

BOTSWANA OPEN UNIVERSITY

Diploma in Business Management

Business Finance

BF121

Sessional Examination

Marks: 100

Time: 3 hours

Instructions

1. The examination consists of **Four** sections: A,B, C and D.
2. Begin each answer to a new question on a new page.
3. Answer questions according to instructions given in each section.
4. Write answers in the answer booklet provided.
5. Write in grammatical English.

SECTION A - MULTIPLE CHOICE QUESTIONS

[10 MARKS]

Answer ALL questions in this section. Each question carries ONE (1) mark.

Choose the best alternative answer.

1. The following is a characteristic of preference shares?
 - A. Profit maximising
 - B. All have fixed redemption
 - C. Non-voting
 - D. All of the above

2. Which of the following is not a part of the credit policy?
 - A. Credit terms
 - B. Credit limits
 - C. Collection procedures
 - D. None of the above

3. Which of the following is not part of the three main components of the cash flow statement?
 - A. Operating activities
 - B. Payment activities
 - C. Investment activities
 - D. Financing activities

4. Which of the following is a characteristic of preference shares?
 - A. Profit maximising
 - B. All have fixed redemption
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5. Which of the following is not part of the credit policy?
- A. Credit terms
 - B. Credit limits
 - C. Collection procedures
 - D. None of the above
6. Which of the following is not part of the three main components of the cash flow statement?
- A. Operating activities
 - B. Payment activities
 - C. Investment activities
 - D. Financing activities
7. Which of the following will give you the lowest future value?
- A. Investing P1 000 for 5 years at 4% compound interest.
 - B. Investing P1 000 for 4 years at 3 % simple interest.
 - C. Investing P1 000 for 5 years at 4% simple interest.
 - D. Investing P1 000 for 4 years at 3% compound interest
8. A loan covenant refers to _____.
- A. A form of long-term loan secured by immovable property.
 - B. A piece of paper given in exchange of the money lent to the company.
 - C. An agreement with obligations and restrictions imposed by the lender.
 - D. None of the above.
9. Which of the following is not part of the classification of cost of capital?
- A. Variable costs.
 - B. Explicit costs.
 - C. Implicit costs.
 - D. Marginal costs.



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 - D. None of the above.

SECTION B - TRUE OR FALSE QUESTIONS

[10 MARKS]

Answer ALL questions. Each question carries ONE (1) mark.

State whether each of the following statements is TRUE or FALSE.

1. Bankruptcy can help companies avoid burdensome lawsuits when their financial situation has deteriorated beyond survival
2. Costs that are fixed per unit of output but vary in total as output changes are referred to variable costs.
3. Some preference shares have a chance to participate in earnings beyond the payment of the stated dividend.
4. Debentures can be classified as creditors in the creditors under long term finance.
5. In the event that the business becomes insolvent, the ordinary shareholders will receive their proceeds before preference shareholder, but after creditors.
6. A fixed period dividend applies to preference shares, which are also known as quasi-debt
7. The money market plays an important role in satisfying the long-term financing needs of the market participants
8. A factor is a company that plays an important role in providing businesses with funding based on what they (are owed by their clients) have in their debtor's book.
9. Gross profit is calculated as the difference between the value of sales and cost of good bought.
10. Financial risk relates to the additional risk of insolvency caused by the use of financing sources that require a fixed return.

SECTION C - SHORT ANSWER QUESTIONS

[40 MARKS]

Answer ALL questions in this section.

Question 1

Differentiate between the capital market and the money market, with relevant examples.

(4 marks)

Question 2

The following data shows the calculation of some efficiency and liquidity ratios for a business operating in the retail sector.

		2014		2015
Inventory Turnover	$(450/1500) \times 365$	110 days	$(450/1600) \times 365$	103 days
Receivables turnover	$(280/2000) \times 365$	51 days	$(400/2050) \times 365$	71 days
Current Ratio	840/280	3	940/376	2.5

- a. Comment on the efficiency ratios given above over the period 2014 to 2015; clearly state the change, whether the ratio has improved or worsened. (4 marks)
- b. Comment on the liquidity of the business over 2014 to 2015. (2 marks)

Question 3

Suppose you decide to invest an amount of P14 000 over a 6 year period. The interest rate is 9% per annum compounded interest.

Calculate the Future Value of your investment half way through the investment period, that is at the end of three years. (4 marks)

Question 4

Explain the following four Cs of credit: (12 marks)

- a. Capacity
- b. Collateral
- c. Character
- d. Condition

Question 5

Two firms have the same total capital, but company A is lowly geared whilst company B is highly geared. Compare the two firms for:

- i) The level of interest paid, and (2 marks)
- ii) The level of control that shareholders have (4 marks)

Question 6

Outline and briefly describe three (3) reasons for holding cash. (6 marks)

Question 7

Explain two (2) advantages of a partnership. (2 marks)

SECTION D - ESSAY TYPE QUESTIONS

[40 MARKS]

There are three questions in this section. Answer any TWO questions.

QUESTION 1

- a. What are the costs of maintaining:
- i. Very high levels of inventory, and; (3 marks)
 - ii. Very low levels of inventory (2 marks)
- b. Discuss in detail the following three sources of short term finance.
- i. Bank overdraft (5 marks)
 - ii. Invoice discounting (5 marks)
 - iii. Trade credit (5 marks)

QUESTION 2

Zacks Place Ltd is considering buying a machine and has two options, machine Alpha and machine Beta. Each machine will cost 135 000 and will have a life of five years, with no residual value thereafter. The following are the expected net cash flows:

Year	Project A	Project B
0	(135 000)	(135 000)
1	38 000	26 000
2	38 000	26 000
3	38 000	38 000
4	38 000	50 000
5	38 000	50 000

NB: Assume Zacks Place Ltd has a cost of capital of 12%.

The discount factors for the 12% are:

Year 1 = 0.893

Year 2 = 0.797

Year 3 = 0.712

Year 4 = 0.636

Year 5 = 0.567

Required:

- a. Determine the payback period in years and months. (4 marks)
- b. Find the net present value (NPV). (8 marks)
- c. Under what conditions could both projects be chosen by Zacks Place Ltd? (2 marks)
- d. Calculate the Profitability Index (PI) for both projects. Comment on the meaning of each (PI) value in relation to a P1 investment in each project. (6 marks)

QUESTION 3

Wally & Co Limited has a capital structure that appears as below:

Long term Loan	30%
Ordinary Shares	60%
Preference Shares	10%

Investors have an expected growth in dividend and earnings of 7%. Dividend per share was paid at P3.60 and the stock currently sells at P60. The prevailing interest rate is 12%, while shares have an expected return of 15%.

New preference shares can be sold at P100 per share. This could earn a dividend of P11 and floatation costs of P5 would be incurred. Debt could be sold at interest rate of 12%, tax = 30%.

- a. Find the cost of capital of each of the three components, Long term Loan, Ordinary Shares and Preference Shares. (10 marks)
- b. Calculate the weighted average cost of capital (WACC) (10 marks)

END OF EXAMINATION