COVENANT UNIVERSITY

TUTORIAL KIT

PROGRAMME: BANKING AND FINANCE

OMEGA SEMESTER

400 LEVEL

Raising A New Generation Of Leaders

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COVENANT UNIVERSITY

CANNANLAND, KM. 10, IDIROKO ROAD
P.M.B 1023, 0TA, OGUN STATE, NIGERIA

TITLE OF EXAMINATION: B.Sc BANKING AND FINANCE
COLLEGE: COLLEGE OF BUSINESS AND SOCIAL SCIENCES
SCHOOL: SCHOOL OF BUSINESS
DEPARTMENT: BANKING AND FINANCE
SESSION: 2014/15 SEMESTER: OMEGA
COURSE CODE: BFN 423 CREDIT UNIT: 2
APRIL, 2015

COURSE TITLE: MANAGEMENT OF BANKS AND FINANCIAL INSTITUTIONS
INSTRUCTIONS:
(i) ATTEMPT FOUR QUESTIONS (ii) ANSWER TWO FROM EACH SECTION
(iii) TIME ALLOWED: 2 HOURS 15MINS (iv) ALL QUESTIONS CARRY EQUAL MARKS

SECTION A

QUESTION ONE
(a).When does a bank receives the rating of a “problem bank” ? **(2 ½ marks)**
(b).Outline and discuss six causes of bank distress/failure. **(9 marks)**
(c). Mention and briefly explain four regulatory measures to control distress in banks **(6 marks)**

QUESTION TWO
(a). What is capital Adequacy? **(2 marks)**
(b) Discuss five factors affecting capital adequacy. **(7 ½ marks)**
(c) Why are financial institutions concerned about capital **(4 marks)**
(d). Outline and briefly discuss the options open to banks for meeting new minimum capital requirement. **(4 marks)**

QUESTION THREE
(a). What is industrial Relation?. **(2 marks)**
(b).Briefly discuss the various forms through which industrial conflict can be expressed. **(6 marks)**
(c).Discuss the issues that may lead to industrial conflict **(6 marks)**
(d).Briefly explain the conditions necessary in preventing conflict. **(3 marks)**

SECTION B

QUESTION FOUR

As the economy develops and becomes more complex, the banker faces diverse risks in the practice of his profession. What are the typical risks that confront the banker, and what steps should he take to manage such risks? **(17 ½ marks)**

QUESTION FIVE

a. What differentiates the Money and Capital market? **(3 marks)**
b. List five active money market instruments, and discuss their features and usefulness to the nation's economy. **(7 ½ marks)**
c. What major roles do the Stock Exchange and the Securities and Exchange Commission play in the development of the Nigerian economy? **(7 marks)**

QUESTION SIX

(a). What significant roles do the following play in the process of cash management in the liquidity perspective of the bank's short term survival effort?

i. Cash planning/Budget
ii. Cash flow (in and out)
iii. Cash forecasting
iv. Optimal Cash Level
v. Investment of idle cash

(9 ½ marks)

(b). How do the following matters affect the liquidity perspective of marketable securities:

i. Safety/Riskiness
ii. Maturity
iii. Profitability
iv. Marketability

(8 marks)

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TITLE OF EXAMINATION: B.Sc. Degree Examination
COLLEGE: Business and Social Sciences
SCHOOL: Business
DEPARTMENT: Banking and Finance
SESSION: 2014/2015 **SEMESTER:** OMEGA
COURSE CODE: BFN 424 **CREDIT UNIT:** 2
COURSE TITLE: Multinational Business Finance
INSTRUCTION: Attempt ANY Four Questions **TIME:** 2 Hours.

1. Briefly explain the term 'currency hedging.' What are the theoretical reasons why the MNC should hedge? Under what conditions would hedging be unprofitable to the MNC?

2. (a) Explain in details the various types of foreign exchange exposures faced by the MNC and the significance of each one of them in its financial management.

   (b) What are the features and limitations of comparative advantage theory in the process of Foreign Direct Investment with the Multinational Corporations in a competitive world trade model?

3. (a) Explain the basic characteristics of capital issues conducted abroad
   (b) Discuss the following securities in the international financial system:
      i. American Deposit Receipts, Global Deposit Receipts, Global Registered Shares
      ii. Clearly distinguish between the following: Foreign Bond, Global Bond, Eurobond.

4. What are the basic objectives of cross listing of shares
   Compare the stock listings in both New York Stock Exchanges with London Stock Exchange. As a promoter, where would you prefer to have your firm listed and why.

5. MNCs that have lower credit risk have more access to credit; conversely, MNCs that have small levels of retained earnings may rely on debt financing. Discuss Briefly?

6. An organization is considering a project costing ₦43 million, which is expected to generate after tax cash flow of ₦10 million annually for a period of 7 years. Assume risk free rate is 3%; Beta stock is 1.5; required rate of return on market is 12%. If the organization can obtain some short term financing, the firm can obtain a loan of ₦35 million to start the project at the rate of 10%, which will be extended for 5 years. If the firm's tax rate is 35%, you are required to:
   i. Ascertain if the project is viable from the NPV point of view

(Note that the cost of equity is to be calculated using CAPM below)

ii. Calculate cost of equity using the Capital Asset Pricing Model

iii. Calculate the Adjusted Present Value

COVENANT UNIVERSITY
COLLEGE OF BUSINESS AND SOCIAL SCENCES
DEPARTMENT OF BANKING AND FINANCE
2014/2015 ACADEMIC SESSION
ALPHA SPECIAL EXAMINATIONS

BFN 425: Quantitative Analysis for Financial Decisions

TIME ALLOWED: 21/2 hours

Instructions:
(i) Indicate your Matric Number, Programme and Department on your Answers Booklet
*(ii) Attempt **ALL** Questions*

Question 1

a. Describe Mathematical Programming and highlight its main features and terms.
b. Explain Linear Programming as a member of the mathematical programming family.
c. List the Mathematical Models and categorize them under conditions of certainty and conditions of uncertainty.
d. What are the main features of the Linear Programming (LP) Model?
e. Write short notes on the operating words of Linear Programming and mention the major approaches to solving linear programming problems. **(10 marks)**

Question 2

Express Commercial Bank PLC provides loans and advances to its customers within the available savings deposits (SD) and time deposit (TD). Each advance (A) absorbs 6SD and 4TD and each loan (L) takes 1SD and 2TD. The bank has only 8SD and 16TD at its disposal. Each overdraft contributes N8.00 profit and loan contributes N10.00 profit.

