

- The higher a firm's **sales growth rate** and the higher its **payout ratio**, the greater will be its need for additional financing.
- The greatest benefit of the forecasted financial statements method is its use in **planning to optimize operations and thereby increase the firm's intrinsic value** and thus its stock price.
- Adjustments must be made if **economies of scale** exist in the use of assets, if **excess capacity** exists, or if growth must occur in large increments (**lumpy assets**).
- **Linear regression** and **excess capacity adjustments** can be used to forecast asset requirements in situations in which assets are not expected to grow at the same rate as sales. See *Web Extension 12A* for more discussion of these issues.

## Questions

- (12-1) Define each of the following terms:
- Mission statement; corporate scope; statement of corporate objectives; corporate strategies
  - Operating plan; financial plan; sales forecast
  - Spontaneous liabilities; profit margin; payout ratio
  - Additional funds needed (AFN); AFN equation; capital intensity ratio; self-supporting growth rate
  - Forecasted financial statement approach
  - Excess capacity; lumpy assets; economies of scale
  - Full capacity sales; target fixed assets/sales ratio; required level of fixed assets
  - Financing feedback effects

- (12-2) Some liability and net worth items increase spontaneously with increases in sales. Put a check (✓) by those items listed below that typically increase spontaneously:

Accounts payable	_____	Mortgage bonds	_____
Notes payable to banks	_____	Common stock	_____
Accrued wages	_____	Retained earnings	_____
Accrued taxes	_____		

- (12-3) The following equation is sometimes used to forecast financial requirements:

$$AFN = (A_0^*/S_0)(\Delta S) - (L_0^*/S_0)(\Delta S) - MS_1(1 - POR)$$

What key assumption do we make when using this equation? Under what conditions might this assumption not hold true?

- (12-4) Name five key factors that affect a firm's external financing requirements.
- (12-5) What is meant by the term "self-supporting growth rate?" How is this rate related to the AFN equation, and how can that equation be used to calculate the self-supporting growth rate?
- (12-6) Suppose a firm makes the policy changes listed below. If a change means that external, nonspontaneous financial requirements (AFN) will increase, indicate this by a (+); indicate a decrease by a (-); and indicate no effect or an indeterminate effect by a (0). Think in terms of the *immediate, short-run* effect on funds requirements.