



UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS
Cambridge International Diploma in Business
Standard Level

BUSINESS FINANCE

5163/01

Optional Module

October 2010

2 hours plus 15 minutes' reading time

Additional Materials: Answer Booklet/Paper

READ THESE INSTRUCTIONS FIRST

Write your Centre number, candidate number and name on all the work you hand in.

Write in dark blue or black pen.

You may use a soft pencil for any diagrams, graphs or rough working.

Do not use staples, paper clips, highlighters, glue or correction fluid.

Attempt **all** tasks.

Start each task on a new piece of paper.

Please leave a margin on the right and left hand side of each new page.

At the end of the examination, fasten all your work securely together, in the correct order.

The number of marks is given in brackets [] at the end of each question or part question.

This document consists of **4** printed pages.



You must read the case study and attempt ALL of the tasks which follow.
(This case study is fictitious.)

Great Wall Trading Ltd.

Great Wall Trading Ltd has been trading for the last three years. The company was formed when two existing firms decided to merge in order to survive in what was becoming a very competitive market. Although there had been some initial opposition from the shareholders of the two firms, the merger was considered to be a safer option than the hostile takeover bid that had been launched by a well known multinational company.

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The new company has adopted a new name, Great Wall Trading Ltd, and has moved all production to a new purpose-built factory. Although there was some disruption to the production process at first, the production lines are now working very efficiently, production costs are falling and as a result the gross profit margins are rising. The Board members are very pleased with the progress so far and have praised the new management team for their efforts. They have also decided to reward the loyalty of the shareholders by offering them the opportunity to increase their shareholdings through a rights issue.

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The Chief Executive Officer (CEO) is a trained financial accountant and he is very keen to introduce a training scheme for all the directors of the company, so that they are aware of the key principles of accounting. He has already developed a training programme to explain the meaning and implications of prudence and realisation and he hopes to address the remaining accounting principles in the future. Once the directors have received the training he hopes to extend the training to most of the employees of the company.

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The finance director of the company is a qualified cost accountant and he has conducted a thorough review of the company's operating procedures and finances. Although he is generally happy with the present position, he has made some recommendations for improvements, including much closer monitoring of the company's working capital and a systematic cash budgeting procedure for all sections of the business.

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The production director is keen to extend the range of products made by the company and he has submitted a proposal to the Board (see **Item A**). He feels very confident that the proposal will break even within a short space of time and that it will then begin to make substantial profits for the company. The finances for this proposal will be raised partly from the rights issue but it is likely that some additional finance will have to be raised through the issue of convertible loan stock (debentures). A proposal to introduce a phased redundancy package for the older members of the workforce has been turned down as it would send the wrong type of signals to the external stakeholders of the company and would disrupt the operations of the company at a crucial point in their history. The internal stakeholders of the company were very upset with this last proposal and want the director to be sacked.

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Financial Information

Item A – Proposal for new equipment

Category	
Purchase of Equipment	\$455 000 ¹
Wages	\$700 per week
Material costs	\$30 per unit
Consumables – maintenance and oils	\$100 per week
Power and Light	\$250 per week
Maximum possible output in units	800 per week
Average sales price	\$60 per week

You should assume that the maximum output will be produced each week and that all output produced can be sold.

Item B-Cash budget

Opening cash balance \$23 000.

The sales figures for the period January to April were as follows:

Month	Units Sold
January	800
February	750
March	700
April	580

The selling price for January and February was \$40 per unit and for March and April was \$45 per unit.

The expenditure during the period January to April was as follows:

Month		\$
January	Material costs	12 000
	Labour costs	18 000
	Sundry expenses	6 000
February	Material costs	11 000
	Labour costs	16 000
	Sundry expenses	7 000
March	Material costs	10 500
	Labour costs	15 000
	Sundry expenses	3 400
April	Material costs	9 600
	Labour costs	13 850
	Sundry expenses	6 150

In addition to the expenditure the company increased its insurance cover and a supplementary premium of \$2 100 was payable in three equal instalments, payable from February to April.

A license fee of \$3 500 was due to be paid in April

¹ Price quoted in \$US

You must attempt ALL of the following tasks.

Where appropriate use information from the case study to support your answer.

- 1 (a) Explain what is meant by a 'merger' and the legal consequences of two firms merging. [6]
- (b) Explain what is meant by a 'hostile takeover bid'. [3]
- (c) Explain what is meant by 'a multinational company'. [3]
- (d) Explain what is meant by a 'rights issue'. [3]
- (e) Explain what is meant by 'working capital' and why monitoring working capital is very important for a company. [5]
- Total: 20]**
- 2 (a) Explain what is meant by the break-even level of output. [4]
- (b) The company is considering purchasing some new equipment. Using the data available in **Item A**, calculate the break-even point in **weeks**, to the nearest whole number. [10]
- (c) The business experiences a 10% increase in the variable costs and a 5% reduction in price. Calculate the new break-even point in **weeks** to the nearest whole number given that the fixed costs remain constant. [6]
- Total: 20]**
- 3 (a) Explain the difference between internal and external stakeholders of a company, giving **two** examples of **each** type of stakeholder. [8]
- (b) For **each** of the stakeholders identified in (a) above, explain what financial information they would be interested in receiving from the company and how they would use this information. [12]
- Total: 20]**
- 4 (a) Explain what is meant by the terms 'realisation' and 'prudence', and explain how these principles are used to create accurate accounts. [2 x 5 = 10]
- (b) Identify **two** other accounting principles and explain how they would be applied in the accounting process. [2 x 5 = 10]
- Total: 20]**
- 5 (a) Using the information in **Item B**, construct a **four-month** cash budget for the period January to April. [12]
- (b) Identify and explain **one** advantage and **one** disadvantage of implementing financial control through a system of cash budgeting. [2 x 4 = 8]
- Total: 20]**

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