Required:

a. Formulate a linear programming model for the bank to maximize the profit by allocating SD and TD between overdraft and loans.
b. Using the simplex algorithm, find an optimum solution to the problem in (a).
c. What are the shadow prices for savings deposit and time deposits in the last simplex table from the index row? **(20 marks)**

Question 3

1a. A Company is considering investing in three different kinds of projects. The company has an overriding objective to obtain a return of 15% under a condition of minimum risk. The expected return for the first project is 8% while the second and third projects have expected returns of 12% and 20% respectively. Project one has standard deviation of its return as 0.02, project two as 0.0245 and project three as 0.0283. The company has a total of ₦1,000,000 to invest on the projects and it is assumed that the returns on the projects are statistically independent.

Required: Analyze and explain with the appropriate mathematical algorithm, how the company can minimize the risks in the face of the constraints.

(20 marks)

Question 4

2. Eleganza Nig. Ltd manufactures and sells two brands of flasks: Stainless Flasks and Plastic Flasks. It is assumed that two resources are constrained for the coming month: production time (90 hours are available), and processing and shipping (only 1600 flasks can be shipped during the coming month regardless of which of the two types of flasks make up the order). The company has sufficient raw materials and working capital to support any desired product mix. Further, the company can sell any number of units of either type of flask at the going market price. However, the company wants to produce a minimum of 700 units of its stainless flask in order to satisfy the demand of its executive and high-class customers for this type of flask. Upon request, the following financial and production data were produced:

Types	Production Time (Hours/unit)	Sales Price/unit
Stainless Flasks	0.1	₦250
Plastic Flask	0.05	₦150

In addition, production time is estimated to cost the firm ₦1200/hr. Shipping and processing costs are estimated to be ₦40/unit. The management also intends to select the product mix that will maximize the total Naira contribution needed to cover fixed cost and generate adequate profit.

Required:
Formulate this problem using the Linear Programming Model and solve it graphically.

(20 marks)

COVENANT UNIVERSITY, OTA

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P.M.B 1023, OTA, OGUN STATE, NIGERIA.

TITLE OF EXAMINATION: B.Sc. EXAMINATION
COLLEGE: BUSINESS & SOCIAL SCIENCE
SCHOOL: BUSINESS SEMESTER: OMEGA
DEPARTMENT: BANKING & FINANCE CREDIT UNIT: 3
SESSION: 2014/2015 TIME: 3 HOURS
COURSE CODE: BFN 427
COURSE TITLE: STRATEGIC FINANCIAL MANAGEMENT
INSTRUCTION: ANSWER ONLY FOUR (4) QUESTIONS.

Question 1:

BAFSA Limited for several years occupied the commanding heights in Nigeria's departmental stores retail business. It has 56 branch offices including 6 zonal headquarters across the country where it stocked and marketed over 1500 brands. In many cities, it occupied 2 or 3 service floors with a high standard of service to customers, who constituted the nation's top politicians, business moguls/contractors as well as civil servant.

It operated a centralized, bureaucratic management system with many layers of mangers. It's purchasing and supply department was very efficient and well-coordinated. It's financial and internal control system where quite good and up to date. Sales and marketing had everything to commend it. In virtually all locations, it traded from its own property and enjoyed a very buoyant cash flow regime.

The economic recession of recent time precipitated a down turn in the fortunes of BAFSA Limited departmental stores. Gradually but steadily more suppliers began to default in areas of supply delivery quantity and time. Debt turnover period increased considerably and working capital requirements of the company could no longer be met in record time. The fall in the oil price as well as federal government introduction of stringent fiscal/monetary policies such as reduction in capital budget, withdrawal/revocations of awarded contracts by the new government, devaluation of the domestic currency, downsizing of government officials as well as ban on importation of certain materials made the numerous customers of BAFSA limited who largely depend on importation and government contract to reduce to just a handful.

The handwriting on the wall was quite clear, to BAFSA Limited management and board. Many managers and staff of retirement age left one after the other. Stock turnover dropped drastically and erstwhile buoyant cash flow lapsed. Stiff competition also contributed to the drop in the market share of the company. Their products gradually became obsolete as better alternatives were introduced into the market at moderate prices. The board during one its meetings agreed that an urgent solution is required to prevent the company from going into extinction.

As the Financial Director of BAFSA Limited you were required at the 20th Board meeting to make your submissions to the Managing Director (to be presented by the MD at an emergency board meeting) explaining in great details the best strategies to be adopted by the management of BAFSA Limited to turn around the company. **(17$^{1/}$2marks)**

Marks will be awarded for clarity, logical and orderly presentation.

Question 2:

(a) For several years now, there have been numerous arguments in Financial Management Literatures on the objective a firm should pursue. Some authors advocated the Profit Maximisation objective; others supported Satisficing objectives while some favoured the Wealth Maximisation objectives. As a Financial Management Consultant, explain to your client why the Wealth Maximisation Objective is superior to other objectives. (5 marks)

(b) The question whether an organisation should adopt international best practices in corporate governance is no longer an issue of debate. This is because various researches and academic literatures haveproved that companies that imbibe corporate governance best practices always do better than those companies without good corporate governance practice. In the light of the above assertion, explain the benefits accruing to companies with good corporate governance practice. **(5 marks)**

(c) Decision Support System (DSS) applications are systems and subsystems that help people make decisions based on data that is culled from a wide range of sources. DSS applications are not single information resources, such as a data base or a program that graphically represents sales figures, but the combination of integrated resources working together.

The software must exemplify all of the important characteristics of an ideal Decision Support System. You are required to mention and explain the characteristics of an ideal DSS.

