increments are made beyond the five-year forecast horizon;
- rely on long-term assumptions such as future population growth and economic growth
- include some degree of recovery to these long-term assumptions in the early years of the projections, if the long-term rates or levels have not been reached at the end of the forecast period, and
- are required to be published annually, as part of the Fiscal Strategy Report, under the Public Finance Act (1989).

10.2 INVESTMENT OF PERMANENT ASSETS: The minimum amount of current assets a company needs to continue operations. Permanent current assets are current assets that are always replaced with like assets within one year. Inventory, depreciating assets, cash and accounts receivable are examples of this. These are the amount of current assets for the company to exist.

There are temporary and permanent current assets. A temporary current asset is a sudden increase in the accounts receivable and inventory due to a sudden increase in sales, such as with a fluctuating asset. A company growing over time has three types of assets: fixed assets, permanent current assets and fluctuating current assets. Fixed assets are long term. Fluctuating current assets are seasonal and occur when sales increase or decrease. Permanent current assets are always financed long-term similar to fixed assets.

After the determination of the level of current assets, the company has to ascertain how the financing of current assets will be carried out and what should be the ideal amount of investment in current assets. The focus is on the ideal blend of short term debt and long term capital that should be applied for backing its current assets.

For a firm which has a stable growth, the entire amount of assets and therefore the working capital requirements vary with the passage of time. In order to simplify matters, the assets are categorized into two types, such as current assets and fixed assets.

Fixed assets are anticipated to increase at a fixed rate that indicates the consistent growth rate in sales. Current assets are also assumed to demonstrate the similar type of growth rate in the long term, nevertheless, they represent significant variation close to the line of trend simply due to cyclical patterns or seasonal patterns in purchases and sales.

Investment in current assets can be categorized into two segments:

Investment in permanent current assets: This denotes what is the requirement of a firm yet at the lowest point of its sales cycle.

Investment in temporary current assets: This indicates a variable constituent that changes according to the seasonal variations.

A company applies a number of strategies for funding its working capital requirements. There are three important strategies among them and they are as

follows:
Strategy 1: Here financing for the long term is utilized to satisfy requirements of fixed assets and prime necessities of working capital. In case the requirement of working capital is lower than the highest requirement, the excess is put into liquid assets, for example tradeable securities and cash.

Strategy 2: Financing in the long term is utilized to satisfy requirements for permanent working capital, necessities of fixed assets, as well as a component part of varying requirements of working capital. At the time of seasonal upturn, financing for short term is utilized. At the time of seasonal downturn, the excess is put into liquid assets.

Strategy 3: Financing for the long term is applied to satisfy the necessities of fixed assets and requirements of permanent working capital. Financing for the short term is utilized for satisfying variable requirements of working capital. This indicates towards the Matching Principle.

The policy of current asset investment states that increased degree of current assets leads to lower anticipated return and lower risk, if every other factor stays constant.

10.3 FUNDING AND RESTRUCTURING OF LIABILITIES:

Financial restructuring is the reorganizing of a business' assets and liabilities. The process is often associated with corporate restructuring where an organization's overall structure and its processes are revamped. Although companies can restructure for any reason, in most cases it is done when there are serious problems with the business, and to avoid bankruptcy liquidation.

Every functioning company controls assets, or economic resources that can be owned and are otherwise considered valuable. Most businesses also hold liabilities, which are debts or other obligations that arise as a result of past transactions. These economic factors will often have the most significant impact on the success or failure of that business, so financial restructuring is likely to focus on effectively managing assets and reducing liabilities.

Debt Restructuring

When a company is in crisis, it may try to renegotiate with its creditors to reduce or eliminate some of its debts. Faced with the possibility that the distressed company may default on a loan, creditors will often work to adjust the terms of repayment, including lowering interest rates and/or extending the repayment schedule. Debts may also be forgiven, in part, often in exchange for the creditor gaining some equity — part ownership — in the company.

Financial restructuring is not only a tool used by companies that are in financial trouble. Healthy companies may also choose to restructure their debt if it will provide a benefit. If interest rates fall, for example, a company may refinance its loans to take advantage of this drop.

Equity Restructuring

Companies that have little debt in comparison to their equity — that is, they are are underleveraged or have a low debt-to-equity ratio — may use some of their equity to buy back stock. This returns more control to the company, which will have fewer stockholders to satisfy and pay dividends to. If the company has excess cash, it can use it to repurchase shares; alternatively, if it doesn't have extra cash available, it may sell off some assets that are not bringing in profits or borrow money for the buyback.
Financial restructuring can also involve writing down assets that are overvalued. This change in value appears on a company's income statement as an expense, which lowers the company's income and, therefore, the amount of tax it owes. Because this is a "paper loss" — the company isn't actually losing any money except on the income statement — this method of restructuring can help reduce how much money a company owes without it needing to spend cash on repurchases.

