
Answers

1 Gold Club Ltd

(a)	Time						
	0	1	2	3	4	5	6
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Market research – ignore							
Membership fees (notes 1 & 2)			2,500	3,500	3,500	3,500	3,500
Set-up costs (note 3)	(375)	(1,125)					
Maintenance costs (note 4)			(100)	(120)	(144)	(173)	(208)
Club cards (5,000 x £3)			(15)	(15)	(15)	(15)	(15)
First Class lounge (note 5)			(200)	(300)	(300)	(300)	(300)
Travel insurance (note 6)			(270)	(420)	(435)	(450)	(465)
Upgrade costs (10 x £100k)			(1,000)	(1,000)	(1,000)	(1,000)	(1,000)
Interest costs – ignore							
Net cash flow	<u>(375)</u>	<u>(1,125)</u>	<u>915</u>	<u>1,645</u>	<u>1,606</u>	<u>1,562</u>	<u>1,512</u>
10% discount factors	<u>1.000</u>	<u>0.909</u>	<u>0.826</u>	<u>0.751</u>	<u>0.683</u>	<u>0.621</u>	<u>0.564</u>
Discounted cash flow	<u>(375)</u>	<u>(1,023)</u>	<u>756</u>	<u>1,235</u>	<u>1,097</u>	<u>970</u>	<u>853</u>

The net present value of the project is £3.513 million. The project should therefore be undertaken, since the net present value is positive.

Note 1: Membership numbers	Year 1	Year 2	Year 3	Year 4	Year 5
	T2	T3	T4	T5	T6
New members	5,000	5,000	5,000	5,000	5,000
Renewals at 50%		2,500	2,500	2,500	2,500
Total members	<u>5,000</u>	<u>7,500</u>	<u>7,500</u>	<u>7,500</u>	<u>7,500</u>
Of which, new members	<u>5,000</u>	<u>5,000</u>	<u>5,000</u>	<u>5,000</u>	<u>5,000</u>
Renewals	<u>0</u>	<u>2,500</u>	<u>2,500</u>	<u>2,500</u>	<u>2,500</u>

Note 2: Fees	Year 1	Year 2	Year 3	Year 4	Year 5
	T2	T3	T4	T5	T6
New members	5,000	5,000	5,000	5,000	5,000
Fee per member £	500	500	500	500	500
	<u>£'000</u>	<u>£'000</u>	<u>£'000</u>	<u>£'000</u>	<u>£'000</u>
Total new member fees	<u>2,500</u>	<u>2,500</u>	<u>2,500</u>	<u>2,500</u>	<u>2,500</u>
Renewal member numbers	0	2,500	2,500	2,500	2,500
Fee per member £	400	400	400	400	400
	<u>£'000</u>	<u>£'000</u>	<u>£'000</u>	<u>£'000</u>	<u>£'000</u>
Total fees from renewals	<u>0</u>	<u>1,000</u>	<u>1,000</u>	<u>1,000</u>	<u>1,000</u>
Total fees	<u>2,500</u>	<u>3,500</u>	<u>3,500</u>	<u>3,500</u>	<u>3,500</u>

Note 3: Set-up costs

Costs = £1,220k + £125k + £155k = £1,500k

T0: 25% x £1,500k = £375k

T1: 75% x £1,500k = £1,125k

Note 4: Maintenance costs	Year 1	Year 2	Year 3	Year 4	Year 5
	£'000	£'000	£'000	£'000	£'000
	T2	T3	T4	T5	T6
£100k in first year	100				
Increasing by 20% each year thereafter		120	144	173	208

Note 5: First Class lounge	Year 1	Year 2	Year 3	Year 4	Year 5
	T2	T3	T4	T5	T6
Number of members	5,000	7,500	7,500	7,500	7,500
	£'000	£'000	£'000	£'000	£'000
40% x £20 x 3	120	180	180	180	180
30% x £20 x 2	60	90	90	90	90
20% x £20 x 1	20	30	30	30	30
Total costs	200	300	300	300	300

(There is effectively an average of two visits per club member per year.)