(7$^{1/}{}_{2}$marks)

Question 3

a. A Nigerian exporter of cocoa wants to trade with a Beverage company in the United States in three months' time. The rate of the Naira to Dollar has been fluctuating rapidly for the past three months. As a professional, what methods do you think he can adopt to avoid the foreign currency risk that could come with such a transaction? **(8marks)**

The world has become a global village and countries of the world trade with each other for varying reasons. What would motivate a country like America to carry out international trade with Nigeria? **(8marks).**

b. . Differentiate between the Eurocurrency market and the Eurobond market. **(1½marks)**

Question 4.

a. Robust economic growth cannot be achieved without putting in place well focused programmes to reduce poverty through empowering the people by increasing their access to factors of production, especially credit. Discuss the benefits that comes with Microfinance. **(7marks).**

b. As a way of assessing the value of potential investments, organisations adopt investment appraisal methods. SMEs prefer using two techniques out of the investment appraisal methods. Identify these two techniques and explain the reasons why they prefer both techniques **(7marks)**

c. The Small and Medium Enterprises Equity Investment Scheme (SMEEIS) was introduced in June 2001 to stimulate economic growth. Briefly explain the objective of the scheme. **(3½ marks)**

Question 5

a. The pure traditional school to capital structure developed a defense of the net income approach to the effect of leverage on the weighted average cost of capital and the value of the firm. With the aid of a graph discuss the views of the school of thought, highlighting their contribution to capital structure theory **(6 marks).**

b. Alpha Plc and Beta Plc are two companies in the same line of business, with the same level of risk and having the same profit before interest. Alpha Plc is entirely equity finance with 2,000,000 25k ordinary shares currently quoted at N1.20k ex div. Beta plc is a geared company with 1,250,000 25k ordinary shares with market value of N1 ex div and N1,500,000 of 10% irredeemable loan stock currently quoted at per. Both companies generate an annual profit before interest of N360,000; all profit after interest is distributed as a dividend. Obi own 62,500 shares in Beta Plc. A friend Isaac has recommended he sells these shares borrow sufficient fund at a rate of 10% and use the proceeds to buy ordinary shares in Alpha Plc.

Required:

a. Calculate the cost of equity and weighted average cost of capital for each company.
b. Advice Obi on whether his proposed transaction is worthwhile both from the point of view of increased income and considering the level of associated risk. **(11 ½).**

Question 6:

a. Five years ago Secured Home Plc invested N12,000,000 in the production of bullet proof doors. However, demand was much lower than market research had suggested and the company experienced considerable losses on its investment, leading to a debit balance on the revenue reserves. Bullet proof door production has now ceased, but the project harmed the company's reputation leading to a reduction in sales of other types of doors. The company hopes to improve its profitability and reputation by producing a new electronic door which automatically open and close using owner vocal sound. The 'electronic door would require new investment in plant totaling N50 million. Members of the board have suggested a reconstruction of the company. The following is the balance sheet of the company and proposed reconstruction.

Secured Home Plc as at 31 December 2011

		N,000			N,000
Ordinary shares of N1		200,000	Goodwill		40,000
10% Preference Shares of N1		40,000	Property		180,000
14% Unsecured debenture		200, 000	Plant		140,000
			Accumulated losses		160,000
		440,000			520,000
Trade Creditors	120,000		Stock	100,000	
Bank overdraft (Unsecured)	140,000	260,000	Debtors	80,000	180,000
		700,000			700,000

It is believed that the assets would realize the following amounts in the event of a forced sale.

	N'000
Goodwill	-
Property	70,000
Plant	50,000
Stock	60,000
Debtors	60,000
	240,000

The directors of the company feel that trading is about to improve and that if a reconstruction were to be agreed with all interested parties the company would reach a break-even point with an injection of N50 million in plant. It also has a new project which would generate a return of N55m per anum before interest charge.

The following proposals are therefore made.

a. Goodwill should be written off.

b. Property and plant are to be written down by 40%

c. Debtors are to be written down by 10%

d. Both ordinary and preference shares capital are to be written down by 90% and the remaining preference share are to be converted to ordinary shares.

e. Accumulated losses are to be written off.

f. Trade creditors are to be written down by 50%

g. Debentures are to be written down by 50% and 40m new ordinary shares will be issued to the debenture holders to compensate them.

h. A right issue of 1 for 2 at par is to be made on the share capital after the above adjustments have been made.

i. The bank overdraft is to be increased by N18m on which interest will be charged at 18%.

j. N50m is to be invested in additional plant and machinery.

Required

a. Prepare a balance sheet of the company after completion of the reconstruction. (5 marks)

b. Prepare the position of the creditors in an immediate liquidation where there is no secured creditor and no liquidation expenses. (2 ½ marks)

c. Explain whether the reconstruction is in the best interest of

i. Ordinary shareholder

ii. Preference share holder

iii. Debenture holder

iv. Trade creditors

v. Bank **(10 marks)**

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COLLEGE: Business and Social Sciences
SCHOOL: Business
DEPARTMENT: Banking and Finance
SESSION: 2014/2015 **SEMESTER:** OMEGA
COURSE CODE: BFN 428 **CREDIT UNIT:** 2
COURSE TITLE: Pension and Social Insurance
INSTRUCTION: Attempt TWO Questions in each section **TIME:** 2 Hours.

Section A

1. (a) Discuss briefly the major types of risks faced by pension schemes or plans. (10 marks)
   (b) Identify and discuss the risks that annuity plans with insurance firms may face for retired persons (7½ marks).

2. (a) What are the problems of information asymmetry that may arise in the process of arranging pension plans? (7½ marks)
   (b) Discuss fully the valuation problems that may arise in both assets and liabilities of defined benefits plans. (10 marks)

3. (a) Discuss the objectives of pensions systems, which of these substantiate the patient capital nature of pension savings. (10 marks)
   (b) Explain your understanding of the basic difference between Defined Benefit and Defined Contribution plans. Justify the reasons for the preference of one over the other? (7½ marks)

Section B

4. (a) Explain any five features of the New Pension Reform Act (7½ marks)
   (b) Explain any five functions of NSTIF under the new pension reform. (10 marks)

5. Explain in details any seven functions and powers of the National Pension Commission. (17½ marks)

6. (a) Explain any five safeguards put in place to ensure the success of the new pension scheme (7 ½ marks)
   (b) Write short notes on the following:
      i. NPF (5 marks)
      ii. NSITF (5 marks)

MARKING SCHEME - BFN 423: MANAGEMENT OF BANKS AND FINANCIAL INSTITUTIONS 2014/15 ACADEMIC SESSION

QUESTION ONE

(a) A problem bank is one that receives poor rating in capital adequacy, asset quality, management competency, earning strength and liquidity sufficiency. **(2 ½ marks)**

(b) The causes of bank distress/failure are:

(i) Board's undue influence and pressure on management to take decisions in particular ways that might turn out to be detrimental to the purpose and profitability of the bank.

(ii) Non-involvement or passive involvement of the board in the definition and articulation of the strategy plan for the bank.

(iii) Non-compliance with CBN prudential directives e.g non-compliance with sectoral distribution of loans could lead to non-diversification of the assets portfolio.

