



5. Marco is the owner in the form of a sole proprietorship of an eyewear retail chain, selling different brands of glasses. Currently, the chain has 11 retail stores all over Hong Kong, and has 30 administrative staff and 60 salespersons. To grasp the opportunity offered by market expansion, Marco wants to open more branches in the coming five years. He is considering various ways to finance his expansion plan.

In a meeting, Daisy, the Marketing Manager reported, 'According to research, the market demand for eyewear is increasing. Customers are more willing to spend money on trendy and high class eyewear. We have already put more resources into advertising in the past three months. I believe that this marketing strategy has helped bring in new customers/

David, the Finance Manager agreed, <sup>4</sup>'With increased advertising, our sales have increased substantially!y.'<sup>?</sup>

John, the Human Resources Manager responded, <sup>4</sup>I am pleased to know that the sales performance has improved. However, our recent staff appraisals show that many salespersons are not satisfied with their jobs. In fact, their salary level is higher than the market rate. We have also offered long-term employment contracts and comprehensive benefits to them. We may need to find other ways to improve their morale.\*

Marco asked, 'Besides enhancing salespersons' morale, what else can we do to further increase sales?'

Daisy replied, <sup>4</sup>Many companies have started implementing a customer relationship management (CRM) system to help increase sales to existing customers. Shall we also introduce a CRM system to achieve this goal? '

John added, <sup>1</sup>If we decide to adopt a CRM system, then we have to recruit a manager to lead this new project. We may consider appointing the customer relationship manager through internal promotion.'

a) List THREE types of methods that Marco could use to finance his five-year expansion plan. Give ONE disadvantage of each of them. (6 marks)

6. King's Restaurant, an international catering chain, has been operating in Hong Kong for a few decades. Its market position is to provide customers with innovative catering services at an affordable price. Its sales and profits have been growing steadily. However, the chain has recently been troubled by complaints about its deteriorating service quality.

In a meeting, May, the Marketing Manager said, 'We are facing keen competition in the catering industry, so it is important to maintain our service quality. However, we have received complaints from customers that the dining environment is unpleasant and some waiters are rude. Sometimes customers need to wait for a long time to be served.'

The Finance Manager, Simon, responded, 'Our revenue is growing at a decreasing rate, and improving our service quality will certainly boost sales.'

The Information Technology Manager, Danny, suggested, 'Some restaurants in other countries have started using robots to take orders and deliver dishes to customers. We should conduct a feasibility study on the introduction of this technology.'

May said, 'I agree with adopting the robotic system as it can provide innovative service which matches our market position. We could do market research to explore whether customers would accept robot service in general. I suggest sending questionnaires to all customers in our membership scheme to collect their views on a robotic system.'

The Managing Director, Peter, queried the reliability of the information collected from questionnaires. He wanted to examine the project's feasibility from the financial perspective.

After the meeting, Simon estimated that the initial outlay for the robotic system would be \$4 000 000, with a project life of 3 years. The cost of capital would be 6%. Taking into consideration the annual expenses incurred and savings in labour costs, the net cash flow generated by the robotic system would be \$1 420 000 per year.

(ci) calculate the **Payback period** of the robotic system(2 marks)

(cii) calculate the **NPV** of the robotic system(2 marks)

(d) Based on the net present value calculated in(c)(ii) above, explain whether the robotic project should be adopted, (2marks)

(e) Other than the payback period methods and the net present value method, suggest and explain one other **capital investment appraisal** methods for evaluating the robotic system project. (2 marks)

7. An airline company is considering enhancing the fringe benefits of its employees. In order to investigate the financial affordability of this measure, the company uses accounting ratios to evaluate its performance.

(7a) Describe the aspects of the airline company's performance that could be evaluated using **accounting ratios**. (8 marks)

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1.(a)

**Pure risk** will only result in the possibility of loss or no loss (1 mark).

**Speculative risk** will result in the possibility of both gain and loss (1 mark).

## 2. Components of Credit standard:

- **Capital:** e.g. consider the amount of capital owned by the borrower, so as to measure the chance that the borrower will stop repaying.
- **Capacity:** e.g. consider the income of the borrower, so as to measure his / her ability of repayment
- **Character:** e.g. consider the record of borrower's repayment, so as to measure his / her sense of responsibility to repay the debt
- **Collateral:** e.g. consider whether the borrower's asset can be collateral, so as to measure the potential loss will be resulted in by the bad debt.
- **Condition:** e.g. consider the change in the economic environment, so as to measure the change of the existence of bad debt.

(2 marks for each relevant credit standard, max. 6 marks)

## 5.(a) Methods to finance 'five-year expansion plan' with disadvantages:

- **Self-finance:** Marco can invest his personal capital for the expansion. Disadvantage: Since the capital of Marco is limited, the amount of funds raised by self-finance is usually smaller.
- **Long term debt:** Marco can borrow from others (such as friends, relatives, banks, financial institutions). Disadvantage: Marco must repay interest and principal regularly.
- **Setting up a partnership:** Marco can invite business partner to join his company, and hence, the company will have new sources of capital. Disadvantage: Marco must share his power / Marco is not easy to find a suitable partner.
- **Setting up a private limited company:** Marco can a private limited company and ask the investors to invest and become share holder. Disadvantage: The procedure of setting up a private limited company is complicated, and the cost is high.

(2 marks for each relevant method with disadvantage, max. 6 marks)

## 6(c)(i) Payback period

= \$4 000 000 / \$1 420 000 per year

= 2.82 years (2 marks)

## (ii) Net present value

=  $(\$1\,420\,000/1.06)^1 + (\$1\,420\,000/1.06)^2 + (\$1\,420\,000/1.06)^3 - \$4\,000\,000$

= -\$204 323 (2 marks)

## 5d) NPV for robotic system project

As the net present value is negative, King's restaurant should not accept the robotic system project (2 marks).

## 5e) other capital investment appraisal Methods:

- account rate of return: the average annual net profit can be earned from the robotic system project per dollar investment.
- internal rate of return: the discount rate at which the net present value of the robotic system project is zero.

(2 marks for each relevant method, max. 2 marks)