

Uva Wellassa University
Faculty of Management



Degree of Bachelor of Business Management in Entrepreneurship and Management

3rd YEAR 1st SEMESTER EXAMINATION – February/March 2011

EMG 351-3 Entrepreneurial Financial Management

Part C- Essay Questions

Total marks for part C : 50

Answer three questions including question number one

01. i. Jameel Company is a five year old small and medium size private company specializing in the manufacture of a range of health drinks, foods and supplements aimed at the fitness market. At present, their biggest customers are health food shops and fitness centers. However, now that their brands have become established, the wealthy owners, who also manage the business, are convinced that sales could be increased dramatically through the opening of a supermarket. They are currently considering how best to fund the expansion of the business. Funds would be needed to set up the supermarket, expand manufacturing at the factory, and employ more staff to deal with administration, dispatch and delivery of the orders.

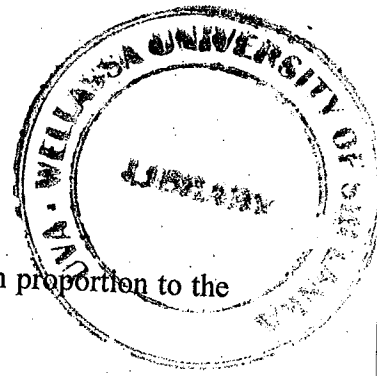
It is estimated that Rs. 2 million would be needed for the expansion. At present, the market value of the company's equity is Rs. 4 million and the company has loans of Rs. 0.5 million, repayable in six months time. The company also has cash built up from retained earnings of Rs.1.3 million.

You are required to:

- a) Outline **THREE** appropriate sources of medium/long term finance that may be available to Jameel Co; to finance its expansions. (Presume that government grants and leasing are **NOT** appropriate.) (5 marks)
- b) Discuss **FIVE** factors that Jameel Co; should take into account when deciding on the mix of debt and equity finance. (5 marks)

ii. Following financial information related to a venture firm in year 2010.

- Sales were Rs. 1.6 million and financial statement projections for venture firm based on expected sales growth rate of 30 percent for next year.
- Cost of goods sold were 60 percent of sales and forecasted to be 60 percent of sales estimated for year 2011.
- The actual marketing expenses related to current year was Rs.160,000. Marketing expenses also are expected to vary with sales since management is planning to



increase its advertising budget and other marketing expenses in proportion to the expected rate of increase in sales.

- General and administration expenses were Rs.152,000 and these expenses are fixed in nature.
- Depreciation expenses were 3% of sales and also would be expected to increase with sales. Consequently, depreciation is expected to remain 3% of sales level in 2011.
- Taxes to be charged on 25% of EBIT.

You are required to prepare income statements for the year 2010 on,

- a) Actual basis (for the year 2010)
- b) Forecasted or Projected basis (for the year 2011)

(10 Marks)

(Total Marks 20)

02. i. "Budgets can be a very useful part of the planning and controlling process". Discuss.

(3 Marks)

ii. Company XYZ Ltd commences trading on 1 June with a capital Rs 240,000. The following estimates have been made.

- Plant and equipment costing Rs. 160,000 will be purchased and installed prior to commencement of the business. The plant and equipment is payable in June and will be depreciated on a straight line basis over eight years with no expected disposal value.
- On 1 June an initial stock of goods will be purchased for Rs.96,000 payable in July. All goods sold from 1 June will be replaced immediately. Purchases will be on two months credit.
- Gross profit will be 33 1/3% on the cost of goods.
- Forecast sale for the first three months are:
 - June Rs 92,000, July 108,000 & August Rs 124,000
 - Sales is on credit payable in the month following sale
- Rent and rates, of Rs 32,000 for twelve months from 1 June is payable in July

- Wages and other overheads commencing in June are estimated at Rs 24,000 per month. 50% will be paid in the month incurred with the balance payable in the following month.

Required:

- a) A **cash budget** for each of the three months June, July and August
- b) A budgeted **Profit and Loss Account** for the three months in total
- c) A budgeted **BALANCE SHEET** at 31st August

(12 Marks)

(Total Marks 15)

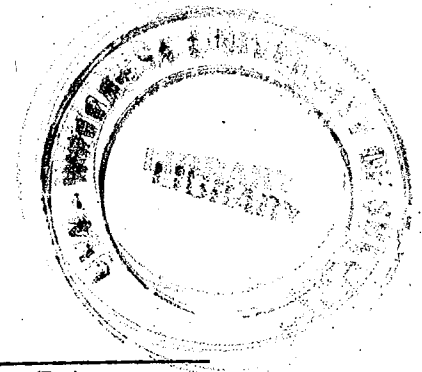
03. i. Briefly explain factors that determine the working capital need of a firm. (2 Marks)

ii. "Merely increasing the level of current asset holding does not necessarily reduce the riskiness of the firm. Rather the composition of current assets, whether highly liquid or highly illiquid, is the important factor to consider" Explain your position.

(3 Marks)

iii. A firm has applied for working capital finance from a commercial bank. You are requested by the bank to prepare an estimate of the WC requirements of the firm. You may add 10% to your estimated figure to account for exigencies. The following is the firm's projected profit and loss a/c.

	(Rs)
Sales	2,247,000
Cost of goods sold	<u>(1,637,100)</u>
Gross Profit	609,900
Administrative Expenses	(149,800)
Selling Expenses	<u>(139,100)</u>
Profit before tax	<u>321,000</u>
Tax provision	(107,000)
Profit after tax	214,000



The cost of goods sold (COGS) is calculated as follows.

	(Rs)
Material used	898,800
Wages and other expenses	668,750
Depreciation	<u>251,450</u>
	1,819,000
Less: Stock of finished goods (10% products not yet sold)	<u>181,900</u>
Cost of goods Sold	<u>1,637,100</u>

The figure given above relate only to the good that have been finished and not to working in progress, goods equal to 15% of the year's production (in term of physical units) are in progress on an average requiring full material but only 40% of other expenses. The firm has a policy of keeping two months consumption of material in stock.

All expenses are paid one month in arrears. Suppliers of material grant one and half months credit. Sales are 20% cash while remaining sold on two months credit. 70% of the income tax has to be paid in advance in quarterly installments.

You are required to prepare a statement showing working capital requirement of the firm.

(10 Marks)

(Total Marks 15)

04. i. Explain the need for the financial analysis. How does the use of ratio help in financial analysis? (2 Marks)
- ii. What do you mean by the liquidity of a firm? How can the liquidity of a firm be assessed? (2 Marks)
- iii. If it possible for a firm to have a high current ratio and still find difficulties in paying its current debt? Explain with illustrations. (3 Marks)

iv. X company has made plans for next year. It is estimated that the company will employ total assets of Rs.800,000, 50% of the assets being financed by borrowed capital at an interest cost of 8% per year. The direct costs for the year are estimated at Rs.480,000 and all other operating expenses are estimated at Rs.80,000. The goods will be sold to customers at 150% of the direct costs. Tax rate is assumed to be 50%.

You are required to calculate,

- a) Net profit margin
- b) Return of assets
- c) Assets turnover
- d) Return on owner's equity

(8 Marks)

(Total Marks 15)