(iv) Unpredictability and inconsistency of government economic policies that impact on the prosperity of their customers and their ability to repay their loans.

(v) Poor loan management.

(vi) Poor treasury management which could lead to illiquidity and assets/liabilities mismatches.

(vii) Non-use, underutilization or mis-use of the internal audit and inspectorate departments by bank management.

(viii) Inability of regulators to provide guidance to operator rather than limit themselves to criticisms of the various aspects of the operations of banks.

(ix) Financial repression e.g sectoral allocation of loans and advances to privilege, pampered groups that may have no ability to efficiently and effectively use the funds, high cash reserve requirement attracting low or indeed no return, force investment in low yielding government securities – TBs, TCs, Development Loan Stocks, regulators' unwillingness to permit closure of inefficient branches and outposts for social/political reasons etc.

(x) Rapid and comprehensive deregulation e.g deregulation of interest rates, deregulation of foreign exchange markets and operations etc.

(xi) The nature and quality of ownership – government, State or Federal. The ownership and control of banks lead to frequent changes of the board.

Discussion of any Six points x 1 ½ marks = **9 marks**

(c) The regulatory measures to control distress are:

The two regulatory institutions in the Nigerian banking system – CBN and NDIC – have statutory responsibilities for ensuring the solvency of our banks. To perform these responsibilities they are confer with the following powers:

(i) The Banking Act enjoins banks to maintain statutory reserves to boost their capital funds. Every licensed bank shall maintain a reserve fund and shall, out of its net profits each year and before any dividend is declared –
- Transfer to the reserve, where the amount of the reserve fund is less than the paid up share capital the sum equal of not less than 25% of such profit;
- Transfer to the reserve, where the amount of the reserve fund is equal to or in excess of the paid up share capital, 12 ½ % of the net profits of the bank

(ii) The regulatory bodies should ensure solvency of banks by prescribing a minimum expected relationship between institutions' capital funds and risk assets.

(iii) Banks should also ensure that 50 percent of their capital funds are in the primary capital (shareholders funds) that is paid up share capital plus all reserve.

(iv) CBN should specify the conditions for and rate of provision for probable and intelligently estimated losses in loans and advances operations.

(v) CBN must solvency of Nigerian banks by engaging in the examination of their books. The power to do this is contain in the Banking Act. This can be done through off-site and on-site examination.

Discussion of any 4 points x 1 ½ = 6 marks

Total = 17 ½ marsk

QUESTION TWO

Capital is the money with which you start a business. A capital fund is your initial capital (issued and paid) plus accumulated reserve of all types. Capital adequacy relates to capital fund adjusted for looses to risk i.e numerator is capital fund unimpaired by losses and denominator is risk adjusted assets. Capital is the money with which to start a business. Capital fund (equity) Initial capital (issued and paid) plus accumulated reserves of all types. Concept of First tier capital and second tier capital) is crucial in capital adequacy. The first tier - capital (primary) consist of issued and fully paid share plus all reserves. The second tier capital (secondary) consists of long term borrowings with 7 years to maturity e.g debenture and loans stock with 10 years to maturity. **(2 marks)**

FACTORS AFFECTING CAPITAL ADEQUACY

1. **Quality of management;** This influences outsiders perception of capital adequacy because if management is good the bank will be profitable and efficiently operated and there will be no need to look for capital to cushion losses, this is the reason why the apex bank (CBN) regulates the bank.

2. **Quality and quantity of liquid assets;** a bank carrying good quality and adequate liquid assets will be able to meet the needs of customers as at when due. When we say liquidity has no quality, it means it is volatile, if such happens to a bank it must have a lot of capital or else it will affect its profitability.

3. **History of earnings and retention;** if a bank has no capital but has a history of earnings to its reserve that is, its management is conservative but planning ahead consciously. Earnings enhances capital adequacy.

4. **Quality and character of ownership;** if a bank allows itself to be politicized, put ethnic considerations before business, it will contribute to the failure of the bank and increase need for capital.
5. **Volatility of deposit structure;** this will affect the liquidity of the bank which will in turn affect the profitability and capital.

6. **Quality of operating procedures;** the way in which management carry out its operation is influenced by the quality of management and will also affect the need for capital.

7. **Support banks get from regulatory and supervisory institutions;** in any economy where the central regulatory institution is supportive, they can assist banks when there is lack of capital e.g. CBN and NDIC. In an economy where the regulatory authority is not supportive, the banks must ensure that they have available capital in their reserve.

(Any five points 1½ marks = 7 ½ marks

C. WHY FINANCIAL INSTITUTIONS ARE CONCERNED ABOUT CAPITAL

1. **Bank failure;** between 1929 and 1933,the depression caused banks to fail because the economy was regressing but between 1933 to 1973, the world economy was strong because there was boom and there were few bank failures. As a result of the oil crisis in 1973, many economies in the world were shaking and there were hiccups here and there. Sinkej jnr S.J studied the bank failures in the 70s, 80s and 90s and came to a conclusion that if banks were better capitalized they would not have failed especially in the USA.

2. **Inflation;** capital funds under liabilities remain the same with inflation but fixed assets and current assets, adjust with inflation.

3. **Competition;** big customers look for big banks with huge capital and interest rates while customers look for small banks. Big customers are easier to deal with because the banks can lend to them in large quantities.

4. **Internationalization of banking business;** in Europe, banking business is done freely across borders, but in Africa, we are trying to emulate such practices, but it has not been easy because the borders are not opened for such operations to take place. Banking business has been made easy in Europe because of the European Union.
   The OECD made an agreement in Basle that banking business should be conducted between countries freely that is no barrier. In 1988, they came into an agreement as to what should be regarded as adequate capital. The major capital is capital that has been adjusted for losses to risk assets, that is total capital/ risk weighted asset

4 points x 1 mark = 4 marks

D. OPTIONS OPEN TO BANKS FOR MEETING NEW MINIMUM PAID-UP CAPITAL

From the Security and Exchange Commission Report (various issues), the following options can be used by banks to meet new minimum paid-up capital:

i. Capitalization of general reserve;
ii. Conversion of deposits to shares by willing and interested depositors;
iii. Rights Issue by existing shareholders;
iv. Private placement by those banks that wish to remain private;
v. Conversion to a Public limited liability company and raising funds by way of a public offer for subscription;
vi. A combination of any of the above options; and/or
vii. Mergers of suitable and compatible banks or outright acquisition

