THE INSTITUTE OF CHARTERED ACCOUNTANTS (GHANA)

MAY 2009 EXAMINATIONS
(PROFESSIONAL)

PART 3

FINANCIAL MANAGEMENT STRATEGY
(Paper 3.3)

Attempt ALL Questions

TIME ALLOWED: 3 HOURS

QUESTION 1

(a) Explain why maximisation of a company's share price is preferred as financial objective to the maximisation of its sales.

(***6 marks)***

(b) Sedem, a freshman in University pursuing an undergraduate course, needs GH¢20,000 in 4 years to start studying for an MBA. His investments with Zobank Ltd earn 5% interest per year.

  (i) How much must he invest today to have that amount at graduation? (***3 marks)***

  (ii) If he invested once a year for 4 years beginning today until the end of the 4 years how much must he invest? (***5 marks)***

(c) Zombo Ltd is in need of financing to get Accra clean. Three banks have offered loans. The first bank offers 4.5% interest bi-annual compounding. The second bank offers 4.3% interest with monthly compounding. The third bank offers 4.65% with annual compounding.

You are required to determine the best offer.

(***6 marks)***

Total: 20 marks

QUESTION 2

(a) Explain the difference between "term structure of interest rates" and the yield curve.

(***4 marks)***

(b) Identify and explain **four (4)** principal instruments that help to eliminate risks in international trade finance. (***6 marks)***

(c) The Langalanga Ltd is in a seasonal business. It requires a permanent base of net working capital of GH¢10 million all year long, but the requirement temporarily increases to GH¢20 million during a four-month period each year. Langalanga has three financing options for net working capital.

1. Finance the peak level year-round with equity which costs 20%, and invest temporarily unused funds in marketable securities which earn 6%.

2. Finance permanent net working capital with equity and temporary net working capital with short-term loan at 12%.

3. Finance all net working capital needs with short-term debt at 12.5%.

Required:

i) Calculate the cost of each option **(*6 marks)***

ii) Which would you choose? Why? (***1 mark*)**

(d) What is the effective interest rate implied by the following terms of sale, using a 365-day year.

i) 2/10, net 30

ii) 1/5, net 15

iii) 5/10, net 30 (***3 marks)***

Total: 20 marks

QUESTION 3

a) Pab Limited, a company producing Tee shirts has a net profit of GH¢2 million and faced with the following three options of how to structure its debts and equity.

i) To take no debt and pay shareholders a return of 9% forever

ii) Borrow GH¢5 million at 3% and pay shareholders an increased return of 10% forever

iii) Borrow GH¢9 million at 6% and pay a 13% return to shareholders forever.

Assuming no taxation and 100% payout ratio, you are required to calculate the market value for each of the options and determine which method is optimal.

(***9 marks)***

b) The calculation of Weighted Average Cost of Capital (WACC) is straightforward in theory, but in practice it is not an easy task.

Outline any possible difficulties that might be experienced when trying to calculate WACC. (***4 marks)***

c) Explain the factors which influence a company's decision to hedge interest rate risk. (***4 marks)***

d) Explain the following methods of payment in International Trade.

i. Letters of credit

ii. Documentary collection

(***3 marks)***
Total: 20 marks

QUESTION 4

(a) Onua Ltd needs to raise GH¢500,000 to finance a large scale project which would produce earnings of GH¢90,000 in perpetuity, but are undecided as to the manner in which the money should be raised.

The company has issued share capital of 2 million ordinary shares of GH¢1 each with a current market price of GH¢1.38 cumulative dividend. The annual dividend (which has been constant for many years) of GH¢360,000 is about to be paid.

Two methods of raising capital are being considered, a public issue, and a rights issue at GH¢1.

You are required to calculate

(i) the price at which the public issue should be made; and

(ii) the price at which you would expect shares to stand immediately after the rights issue. (***10 marks)***

(b) What are the advantages and disadvantages of a currently unquoted company obtaining a listing on the Ghana Stock Exchange? (***6 marks)***

(c) Distinguish between a Call Option and a Put Option. (***4 marks)***
Total: 20 marks

QUESTION 5

(a) Metcom Ltd is considering offering a discount for payment within 15 days to its existing customers who currently pay after 60 days. Research conducted by the retail shop shows that only 30% of credit customers would take the discount although selling and distribution cost savings of GH¢12,250 per year would be gained. Sales which is not affected by the discount per year is GH¢2,250,000. The company's cost of short term finance is 20%.

You are required to:

i) List **four (4)** functions of a Factor in credit management.

(***2 marks***)

ii) Advise Metcom Ltd on the maximum discount that it could offer to its customers.

(***10 marks)***

(b) Identify **four (4)** main differences between factoring and invoice discounting.

(***4 marks)***

(c) What are the problems associated with using ratio analysis to analyse the financial health and performance of companies?

(***4 marks)***

Total: 20 marks