THE UNIVERSITY OF THE WEST INDIES
CAVE HILL

EXAMINATIONS OF APRIL/MAY 2010.

CODE AND NAME OF COURSE: MGMT3090 - ENTREPRENEURIAL FINANCE

DATE AND TIME: **DURATION: 2 HOURS**

INSTRUCTIONS TO CANDIDATES: This paper has 4 pages and 6 questions.

This paper has three (3) Sections. Students must answer Section A which is compulsory and one (1) question each from Section B and Section C.

Section A

This section is compulsory. The question is worth 20 marks
Read the case carefully and answer all questions.

The Friendly Market is a large supermarket located in a city in the Southwest, USA. 'Friendlys' as it is popularly known, has more sales per square foot than any of its competitors because it lives up to its name. The personnel go out of their way to be friendly and helpful. If someone asks for a particular brand-name item and the store does not carry it, the product will be ordered. If enough customers want a particular product, it is added to the regular line. Additionally, the store provides free delivery of groceries for senior citizens, check-cashing privileges for its regular customers, and credit for those who have filled out the necessary application and have been accepted into the "Friendly Credit" group.

The owner, Charles Belmont, believes that his marketing approach can be successfully used in any area of the country. He is therefore thinking about expanding and opening two new stores. Locations have been scouted and a detailed business plan has been drawn up. He has estimated that he needs an additional $3 million to get both stores up and running and any additional funding can be obtained from the current operation which generates cash of $100,000 monthly.

TURN OVER

Question 1 (cont'd)

There are two avenues available to him: debt and equity financing. His local banker has told him that the bank would be willing to look over any business plan he submits and would give him an answer within five days. However, although he believes that the bank would lend him the funds, he is not comfortable with that high level of debt and he believes that selling shares in the business would be the preferred option.

a) Identify and briefly explain FIVE (5) important aspects which should be contained in the business plan. **(5 marks)**

b) Would you advise Mr. Belmont to acquire debt or equity financing? Identify FOUR (4) advantages of your recommendation. **(5 marks)**

c) Why would the value of the business be important to potential lenders and investors? Why is the valuation of this existing business easier to calculate than valuing a new venture? **(5 marks)**

d) The risks of this venture should be considered in the financial contracting process. Identify TWO (2) risks to the entrepreneur and state how they could be handled in the financial agreement. **(5 marks)**

TURN OVER

Section B

Answer ONE question in this section. Each question is worth 25 marks.

1. You are considering investing in XYZ Co. Ltd. Five year projections have been prepared which indicate $60 million in revenue; EBIT of $4 million and assets of $45 million. The compound annual growth of sales at year 5 is 20% and no dividends are planned for the five year period.

   As a basis for estimating the continuing value of the venture, you have compiled information on five public companies that are in similar industries. Note that dollar figures are in the millions.

   Analyse the information and use it to estimate the continuing value of the venture.

Comparable firm	Age in years	Assets	Sales	EBIT	Dividends	3-yr CAGR	Asset Market Value
Firm I	3	30	45	5	0	15%	85
Firm II	6	55	50	(5)	0	5%	70
Firm III	8	75	70	10	0	25%	120
Firm IV	10	45	35	7	0	20%	45
Firm V	12	130	95	30	0	45%	65

2. David and Maria plan to open a restaurant and they have prepared the following projections for three years. They have a cash investment of $120,000, $30,000 in equipment and have received a loan of $75,000 from their credit union.

   Prepare three year financial projections using the following assumptions:

   a) Sales are projected to be $100,000 in the first year and increase by 20% in year 2 and 10% in year 3.
   b) Direct costs are estimated to be 35% of sales.
   c) Operating expenses are 45% of yearly sales.
   d) Depreciation is on a straight-line basis over 5 years. There is no salvage value.
   e) Based on industry norms the following has been suggested:

Ending inventory	30% of sales
Ending accounts receivable	10% of sales
Ending accounts payable	10% of cost of sales

   f) There is a moratorium on all payments for three months thereafter monthly payments of $835 in interest and $1,300 in loan principal are required.
   g) There is no taxation.

Section C

Choose ONE question in this section. Each question is worth 15 marks.

1. a) Identify and explain FOUR (4) important aspects which should be included in any financial agreement. **(12 marks)**

   b) Identify TWO (2) mechanisms for resolving problems in financial contracts. **(3 marks)**

2. a) Identify FIVE (5) methods of raising financing for a business. **(5 marks)**

   b) What are the ideal options of finance for the following types of businesses? Explain the reasons for your answer. **(10 marks)**

      I) An IT firm which has developed a new software package for educational purposes. The system now needs to be tested.

      ii) An entrepreneur plans to open a day care center in a property which is owned by her family.

      iii) A small construction firm has signed a number of Government contracts and needs a measure of financing to cover them until Government pays the firm for work completed.

      iv) A group of farmers decide to open a business together to sell their produce.

      v) A group of pilots require finance so that they can increase the number of planes used in their airline business.

3. a) Identify THREE (3) factors which could affect the decision by an investor of how to harvest their shares in an early-stage business. **(5 marks)**

   b) Define 'IPO' and the process which occurs to achieve this action. Explain fully. **(5 marks)**

   c) Additional harvesting options include 'acquisitions' and 'management buy-outs'. Explain the difference between these two options. **(5 marks)**

END OF QUESTION PAPER