(Discussion of any 4 points x 1 = 4 marks

Total 17 ½ marks

QUESTION THREE

(A) Industrial Relation can be defined broadly as a discipline concerned with the systematic study of all aspect of employment or employment relationship. It deals with everything that affects the relationship between workers and employers, perhaps from the time the employee joins the organization until he leaves his job. It starts from the day you receive your job offer, and as such it is a continuous process. **(2 marks)**

(B) There are various forms through which industrial conflict can be expressed. It could be expressed in the form of:

(i) High accident rate
(ii) Go-slow tactics
(iii) Labour turnover
(iv) Worker's strike
(v) High rate of absentism
(vi) Pen-down strike e.g warning strike of ASUU
(vii) Sympathy strike
(viii) Restriction of output
(ix) Hunger strike
(x) Lock-out

(**Discussion of any 6 points x 1 = 6 marks)**

(C) The issues which may lead to industrial conflict are:

(i) Retrenchment of workers following close down of a factory, lay off, discharge or dismissal, reinstatement of dismissed employees and compensation for them.
(ii) Wages, fixation of wages and minimum rates.
(iii) Benefit of an award denied to a worker.
(iv) Non-payment of personal allowance to seasonal employees.
(v) The demand of employees for medical reliefs for their parents.

(vi) Lock-out and claim for damage by the employer because employees resulted to an illegal strike.
(vii) Payment of loans, gratuity, pension funds, travelling allowances
(viii) Disputes between rival unions.

(**Discussion of any 6 points x 1 = 6 marks)**

(D) The conditions necessary in preventing conflict are:

(i) There must be an organizational dynamic approach to managing conflict.
(ii) Proper all round communication between workers and management
(iii) Leadership by example, leaders and managers are judged not by what they say but what they do and how they behave. We should not say NO when we mean YES.
(iv) Good and effective group leader's relations are essential in preventing group conflict.
(v) A serious organizational culture where values are elevated and not avoided.
(vi) Grievances of employees must be handled properly
(vii) Reward should be based on merit.
(viii) Proper training and development.
(ix) Proper Job evaluation and enlargement
(x) Effective utilization of team work, team spirit and team effort.
(xi) Collective bargaining machinery should be properly utilized.

(**Discussion of any 3 points x 1 = 3 marks)**

Total 17 ½ marks

SECTION B

QUESTION FOUR

The banking profession and the practice of it is fraught with diverse risks. It takes adequate training and experience gained over the years to manage the risks.

Essentially, the question is to test the students' knowledge in banking risks and how the risks are managed.

Types of risks that are encountered in banks are:

1. **Personal Risk:** This refers to sickness, injury and death of the customers. Bankers do not know precisely when a serious illness or death may occur to borrowing customer.

Managing this type of risk entails that lending banker appraises the age, and health conditions of the borrower as best is possible, particularly when the amount involved is fairly large.

The usual collateral security must be taken and duly perfected before draw down is allowed.

Where it is considered necessary, guarantee must be taken in addition to the main collateral security. Finally, the banker should ensure that the customer has life assurance policy.

2. **Account Opening Risk:** Care must be taken when the banker opens current accounts for customers. Experience has shown that forged documents could be used to open fictitious bank accounts and stolen money or money instruments such as dividend warrants could be deposited on the accounts and withdrawn immediately.

   To manage this risk, the banker must ensure that all laid down rules for opening all types of accounts are strictly followed.

3. **Fraud Risk:** Banks experience fraud perpetration by both staff and customers. In fact, records show that banks incur large amounts of loss because of frauds. The frauds may be by way of forging customers' signature, or stealing of raw cash by staff. Cashiers have been known to declare false shortage while they pocket the money.

   To manage fraud risks, staff of undoubtful integrity should be employed. Training and retraining of staff is essential. Also, staff should be adequately remunerated.

4. **Bad Debt Risk:** This is the inability or unwillingness of customers to pay back money lent to them, constituting a major source of loss to banks. To manage this risk, credit appraisal before lending is approved must be thorough and adequate collateral taken in support of the borrowing.

5. **Risk of Asset Wastage:** Fire outbreak and destruction of large assets of banks through other disasters have been witnessed from time to time. Recently, fire damaged branches of the Central Bank of Nigeria in Ibadan and Kano.

The Bank of Industry (BOI) in Lagos was burnt down recently by fire. The way to manage this type of risk is adequate insurance cover.

6. **Collateral Risk:** Even when prudent lending has been done, there are instances where risks do occur through deplecting the value of the security taken such as:
   a. Fall in the price of share taken as security
   b. Destruction of property taken as security by fire or by flood or earthquake.
   c. The guarantor may die or be incapacitated.
7. **Exchange Risk:** Banks often extend credit facilities to customers for importation of goods – raw materials, finished goods or spare parts via letter of credit facilities. Because of instability in exchange rate, the rate of exchange at the time of letter of credit is opened is not likely to be the same when payments are made on receipts of goods. If not properly managed, the bank may incur loss in such transaction.

   To manage this type of risk, the banker should enter into Exchange Rate Differential agreement with the customer, which will make the borrower to be liable to any adverse exchange differential.

   Other types of risk, which the banks need to, managed are:

i. Political or governmental Policy risk
ii. Uncertainty in weather and other production conditions that affect the customers to whom credit facilities have been extended.
iii. Shareholders risk.

QUESTION FIVE

(a) Difference Between money Market and Capital Market

The difference between the money Market and the Capital Market is best illustrated by defining each of the terms as follows:

i. The Money Market is the market for short-term instruments. This means that the instruments traded in this market are highly liquid as the instruments can be converted into cash within a short period of time.

ii. The Capital Market on the other hand is the market for long-term end of the financial market. It consists of the Nigerian Stock Exchange where shares are traded and the Securities and Exchange Commission, which provides regulatory framework within which the Capital Market operates.

(b) The following are the five active money market instruments:

i. Treasury Bills

ii. Treasury Certificate

iii. Government Development Stock

iv. Call money/money at call

v. Certificate of Deposit

1. Treasury Bills:

i. Treasury bills are financial instruments evidencing the Federal Government's indebtedness to persons, or institutions holding them. They are managed by the CBN on behalf of the Federal Government.

ii. Treasury Bills ordinance of 19th March, 1959 gave the Federal Government power to borrow money from the public by issuing Treasury Bills.

iii. The first bills were issued at discount i.e. holders pay the bills less discount rate while they are paid in full face value when due.

iv. The usefulness of the bills to the economy is that they are veritable method for Government sector short-term borrowing from the public and they are a useful avenue for investors to invest their excess funds on short-term basis.

v. They enrich the nation's money market.

