

## Exam Question

(45 mins)

You have been hired to help a well-known artist to commercialise her oil and acrylic paintings. Your client has never worked in industry since leaving art college, having been funded by academic grants, and has very little understanding of how to develop a business that captures the true value of her artistic creations. In fact, she admits to you that she does not know one thing about running a business and asks you to define what you can do for her company. Specifically, she has a number of queries that she feels are important to understand before going forward:

- a. As a financial manager, what will be your main activities in her new company? (12 marks)

Covered in “SKILLS NEEDED FOR A CHIEF FINANCIAL OFFICER” (not all of them though since the company is just established).

- b. What will be your first priority? Explain. (12 marks)

Covered in the “The Financial Manager”: “The most important job of a financial manager is to create value from the firm’s capital budgeting, financing, and net working capital activities.” Also covered in “The Goal of Financial Management” (page21).

- c. Will the company need to invest money? Explain. (12 marks)

Covered in 1.1: She may need to invest money in raw materials, renting a land or building to sell her products etc.

- d. Will the company need financing? Explain. (12 marks)

Covered in 1.1: It will need financing to invest in assets. A firm has generated no cash before starts operating.

- e. How will the company raise financing? Is it sensible to list the company on the stock market or issue debt? What about bank loans? (12 marks)

Covered in Capital Structure: “The firm might initially have raised the cash to invest in its assets by issuing more debt than equity”. Also covered in detail in section 1.3 Financial Markets. It may be cheaper to get a bank loan in the beginning. It won’t be able to meet the listing criteria immediately (“Listing, page32). If bank loan is not possible (difficult to obtain now) then the company may want to look at equity financing like venture capitalist, etc. Possibly also look at government grant.

f. What are the benefits of holding cash? (12 marks)

Liquidity, ability to pay dividends, taxes, payback the bondholders (page13). Value creation depends on cash flows (page16). Flexibility.

g. What should be the goal of the company? (12 marks)

Covered in 1.1: Create value for the owner. Also those listed in page19 (1.2 The Goal of Financial Management) and in page22 “A More General Goal”: Maximise the market value of the owner’s equity (when the firm has no traded shares).

h. The artist has said to you that she does not wish to run a company that does not contribute to society. She asks whether it is sensible to run a company that donates 10 per cent of all profits to good causes. She asks you whether this is a sensible objective and, if not, are there other options to contribute to society? Explain your view in a way she can easily understand. (16 marks)

Initially this may not be feasible as a sensible time period is required before a company begins to generate cash. However, there are limitations at a later stage too as potential shareholders may demand a minimum dividend payment before any profit is paid to charities.

A firm can also contribute to the society by creating new jobs and developing its values and culture (taken by the Google example). Buying from local suppliers to support the local economy.

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