Note 6: Travel insurance costs	Year 1	Year 2	Year 3	Year 4	Year 5
	T2	T3	T4	T5	T6
Flat rate per member £	50	52	54	56	58
E-mail costs: 2 x £2	4	4	4	4	4
	54	56	58	60	62
Total number of members	5,000	7,500	7,500	7,500	7,500
	£'000	£'000	£'000	£'000	£'000
Total costs	270	420	435	450	465

(b) Venture capitalists

Factors that a venture capitalist organisation will take into account are as follows:

(i) Level of expertise of Gold Club Ltd's management

Venture capitalists will believe that the success of Gold Club Ltd's membership scheme is dependent on the quality of the two shareholders/directors. They will expect these two key personnel to show a high level of commitment to the project. As both the existing owners of the business are all involved in the running of the company, this should be proof of their commitment. The venture capitalists will also look at the amount of money that the owners themselves have invested in the project in assessing their level of commitment. The venture capitalists will expect a place on Gold Club Ltd's Board of Directors so that they can have a say in future business strategy.

(ii) Level of expertise in the area of service

The venture capitalists will seek assurance that the directors have the necessary know-how and technical support to be able to run the website properly. In addition, they will need assurance that Gold Club Ltd can really provide the services to its customers.

(iii) The nature of Gold Club Ltd's product

The venture capitalists will consider the feasibility of providing the service at the membership prices proposed. This will involve analysing the cost estimates to ascertain their accuracy and ensuring, for example, that key airlines have agreed to the discounted upgrades and to the use of their First Class lounges. The venture capitalists will need a high level of assurance about the accuracy of the forecast membership numbers.

(iv) The market and competition

The venture capitalists will seek assurance that there is actually a market for the Club, as there are already some similar memberships available in the market place. They will ask to see the market research that has already been carried out. The venture capitalists will also look at the threat posed by new entrants in the market, and current rival membership schemes.

(v) Future prospects

Since the risk involved in investing in a new company is fairly high, the venture capitalists will seek to ensure that the prospects for future profits compensate for the risk. They will therefore want to see a detailed business plan setting out the future business strategy.

(vi) Exit routes

The venture capitalists will consider potential exit routes before they invest in the venture. They will not invest money in a share of the business unless they are confident that it can be sold at some point in the future.

Note: Only five factors were required.

2 Cleanly Ltd

Cleared Funds Forecast

	2 Jan £	3 Jan £	4 Jan £	5 Jan £	6 Jan £
Receipts					
W Ltd	130,000	0	0	0	0
X Ltd	0	0	0	180,000	0
	<u>130,000</u>	<u>0</u>	<u>0</u>	<u>180,000</u>	<u>0</u>
Payments					
A Ltd	45,000	0	0	0	0
B Ltd	0	0	75,000	0	0
C Ltd	0	0	95,000	0	0
Wages	0	0	0	0	12,000
Salaries	56,000	0	0	0	0
Petty Cash	200	0	0	0	0
Stationery	0	0	300	0	0
	<u>101,200</u>	<u>0</u>	<u>170,300</u>	<u>0</u>	<u>12,000</u>
Cleared excess receipts over payments	28,800	0	(170,300)	180,000	(12,000)
Cleared balance b/f	<u>200,000</u>	<u>228,800</u>	<u>228,800</u>	<u>58,500</u>	<u>238,500</u>
Cleared balance c/f	<u>228,800</u>	<u>228,800</u>	<u>58,500</u>	<u>238,500</u>	<u>226,500</u>
Uncleared funds float					
Receipts	180,000	180,000	180,000	0	0
Payments	(170,000)	(170,300)	0	(6,500)	(6,500)
	<u>10,000</u>	<u>9,700</u>	<u>180,000</u>	<u>(6,500)</u>	<u>(6,500)</u>
Total book balance c/f	<u>238,800</u>	<u>238,500</u>	<u>238,500</u>	<u>232,000</u>	<u>220,000</u>

3 Fibre Clean Ltd

(a) (i) Trade reference

A trade reference is a reference received from another business that the potential customer deals with. The trade referee selected should offer similar terms to those now being offered to Mr Sykes' customers, that is, 30-days terms.