Treasury Certificate

i. Medium-term money market issued by the CBN on behalf of the Federal Government.

ii. Its tenure is between 1-2 years

iii. It is intended to bridge the gap between the Treasury bills and the Government Development Stock.

iv. It enriches nation’s Money Market as a trading instrument.

v. Like the Treasury bills, it is discountable.

2. Government Development Stock/Bonds.

i. These are also Government securities with tenure of 1 – 5 years tenure.

ii. They are eligible money market instruments like the Treasury Bills and Treasury Certificates.

iii. Both the Federal Government and State Governments issue them through the CBN to fund specific projects.

iv. They enrich the nation’s money market.

3. Call Money/Money at Call

i. This instrument has evolved overtime in the banking industry, as a means of financing very short-term fund needs particularly banks with overnight debit balance with CBN, which needs to be funded.

ii. Banks with excess funds on short-term basis use it as source of investment, so that such funds do not stay idle.

iii. It is called Call Money because it is operated at call. i.e. can be requested for repayment at a short period of time by demand.

4. Certificate of Deposit:

i. Its origin was in 1975 when there was excess liquidity in the economy and there were very few money market instruments with which to manage the excess funds.

ii. It was intended for use as additional money market instrument.

iii. There were two types - Negotiable Certificates of Deposit and Non-Negotiable Certificate of Deposit.

2(c) Roles of Stock Exchange

i. Act as a central meeting place for members to buy existing shares and stocks.

ii. It grants quotations to new issues.

iii. Provides machinery for mobilizing private and public savings and making such savings available for productive investment.
iv. To facilitate the purchase and sale of securities in order to reduce the risk of liquidity
v. It is a channel for attracting foreign capital into Nigeria.
vi. It facilitates dealings in Government securities such as long-term bonds and Development Stocks

Roles of Securities and Exchange Commission

i. Determines the amount of securities that are to be offered for sale
ii. Determines the time of offer.
iii. Determines the price at which to sell security
iv. Registers all security dealers i.e. Issuing House, Stock Exchange and Investment bankers.
v. Supervises the securities market.
vi. Grants approval for merger and acquisitions.

QUESTION SIX

i. Cash Planning/Budget

Cash budgets should be prepared in order to project cash surplus or deficient for the period in plan. Once this is done, any excess cash should be invested while short fall is met by sales of marketable securities.

ii. Cash Flows (In & Out)

It is advantageous in cash management to delay cash out-flow while cash inflow is accelerated. In the case of the bank, efforts should be made to discourage withdrawals while all efforts should be geared towards getting customers to save and marketing for new customers to enhance inflow of cash is the rule of the game.

iii. Optimal Cash Level

The bank should be able to decide the appropriate level of cash holding/balances so as to be able to arrive at a tradeoff point between cost of excess cash holding and danger of cash deficiency. This helps to determine optimal level for cash balances to be held.

iv. **Investing Idle Cash**

In cash management, idle cash should be profitably invested in decided portfolios between the various types available, bearing in mind ease of convertibility back to cash when required – maturity is very key.

v. **Cash Forecasting**

This is simply a forward plan for cash needs for preparation of cash budgets on short and long-term basis.

- Short Term covering a period of one year only
- Long Term covering more than one year.

Answer to Question 3b

i. **Safety/Riskiness**

From experience, the bank should be able to select which securities has less risk and can earn high returns.

ii. **Maturity**

Time period over which principle and interest will be paid is of essence. If a security matures within 7 days and another matures within 45 days, one can predict what can happen within 7 days more than 45 days, though interest on the security which matures within 45 days will be higher than that of 7 days.

iii. **Profitability**

Like in the case sighted above, if profitability is the bank's priority, it is likely to invest in the security maturing within 45 days with higher interest rate.

iv. **Marketability (Convertibility)**

This refers to the convenience and speed with which the security can be converted to cash. If it can be sold within a short period of time, then it is considered liquid. ***Government Treasury Bills, Money at Call, Short Bonds*** (3 months-6 months) ***Treasury certificates and Fixed Deposits*** fall under this category of marketable securities.

Covenant University

College of Business and Social Sciences

School of Business

Department of Banking and Finance

BFN: 422 Marking Guide for Omega Semester, 2014/2015 Academic Session

Answer to Question 1

From the information made available, the customer has a generally acceptable profile. However, it is necessary to do a detailed assessment by analyzing and interpreting the account's performance using financial ratios to measure the following indices: Liquidity, Profitability, Turnover and Leverage as follows:

1. **Liquidity Assessment**

a. Current Ratio = $\dfrac{\text{Current Assts}}{\text{Current Liabilities}} = \dfrac{₦\ 600{,}000}{₦\ 800{,}000}$ = 75% or 0.75:1

b. Quick Ratio= $\dfrac{\text{Cash + Marketable Securities}}{\text{Current Assets}} = \dfrac{₦\ 50{,}000 + ₦250{,}000}{₦\ 800{,}000}$

$\dfrac{₦300{,}000}{₦\ 800{,}000}$ 37.5% 0r 0.37:1

c. Quick Quick Ratio = $\dfrac{\text{Cash}}{\text{Current Liabilities}} = \dfrac{₦50{,}000}{₦800,\ 0000}$ = 6.25% or 0.0625:1

2. <u>**Profitability Assessment**</u>

a. Gross Profit Margin = $\frac{\text{Sales – Cost of Sales}}{\text{Sales}} = \frac{₦1{,}000{,}000 – ₦300{,}000}{₦100{,}000}$

$\frac{₦\ 700{,}000}{₦\ 1{,}000{,}000} = 70\%$

b. Net Profit Margin = $\frac{\text{Net Profit}}{\text{Sales}} = \frac{₦300{,}0000}{₦\ 1000{,}000} = 30\%$

c. Return on Equity = $\frac{\text{Net Profit}}{\text{Capital Employed}} = \frac{₦\ 300{,}000}{₦\ 700{,}000} = 42.6\%$

d. Return on Assets = $\frac{\text{Net Profit}}{\text{Total Assets}} = \frac{₦300{,}0000}{₦\ 1{,}900{,}000}$ 15.8%

