



STRATHMORE BUSINESS SCHOOL

MASTER OF SCIENCE IN DEVELOPMENT FINANCE

END OF SEMESTER EXAMINATION

MDF 8101: MICRO-ENTERPRISE FINANCE

Date: Wednesday, 6th January 2021

Time: 3 Hours

Instructions

1. Answer Question **ONE** and any other **TWO** Questions.
2. Marks will be awarded on the basis of clear exposition of your ideas, precision in the use of language and the validity of your logic.
3. Where relevant, show all your workings on the answer sheet provided.
4. In all instances, the currency utilised is denominated in Kenya Shillings (Kes.). You can assume an exchange rate of US\$1 = approximately Kes. 100.

Question 1 (50 Marks)

Study the mini-case and answer the questions that follow.

Adrian Foods Limited is a small venture which operates a restaurant in a busy city centre. The business was founded by Adrian Moto, who started selling snacks back then in campus. Adrian got so interested in the venture that he decided to run it full time after completing his bachelor's degree in business with some concentration in entrepreneurship. The business has grown in phases with an investment from Adrian's friends, family and personal funds. The business has also obtained a number of small loans over a period of time and has always been able to repay the loans on a regular basis and within the agreed period of time.

Adrian has had the opportunity to receive standing and consistent orders from three major companies within the busy centre for its employees. He has been able to fulfil these orders through outside catering, which was primarily driven by slowed business owing to the Covid-19 related effects. To satisfy the orders, the business requires Kes. 20,000 each day. Owing to the challenges posed by the pandemic, Adrian is considering attracting an investor to assist in running the affairs of the business.

Adrian has heard about venture capital and has been wondering about the options for financing the business. He has approached you as a business advisor on various financial as well as managerial aspects relating to the business venture. The most recent financial statements for Adrian Foods for the year ended 31st December 2020 are as follows:

Adrian Foods

Statement of Profit or Loss for the year ended 31st December 2020

	Kes.
Sales	5,778,000
Cost of sales	<u>(4,800,000)</u>
Gross profit	978,000
Depreciation	<u>(152,000)</u>
EBIT	826,000
Interest paid	<u>(49,621)</u>
Taxable income	776,379
Taxes	<u>(392,000)</u>
Net income	<u>384,379</u>
Dividends	<u>400,000</u>

Adrian Foods

Statement of financial position as at 31st December

	2019	2020
<i>Assets</i>		
Non-current assets		
Net property, plant and equipment	1,515,400	1,413,400
Current assets		
Inventory	460,800	240,600
Accounts receivable	240,500	351,000
Cash and cash equivalents	<u>81,500</u>	<u>90,731</u>
Total current assets	<u>782,800</u>	<u>682,331</u>
Total assets	<u>2,298,200</u>	<u>2,095,731</u>
<i>Equity and liabilities</i>		
Equity		
Ordinary share capital	1,000,000	1,000,000
Retained earnings	<u>636,700</u>	<u>621,079</u>
Total owners' equity	1,636,700	1,621,079
Current liability: Accounts payable	179,800	92,952
Long-term debt	<u>481,700</u>	<u>381,700</u>
Total equity and liabilities	<u>2,298,200</u>	<u>2,095,731</u>

Required

- (a) Would you consider Adrian Moto to be an entrepreneur? Give TWO reasons for your answer. **(4 marks)**
- (b) Identify and explain TWO aspects of a business plan that Adrian may consider when putting together a case to convince a potential investor to invest in Adrian Foods. **(4 marks)**
- (c) Perform comprehensive financial analysis that could be presented to a venture capitalist to assist in making an informed perspective of the venture in terms of its financial health. Your analysis should cover all possible aspects regarding the venture's liquidity,

profitability, leverage and efficiency. Where appropriate, provide comparative analyses for the two years. **(20 marks)**

(d) If you are to value the business, what would be:

- (i) Net worth per share as at 31st December 2020 **(4 marks)**
- (ii) The earnings per share as of 31st December 2020 **(4 marks)**
- (iii)** Cashflow from operations per share as of 31st December 2020 **(8 marks)**

Assume the par value per share is Kes. 100.