A well known company stated as a referee should always be followed up, but if the name given is that of an unknown company, it should be treated with caution. This is because there is an increased likelihood of collusion between Mr Sykes' new customer and their referee. Mr Sykes should contact the referee himself, enclosing a stamped addressed envelope so that the reply comes direct to him. This prevents possible alteration by the customer.

The main problem with obtaining trade references arises from the fact that Mr Sykes' potential customers are unlikely to provide him with the names of referees who will provide bad references. They will only provide the names of those creditors with whom they have a good credit history. Their usefulness is severely limited by this factor.

(ii) Credit reference agency

These agencies provide information about businesses so that their creditworthiness can be assessed by potential suppliers. The level of information they hold varies. Some merely hold background information, for example, a set of a company's financial statements. Others hold more up to date information and may offer a credit rating.

Some of the main agencies include Equifax, Infolink, CCN, Moody's and Dunn & Bradstreet.

The main restriction on the usefulness of these agencies is that the information is often out of date. They are also of less use for assessing newer businesses which do not have enough history on which to base a credit assessment.

(b) Debt Factoring and Invoice Discounting

Debt Factoring

'Debt Factoring' is a service provided by factors whereby the factor collects debts on behalf of their client and often invoices their client's customers as well. The factor also advances, to its client, a proportion of the money it is due to collect (typically about 80% is advanced).

Mr Sykes would find the service useful because he could both receive cash early and reduce administration.

There are two types of factoring agreements: 'with recourse' and 'without recourse' agreements. With the first of these agreements, although the factor advances monies, the risk of non-payment of debts stays with the client. If a debtor defaults, the factor has 'recourse' to their client for the money. If the agreement is 'without recourse' the factor bears the risk of non-payment.

Debt factoring has to be paid for, usually as a percentage of the amounts advanced and as a percentage of turnover. Agreements without recourse to the client obviously cost more. Mr Sykes would have to compare his total costs if he uses a factor to his total costs if he does not use a factor before making a decision. He should also take into account the fact that there is some stigma attached to debt factoring as clients sometimes assume that a business using a factor must be in financial difficulty.

Invoice Discounting

Invoice discounting is a service whereby a provider (often a factoring company) purchases invoices from a client at a discount. In this case, they are merely advancing cash, rather than providing a debt collection service.

Again there will be a charge for discounting, calculated as a percentage of the invoices purchased.

Given Mr Sykes' concerns about his increased workload, a factoring arrangement would be far more suited to his needs.

(c) Cost of factoring

	£	£
Cost of financing debtors		
Average debtors £75,000 x 30/365	6,164	
20% financed by overdraft at 10%		123
Average level of factor's advance: £6,164 x 80%	4,931	
Cost at 8%		<u>394</u>
Total cost of financing debtors		517
Sales administration cost 2% x £75,000		1,500
Invoicing administrator employed		<u>1,000</u>
Total cost of arrangement		<u>3,017</u>

Cost of not factoring

Cost of financing debtors		
Average debtors £75,000 x 30/365	6,164	
Financed by overdraft at 10%		616
Sales administration cost New staff		<u>2,000</u>
Total cost of arrangement		<u>2,616</u>

The factoring arrangement would cost Mr Sykes £401 per annum more than not factoring. Therefore, he should not enter into the agreement.

4 Financial matters

(a) Financial intermediaries

A financial intermediary is an organisation that brings together potential borrowers and potential lenders. Such an intermediary can act as a broker, whereby they handle a transaction on behalf of others. Alternatively, they may act as a principal, whereby they hold money balances of lenders for lending on to borrowers.

Examples of financial intermediaries include:

- Banks
- Building societies
- Finance houses
- Insurance companies
- Pension funds
- Unit trusts
- Investment trust companies

Note: Only four examples were required.

(b) Benefits of financial intermediation

(i) Lending/borrowing becomes easier

The intermediary has a whole range of lenders and a whole range of borrowers. This makes lending and borrowing easier. Both parties know where to go to lend or borrow money since the services of financial intermediaries are well-advertised.

(ii) Risk reduction

The intermediary helps to spread the risk of lending money to borrowers among the various lenders who deposit money with the intermediary. This clearly benefits the lender.

