

South Tuen Mun Government Secondary School
BAFS_Financial Management_DSE_2013

2. Explain THREE types of factors that a company would consider to evaluate the risk of granting credit to a customer. (6 marks)

7. Yummy Group is a listed fast food chain in Hong Kong, established by Mr Lee twenty years ago.

In a meeting, Mr Lee said, "I want to discuss two issues today. First, as discussed before, the fast food market is saturated, so is it time for us to diversify our business? Second, in view of the recent incidents of food poisoning in some local fast food chains, we have to formulate strategies to manage this risk."

The Marketing Director, Miss Ma said, "People in Hong Kong are now more health conscious. Instead of focusing our business on fast food, we can diversify our business to the health food market. I propose to set up some organic food restaurants offering health food like fresh fruit juices, salads and sandwiches using organic ingredients. Unlike in our fast food chain, there would be waiters in these restaurants to serve the customers. I have conducted some preliminary studies and found that the middle-class should be our target customers. I have also generated many initial ideas on the menu and will conduct a market research to help sorting out those alternatives that are feasible."

Mr Lee said, "You have done a good job. However, are you sure that the middle-class is an effective market segment for us? Do we have enough capital to carry out this diversification project?"

Miss Ma remarked, "**Based on the criteria for evaluating a market segment, the proposed segment is the most effective. Since the segment is new to us, we have to find ways to promote the organic food restaurants."

The Finance Director, Mr Fung responded, "Setting up such a new line of restaurants requires a substantial amount of capital. We will need at least \$100 million. As our group has used up almost all the retained earnings, we don't have enough capital for this project."

- a) Suggest two risk management strategies for handling the risk of food poisoning faced by Yummy Group. (4 marks)
- b) Give three types of data collection method that Miss Ma can use in conducting the market research. Explain each with an example.(6 marks)
- c) With reference to the criteria for evaluating a market segment, explain why the middle-class is an effective market segment for organic food restaurants. (6 marks)
- d) List three sources of capital for raising \$100 million to finance the setting up of the organic food restaurants. (3 marks)
- e) With reference to any three elements of the promotion mix, suggest one way each to promote the organic food restaurants.(6 marks)

(Total: 25 marks)

8. Wing Hung is a locally-based department store chain established seventy years ago. Mr Richard Li son of the founder, took over the business forty years ago. He is going to retire and plans to pass the business to his son, Raymond. He has asked Raymond to visit the stores and study the business.

After several store visits, Raymond reported his observations to Richard, "I think our employees lack initiative and their service quality fails to meet today's standard. It seems that they have to follow rigid rules in carrying out their duties."

Richard responded, "I do it this way on purpose. I believe that close supervision and motivation by money are the keys to our success. I pay them salaries at a higher rate than the market level. They are required to listen to my instructions and stick to the existing practices. You should follow management style in order to be successful."

Richard responded, "I do it this way on purpose. I believe that close supervision and motivation by money are the keys to our success. I pay them salaries at a higher rate than the market level. They are required to listen to my instructions and stick to the existing practices. You should follow my management style in order to be successful."

Raymond replied, "You may be right, maybe we can consider other monetary compensation methods to motivate our employees to perform better. We can also provide some training to enhance their quality of service. In addition, as on-line purchasing is very popular nowadays, we should launch an on-line shopping system. According to my estimation, the initial installation will cost \$12 million and the net cash flows would be \$4 million per year for a useful life of four years."

Richard replied, "Very good. The payback period of the project is short! We can get back the investment very quickly."

Raymond said, "Using the payback period method alone to evaluate the project is not appropriate, we need to calculate its net present value as well."

- (a) With reference to McGregor's Theory X and Theory Y, state THREE assumptions that Richard holds in relation to managing his employees. Illustrate each with an example. (6 marks)
- (b) Apart from providing above market level salaries, suggest three other types of monetary compensation methods that Wing Hung could adopt to motivate its employees to perform better. (6 marks)
- (c) With reference to two characteristics of service, give one reason each to explain why training can help Wing Hung to meet today's service standard. (4 marks)
- (d) i. Calculate the payback period of the on-line shopping project. (1 mark)
ii. Give two reasons why it is not appropriate to use the payback period method to evaluate the on-line shopping project. (4 marks)
- (e)(i) Based on Raymond's estimates of the cash flows for the on-line shopping project, and assuming a discount rate of 8% per annum, calculate the net present value of the project (to the nearest dollar). Show your workings. (2 marks)
(ii) According to your calculation in (e) (i), explain whether the project should be adopted. (2 marks)
- (Total:25 marks)

2013_ QUESTION 2

Factors:

- character: e.g. whether the customer has a sense of responsibility to repay the debt
- capacity: e.g. whether the customer has sufficient cash flows to meet the obligation
- capital: e.g. whether the customer has sufficient capital to back up his debt
- collateral: e.g. whether the customer has sufficient assets to secure the debt
- conditions: e.g. industry outlook, general economic conditions

2013_Paper II_section B_Q7

(a) Risk management strategies:

- risk avoidance: e.g. avoid using easily infected food ingredients
- risk reduction: e.g. source raw materials from reliable suppliers
- risk transfer: e.g. take insurance to cover the losses resulting from food poisoning
- risk assumption: e.g. assume the losses resulting from food poisoning

(b) Methods:

- survey research, e.g. questionnaire
- qualitative research, e.g. interview
- observational research, e.g. on-site observation
- experiments, e.g. taste tests

(c) Criteria:

- purchasing power: e.g. middle-class customers have higher income
- growth of the segment: e.g. middle
- class customers become more health conscious
- competition: e.g. no dominant competitor in the field serving the middle-class customers
- distinctiveness: e.g. the market segment of middle-class is differentiable from other segments

(d) Sources of capital:

- issue shares
- issue long-term bond - borrow long-term loan - set up joint venture

(e) Ways of promotion:

- advertising; e.g. advertising on TV, food magazine or websites
- sales promotion: e.g. discounts, free gifts, lucky draw
- public relations: e.g. grand opening, press conference, press release
- personal selling: e.g. waiters recommend dishes to customers

2013_Paper II_section B_Q8

(a) Theory X assumptions:

- people inherently dislike work, e.g. employees of Wing Hung lack initiative
- people have little ambition and try to avoid responsibility, e.g. employees of Wing Hung follow instructions
- people prefer to be led, e.g. close supervision by Richard
- people prefer monetary rewards, e.g. above market level salary at Wing Hung
- people want stability and resist to change, e.g. follow rigid rules

(b) Other types of monetary compensation methods:

- commission - bonus
- merit pay
- profit-sharing
- stock option

(c) Reasons

- intangibility: training helps to provide tangible signals of good service
- heterogeneity: training helps to reduce variability of service
- inseparability: training helps to equip employees with good interpersonal skills
- perishability: training helps to enhance employees' adaptability in dealing with fluctuating demand

(d) i. Payback period = \$ 12m/\$4m = 3 years

ii. Reasons:

- ignore time value of money
- fail to indicate the absolute worth of project
- ignore the cash flows after the payback period

$$(e) \quad (i) \quad NPV = \left(\frac{4m}{1.08} + \frac{4m}{1.08^2} + \frac{4m}{1.08^3} + \frac{4m}{1.08^4} \right) - 12 m$$

$$NPV = \$1\,248\,507$$

(ii) Since the NPV is positive, the project should be adopted.