The chairman of your company has become concerned about the accumulation of cash in hand and in the deposit accounts shown in the company's balance sheet. The company is in the manufacturing sector, supplying aerospace components to the civil aviation markets in the UK and Europe. For the last 20 years the company has grown predominantly by acquisition and has not invested significantly in research and development on its own account.

The acquisitions have given the company the technology that it has required and have all tended to be small, relative to the company's total market capitalisation. The company has a healthy current asset ratio of 1.3, although its working capital cycle has an average of 24 unfunded days.

The company has not systematically embraced new manufacturing technologies nor has it sought to reduce costs as a way of rebuilding profitability. Managerial and structural problems within divisions have led to a number of substantial projects overrunning and losses being incurred as a result.

It has also proven difficult to ensure the accountability of managers promoting projects — many of which have not subsequently earned the cash flows originally promised. At the corporate level, much of the company’s accounting is on a contracts basis and over the years it has tended to be cautious in its revenue recognition practices. This has meant that earnings growth has lagged behind cash flow.

Over the last 12 months the company has come under strong competitive pressure on the dominant defence side of its business which, coupled with the slow-down in spending in this area across the major western economies, has slowed the rate of growth of its earnings. The company's gearing ratio is very low at 12% of total market capitalisation and borrowing has invariably been obtained in the European fixed interest market and used to support capital investment in its European production facility. In the current year, investment plans are at the lowest they have been in real terms since the company was founded in the 19305.

In discussion, the chairman comments upon the poor nature of the company's buildings and its poor levels of pay which could, in his view. be improved to reflect standards across the industry. Directors' pay, he reminds you, is some 15% below industry benchmarks and there is very little equity participation by the board of directors. He also points out that the company’s environmental performance has not been good. Last year the company was fined for an untreated discharge into a local river.

There are, he says, many useful things the company could do with the money to help improve the long-term health of the business. However, he does admit some pessimism that business opportunities will ever again be the same as in previous years and he would like a free and frank discussion at the next board meeting about the options for the company. The company has a very open culture where ideas are encouraged and freely debated.

The chairman asks if you, as the newly appointed chief financial officer, would lead the discussion at the next board.

Required:

(a) In preparation for a board paper entitled ‘Agenda for Change’, write brief notes which identify the strategic financial issues the company faces and the alternatives it might pursue. (10 marks)

(b) Identify and discuss any ethical issues you believe are in the above case and how the various alternatives you have identified in (a) may lead to their resolution. (10 marks)