3. Turnover Assessment = $\frac{\text{Sales}}{\text{Cash or Sales}} = \frac{₦1{,}000{,}000}{₦\ 300{,}000} = 333.3\%$

4. Leverage/Solvency Measurement

a. Debt/ Equity Ratio = $\frac{\text{Total Debts}}{\text{Equity}} = \frac{₦\ 100{,}000}{₦\ 700{,}000}$ 14.3 %

b. Shareholders' Equity Ratio = $\frac{\text{Shareholders' Equity}}{\text{Total Equity (Equity + Reserve + Profit)}}$

$$= \frac{₦\ 700{,}000}{₦\ 700000 + ₦\ 100{,}000 + ₦\ 300{,}000} = 63.6\%$$

<u>Decision</u>

The details of assessments show the following:

1. Liquidity – The Company is liquid enough to meet all current obligations with Current Ratio of 75%, Quick Ratio of 37.55 and Quick Quick Ratio of 6.25%.
2. Profitability – The Company is profitable, with Gross Profit of 70%, Net profit of 30%, Return on Equity of 42.6% and Return on Assets of 15.8%.
3. Turnover – The Company has a turnover of 333%. This is very good.
4. Leverage/Solvency Measurement – The Company's leverage is good at Debt Equity Ratio of 14.3% and shareholders Ratio of 63.6%

The bank should go ahead and lend the sum of ₦ 1000,000 as requested with appropriate collateral in place, as the best arrangements in a lending proposition can turn bad for unforeseen reasons.

Answer to Question 2

2(a) <u>Debt Recovery Strategies</u>

1. **<u>Department for Debt Recovery:</u>** Staff of debt recovery Department systematically go after the debtors. This system has proved effective and much recovery has been achieved using staff.
2. **<u>Recovery Agents:</u>** These are professional debt recoverers who use many unorthodox methods to recover bank debts. Their earning is an agreed percentage of what they are able to recover ranging from 5% – 10%.
3. **<u>Litigation:</u>** When debts become hard-core and the debtors are unwilling to cooperate, the bank goes to the Court. It is not always easy as there are

adjournments over and over but the bank usually has its way out at last. This step is needed where there are no collaterals to fall back upon.

4. **Realization of Perfected Securities:** This is the easiest method of debt recovery provided there is perfection of the securities taken from the start. Shares can be sold, and properties can also be sold and proceeds used to pay off the debts.
5. **Assistance from NDIC/EFCC:** The NDIC has assisted many banks in their recovery strategies over the years. This become prominent in the period between 1996 and 1998 when failed Banks Tribunals were set up. NDIC was introducing legal firms to banks who assisted them by writing letters of demand to the debtors. Much recovery was achieved. This method can still be employed in recent times with some form of modifications.

2(b) The observed Causes of Problem Accounts are:

1. Poor liquidity in customer's business leading to pressure for payment against uncleared effects.
2. **Window dressing** : a situation where the customer deposits a sum of money into his account, and withdraws same amount immediately in order to boost the turnover of the account.
3. Frequent request for temporary excesses over and above approved limits
4. **Cross-firing of cheques:** very common at month ends in order to reduce limits or press down balances on accounts that have been irregularly overdrawn, customer draws cheques on one bank to pay it into account in another bank without actually putting funds.
5. **Skipping payments on loan installments:** This is the act of paying one installment of loans as arranged and failing to pay subsequent ones because funds are not available or the customer is not willing to pay as at when due.

6. Increase in the number of status enquiries from other banks about the customer's account. This indicates that the customer is not faithful.
7. Low operation on accounts leading to low turnover; account almost abandoned
8. **Hard-core Situation:** No swing from debit to credit balances, perpetually in debit as a result of interest charges on unserviced advances
9. Nonchalant attitude of customers toward renewal of facilities when due for renewal.

Answer to Question 3

3(a)

i. Fixed charge is a charge over special assets; usually it is a charge over a company's assets in a debenture arrangement. The charge is taken over certain and known (listed) fixed assets or the company in return for money lent by the bank. It is a kind of security. The company (charger) cannot deal with such assets.

ii. Floating Charge covers all the assets of the company both fixed and current and the company (charger) can use them in the ordinary course of business while the debenture lasts. Fixed charge is safer for the bank as the assets are intact.

3(b) Measures to Avoid/Reduce Frauds in Banks

i. Effective internal audit and bank inspection which serve to review operations from time to time – a kind of watchdog on the bank's funds and records.

ii. Ensuring that the bank's funds and properties are not used improperly.

iii. Effective and timely investigation of malpractices and bringing the culprits to justice.

iv. Dual control of processes, graduated limits of authority for approval in funds dispensing and effective use of manual of operations
v. Lending limits should be established and should be observed by approving officers with regards to credit administration.
vi. Dormant accounts should be watched to ensure that unscrupulous staff and customers do not tamper with them.
vii. Put a close watch on the lifestyle of staff in order to identify those staff that are living beyond their income.
viii. Observe laid down rules in opening and closing customers’ accounts.
ix. The use of regiscope camera to photograph persons cashing cheques involving large sums of money.
x. Check cashiers at the close of business and ensure that vault cash balances on daily basis.

3 (c) Sanctions/Penalties for not Rendering Statutory Returns to the Central Bank of Nigeria by Deposit Money Banks

i. Warning letter to the Managing Director of the bank concerned requesting the bank to desist from further defaults in future.
ii. Imposition of fine, payable by the bank for the particular offence.
iii. Imposition of fine, payable by the officer responsible for the offence
iv. CBN denying certain services to the offending bank
v. As an extreme measure, CBN may suspend the operating licence of the defaulting bank.

BFN 427 2014/2015 OMEGA SEMESTER EXAM - MARKING GUIDE

Solution to Question 1:

INTERNAL MEMO
BAFSA LIMITED

To: **Managing Director**

From: **Financial Director**

Date: **April 5**, 2015

Subject: **Proposed Strategies to turnaround BAFSA Limited.**

Sir, recall that at its 20^{th} Board Meeting held in Lagos, the Board directed that I make my submissions to you on the best strategies to be adopted by BAFSA Limited to turnaround its fortunes and put it back on the path to progress. Having considered the different challenges faced by BAFSA Limited I make my submission as follows:

First, the economic recession presently experienced in the economy is not easy to be managed by a mono-product economy like Nigeria that is characterised by high level of corruption, absence of viable economic infrastructure, insecurity, large and growing unemployment profile, energy problems and general state of poverty and deprivation. Having said this, BAFSA Limited should focus on the internal weaknesses of the company as little or nothing could be done on its external environment (threats).