(e) After operating the business for another ten years, Adrian decides to leave this business to pursue other opportunities. Identify TWO options which he can consider as potential exit strategies and identify three factors he should consider in making as he considers the options. **(6 marks)**

Question 2 (20 Marks)

Patricia Mmasi operates a bed and breakfast guesthouse. While cash management is one of the skills she needs to develop, she has requested for advice as she faced a myriad of situations during the year ending 31st December 2020. Her business has experienced a downward trend in revenue and cash due to the persistent Covid-19 pandemic among other micro and macro-specific challenges.

Required:

For each situation below, identify and discuss the issues that need to be considered to make an informed decision.

- (a) The business ends the financial year with an overdraft of Kes. 250,000. She is yet to settle her tax due and some wages for the year just ended. The government has announced a reduction in value added tax payable on hospitality from 10% to 5% for the next six months due to the ongoing global pandemic. The corporation tax payable has also been reduced from 30% to 25% for a similar period. Whereas the cash budget suggests that there is likely to be a continued shortfall of Kes. 150,000 by April 2021, the projections indicate that in July 2021, the business should generate extra cash of Kes. 350,000. **(5 marks)**
- (b) The property is regularly used for business retreats. The existing customers have tended to delay payments to the guesthouse. This has moved from an average of 30 days delay to over 90 days delay. Patricia has therefore decided to develop a credit policy to deal with new and existing customers. **(5 marks)**
- (c) Cash generated from operations has been on the decline but there has been some cash generated from sale of assets during the year. Patricia also sought for a loan of Kes. 100,000 from a savings and credit cooperative society during the year to deal with some of her cash needs. **(5 marks)**
- (d) The business has approximately Kes. 400,000 owed to them by various creditors. There is an opportunity for pursuing a factoring option where the business may recover 75% of the funds outstanding for the past six months. **(5 marks)**

Question 3 (20 Marks)

David and Maria plan to open a bakery and have prepared the following projections for three years. They have a cash investment of Kes. 1.2 million, Kes. 300,000 in equipment and have received a loan of Kes. 750,000 from their financial cooperative. The following assumptions are to be applied in preparing the three-year financial projections:

- (a) Sales are projected to be Kes. 1 million in the first year and are to increase by 20% in year 2 and 10% in year 3.
- (b) Direct costs are estimated to be 35% of the 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:
 - (i) Ending inventory: 30% of the sales
 - (ii) Ending accounts receivable: 10% of sales
 - (iii) Ending accounts payable: 10% of the cost of sales.
- (f) There is a moratorium on all payments for three months thereafter monthly payments of Kes. 84,000 in interest and Kes. 130,000 in loan principal are required.
- (g) There is no taxation.

Required :

Prepare three-year financing projections using the information provided. Be sure to comment briefly on the financial projections. **(20 marks)**

Question 4 (20 Marks)

- (a) Discuss, with the aid of an example, the main difficulty in calculating the value of a new business as compared with the valuation of an existing business. **(5 marks)**
- (b) With the aid of an illustration, briefly describe TWO methods of business valuation while explaining the merit of each method. **(5 marks)**
- (c) List FIVE pieces of information which are essential in determining the true value of a business. Explain why the information is a necessary aspect of the decision-making process. **(10 marks)**

Question 5 (20 Marks)

- (a) Identify and describe TWO major options available for financing a business enterprise which is in its rapid growth stage. **(4 marks)**
- (b) Using an example, explain what “bootstrapping” is and explain the benefits of pursuing this method of financing for an entrepreneur. **(4 marks)**
- (c) Explain why finance is often cited as one of the top two major hurdles hindering small enterprise growth, although there are many providers of business finance in existence. Your answer should identify FOUR issues, with a suggestion on how each issue can be dealt with in a practical way. **(12 marks)**