In addition, intermediation reduces risk for the borrower too. For example, an organisation such as a unit trust company invests money in a variety of stocks and shares thereby ensuring diversification. Individuals then buy a small share of such investments, thus benefiting from risk reduction through diversification, but without having to invest large sums of money in numerous investments.

(iii) Aggregation

The intermediary is able to aggregate the amount lent by savers into amounts which the borrower may require. This makes the process of borrowing large sums of money much easier for the borrower. For example, if an individual requiring £100,000 to buy a house had to approach numerous different lenders, the process would be time-consuming and expensive.

(iv) Maturity transformation

The intermediary bridges the gap between the desire of many lenders for liquidity and the need of many borrowers for long-term loans. In order to fulfil this role, it is essential that the intermediary keeps an adequate reserve of liquid assets.

(c) Financial instruments

- Deposits: deposits of money with financial intermediaries such as banks.
- Bills: short-term financial assets which can be converted into cash at short notice by selling them in the discount market.
- Commercial paper: short-term IOUs issued by large companies. They can either be held until maturity or sold on before then.
- Certificates of deposit: available to customers who deposit a minimum of £50,000 for fixed terms. They can be held until maturity or sold in the CD market.

(d) Monetary policies

Quantitative controls

Quantitative controls are those controls introduced by the government to restrict the amount of money lent by the clearing banks.

Qualitative controls

These are where the government restricts the type of lending that banks can do, rather than the amounts which they can lend. For example, the government may introduce incentives for lending to manufacturing businesses, or create disincentives for lending to individuals.

	Marks
1 Gold Club Ltd	
(a) NPV	
Ignore market research	2
Membership numbers	2
Membership fees	4
Set-up costs	2
Maintenance costs	1
Club cards	1
First class lounge	4
Travel insurance	3
Upgrade costs	1
Ignore interest costs	1
Net cash flow	2
Correct discount factors	1
Discounted cash flow	2
NPV	1
Conclusion and reason	2
Presentation	1
Total	<u>30</u>
(b) Venture capitalists	
For each factor discussed	2
Max marks	<u>10</u>
Total marks	<u>40</u>
2 Cleanly Ltd	
Receipts:	
W Ltd	1
X Ltd	1
Payments:	
A Ltd	1
B Ltd	1
C Ltd	1
Wages	1
Salaries	1
Petty Cash	1
Ignore window cleaner	1
Stationery	1
Total	1
Cleared excess	1
Cleared balance b/f	2
Cleared balance c/f	1
Uncleared funds float	
Receipts	1
Payments	1
Total book balance c/f	1
Correct presentation	2
Total marks	<u>20</u>

	Marks
3 Fibre Clean Ltd	
(a) References and agencies	
(i) Trade reference	
Definition	1
Similar terms	1
Well known co. vs unheard of	1
Contact directly	1
Limitation	1
Max marks	3
(ii) Credit reference agency	
Provide info re suppliers	1
Detail of info varies	1
Main agencies	1
Out of date	1
Not good for new companies	1
Max marks	3
(1 mark each awarded for any useful comments)	
(b) Factoring and invoicing	
Factoring	
Definition	1
Includes administration	1
With recourse agreements	1
Without recourse agreements	1
Cost	1
Invoice discounting	
Definition	1
Advancing cash	1
Cost	1
Conclusion on most suitable	1
Max marks	5
(c) Cost of factoring	
Factoring	
Average debtors figure	1
20% overdraft cost	1
80% advance figure	1
Cost at 15%	1
Sales admin cost at 2%	1
Invoicer cost	1
Not factoring	
Overdraft cost at 100%	1
Administrator cost	1
Conclusion	1
Total	9
Total marks	20

	Marks
4 Financial matters	
(a) Financial intermediaries	
Definition	1
Broker/principal	1
Examples	2
(O·5 each, max 2 marks)	
Total	4
(b) Benefits	
Easier	2
Risk reduction	2
Aggregation	2
Maturity transformation	2
Total	8
(Award marks for all sensible points)	
(c) Financial instruments	
Each one	1
Total	4
(d) Monetary policies	
Quantitative controls	2
Qualitative controls	2
Total	4
Total marks	20