Reasons for Restructuring

Most businesses go through a phase of financial restructuring at some point, though not necessarily to address shortfalls. In some cases, the process of restructuring takes place as a means of allocating resources for a new marketing campaign or the launch of a new product line. When this happens, the restructure is often viewed as a sign that the company is financially stable and has set goals for future growth and expansion.
A company may also need to restructure its finances if it merges with or acquires another company. When two firms merge, their debt and equity are also combined, and the resulting corporation may have a very different debt-to-equity ratio than either of the original companies. An acquisition may even be used as a form of financial restructuring, as a company with a low debt-to-equity ratio may target a business with a high ratio as a means of better balancing its finances.

Operational Restructuring

Along with financial restructuring, a company may need to restructure its operations to help eliminate waste. For example, two divisions or departments of a company may perform related functions and in some cases duplicate efforts. Rather than continue to use financial resources to fund the operation of both departments, their efforts are combined. This helps reduce costs without impairing the ability of the company to achieve the same ends in a timely manner. Operational restructuring, also known as corporate restructuring, may also involve downsizing, eliminating staff to reduce costs.

In some cases, restructuring must take place in order for the company to continue operations. This is especially true when sales decline and the corporation no longer generates a consistent net profit. The operational restructuring process may include a review of the costs associated with each sector of the business and an analysis of ways to cut costs and increase the net profit. The process may also call for the reduction or suspension of obsolete facilities that produce goods that are not selling well and are scheduled to be phased out.

10.4 FINANCING AND CAPITAL RESTRUCTURING: Capital Restructuring is much like remodeling your own home, it makes it more appealing.

Capital Restructuring can make your business more appealing to prospective stakeholders because this financial management tactic most often:

- decreases expenses
- improves operational efficiency,
- raises the EPS of the business and
- provides a base for much better overall operational results.

Businesses are like people in many ways, they never stop changing.

Businesses face ever-increasing competitive challenges, ongoing shareholder requirements, management's choices with associated positive and negative results all combined with an ever-changing legal and political ecosystem.

All of this requires that a business continues to reinvent itself and adapt to a constantly changing business environment.

Sometimes capital restructuring is a viable response to these marketplace realities and conditions.

Capital Restructuring can be considered when a company explores business expansion, asset divestitures, debt modifications, changes in corporate control , as well as modifications in the ownership framework.

A share repurchase plan is actually just one of the primary methods which a company uses for capital restructuring by altering its ownership framework. A business may use the share repurchase option when it's got extra money.
The surplus money can easily be put to work through investing in the business itself which will reduce the number of outstanding shares and thereby increase the company's Earnings-Per-Share (EPS.) The organization may also purchase its shares in the open market in order to combat an unwanted takeover bid.

Capital restructuring that involves such repurchases may possibly present many advantages to businesses. Stock repurchases are usually one-time returns of money. Instead of paying out dividends, businesses can use extra cash to buy-back their own stock. A stock repurchase can offer certain tax benefits to stockholders since the shareholders' profits will typically be taxed at the capital gains tax rate, which is generally less than the shareholder's earned income tax rate.
In addition to the tax benefits, capital restructuring through stock buy-backs can be quite effective as a quick way to make an acquisition less attractive to a potential, but undesirable, acquirer by depleting the level of excess cash on hand.
Experience indicates that the marketplace can view a share repurchase as either a positive or negative signal depending on the specifics of the repurchase offer and market conditions in general.

It is feasible that a repurchase of shares might send a negative indicator since the marketplace may think the organization doesn't have any lucrative projects to pursue. Because repurchases reduce hard cash assets, the business may also forfeit some development opportunities. Finally, in the event the repurchase is not effectively executed, the capital restructuring of the business might be exposed to financial stress possibly including bankruptcy.

The actual shares which businesses need to purchase back would be from the outstanding shares of common stock. The shares may be held by commonplace investors or may be within the ownership of a few big investors. The organization generally provides a premium to owners over the marketplace valuation on the share when repurchasing them.

What three methods of capital restructuring can a business typically employ?
The repurchase methods include:
1. capital restructuring through repurchase tender offer
2. capital restructuring through open market purchases
3. capital restructuring through privately negotiated repurchases

Your organization may tender a cash offer in the open marketplace to buy-back the common stock. A tender offer generally specifies the actual number of shares which the company wants to buy back and also specifies the price that it is willing to pay for these shares.

The tender offer will typically be time-bound and state a specific time period during which the repurchase offer would be valid. Stock tender repurchase offers are usually reserved for large stock repurchases.

In well-developed markets, open market buy-backs happen much more frequently compared to tender offers simply because they will tend to be a lot cheaper to manage. Open market buy-backs may also be distributed over lengthier time periods than stock tender offers. Open market buy-backs are generally used when dealing with smaller equity buy-back transactions.

Privately negotiated buy backs may be utilized to circumvent the activities of a hostile takeover when the aggressor is attempting to sweep the common shares of the targeted business in the marketplace. Negotiated purchases involve a small number of investors who hold significant chunks of a firm's shares.
Apart from simply being a purely economic option, stock buy-back can also be a positive signal to the marketplace. Possibly the organization is offering to repurchase its common stock by offering a very high price compared to its current value. Such an offer could be an indication that the company believes that its shares are currently undervalued.

The decision to go for share buy-back or invest the spare cash in other activities is a tough one. Usually, managers and shareholders have different views on the issue. However, the management-shareholder conflict can be resolved when there are large shareholders who can monitor and discipline the management.