Specifically the following programmes should be of great benefit to BAFSA Limited:

(i) **Downsizing Programmes:**

- Retrenchment of redundant and unproductive staff
- Organised discount sales supported with sales promotional strategies to be worked out by the Marketing Director
- Reduction of market outlets at least to major cities in the 6 geopolitical zones of the country.
- Organised 3 months long sales discount to coincide with the major religious festival periods.
- Disposal of the balance of stock as management shall direct in due course.
- Disposal of all office equipment, cars and delivery van not required by the auction committee.

- Short and long lease agreement over vacant premises and floor spaces.
- Call in staff contributory pension insurance fund.

(ii) **Cash Management (Conservative) Programme:**

- Retiring Senior Management staffs should be given the first option of buying their official cars or from the disposable fleet and to have the price offset from their final retirement benefit.
- All Managers and staff likewise shall have the option to have the price of any of the company's equipment, cars or vans he or she may be interested in and offset from his or her final benefit.
- All funds from discount sales, pension insurance scheme drawdown, and sale of moveable asset should be deposited in a designated account and weekly reconciliation report made available to the MD.
- Downward review of daily/weekly imprest to reflect the financial reality of the company.
- Review of all payments to contractors or suppliers in order to conserve cash for operations.

(iii) **Re-branding/Marketing Programme**

- Introduction of more innovative products that will meet customers need and taste.
- Repackaging and rebranding of existing products to give product a new look and customers a different appeal.
- Embark on aggressive promotional/sales campaign (eg road show) to attract existing and new customers.
- The company can also embark on discount sales of the old product.
- Internet marketing, web design for the company and its products will be ideal.

(iv) **Re-financing Programme:**

- Exhaust all sources of internal re-financing.
- Seek for strategic alliance with suppliers inform of trade credits.
- After all internal sources have been exhausted and the capital need is not met, it can go for external borrowing from friends, leasing, bank loan etc.
- Contract its debt at a discount to a factor company.

Consideration of the above strategies and many others that may be suggested from time to time will put the company back on its feet to progress.

You may wish to call my attention to any issue that needs further explanation(s) or clarification as contained in my memo.

Thanks for the opportunity to make this presentation

Grace Divine

Note: students are expected to mention at least three (3) points from any 3 programmes proposed above. Introduction/proper, situation of the problem will take 3 marks, conclusion/signing off will take 2 marks, the main body will take 9 marks. The remaining $3^{1/}{}_{2}$ marks will be awarded for logical and orderly presentation.

Solution to Question 2.

(a) SUPERIORITY OF WEALTH MAXIMISATION OBJS OVER OTHERS

1. It considers timing of returns
2. It takes account of both returns and risk.
3. It balances short and long-term benefits.
4. It provides appropriate and operationally visible criteria for choosing between alternative courses of action.
5. It resolves the problem associated with the flow of benefits
6. It consistent with the objective of maximizing the stakeholders' economic welfare.
7. It indicates how well management is doing on behalf of its shareholders via share market price of the company.

(b) Benefits of Good Corporate Governance to a firm

- Good corporate governance ensures corporate success and economic growth.
- Strong corporate governance maintains investors' confidence, as a result of which, company can raise capital efficiently and effectively.
- It lowers the capital cost.
- There is a positive impact on the share price.
- It provides proper inducement to the owners as well as managers to achieve objectives that are in interests of the shareholders and the organization.
- Good corporate governance also minimizes wastages, corruption, risks and mismanagement.
- It helps in brand formation and development.
- It ensures organization is managed in a manner that fits the best interests of all.

(c)Basic Characteristics of Decision Support Systems are:

- **Supports individual and group decision-making:** provides a single platform that allows all users to access the same information and access the same version of truth, while providing autonomy to individual users and development groups to design reporting content locally.

- **Easy to develop and deploy:** delivers an interactive, scalable platform for rapidly developing and deploying projects. Multiple projects can be created within a single shared metadata. Within each project, development teams create a wide variety of re-usable metadata objects. As decision support system deployment expands within an organization, the platform must effortlessly support an increasing concurrent user base.
- **Comprehensive Data Access:** software should allow users to access data from different sources concurrently, leaving organizations the freedom to choose the data warehouse that best suits their unique requirements and preferences.
- **Integrated software:** an integrated platform enables administrators and IT professionals to develop data models, perform sophisticated analysis, generate analytical reports, and deliver these reports to end users via different channels (Web, email, file, print and mobile devices). This eliminates the need for companies to spend countless effort purchasing and integrating disparate software products in an attempt to deliver a consistent user experience.
- **Flexibility:** customers can choose to leverage the power of the software's flexible APIs to design and deploy solutions tailored to their unique business needs

Solution to Question 3

c. The Nigerian exporter of cocoa can consider the following method in order to avoid foreign currency risk:

i. **Forward contracts**: this is a contract usually between a bank and a customer to buy or sell a specified quantity of foreign currency at an agreed future date or within specific future time period. The contract could be fixed, if the future date is fixed. It could be floating, if the future date falls within a range. The former is referred to as fixed forward contract and the latter floating/option contract.

   In forward contract, the exchange rate today will be used for transaction in the future based on agreement.

ii **Matching:** if a Nigerian company expects to receive some earnings in foreign currency and at the same time expects to incur certain expenses in the same foreign currency, it may plan to offset its payments against foreign currency, it may plan to offset its payments against receipts in the currency. In this way, movements in exchange rates between the naira and the currency in question would be irrelevant, to the extent that matching can take place as there will be no need to purchase or sell foreign currency. This process of matching would be easier if the company were able to maintain a domiciliary account (i.e maintain a bank account in foreign currency.)

iii **Borrowing in a foreign currency**: an exporter who invoices foreign customers in a foreign currency can hedge against the exchange rate risk by:

i. Borrowing an amount in the foreign currency ‘now’
ii. Converting the foreign currency into domestic currency at the ‘spot rate’ i.e rate ruling on the conversion date
iii. Repaying the loan with interest out of the eventual foreign currency receipts.

Borrowing in foreign currency requires the approval of the central bank of Nigeria and the federal ministry of finance.

iv **Pricing policy**: a company can anticipate adverse exchange rate movement by building an extra profit margin into the selling price to act as a cushion in the event that exchange rates do in fact move adversely.

v **Foreign currency invoicing**: one way of avoiding exchange rate risk is for an exporter (e.g. a Nigerian exporter) to invoice his foreign customer in naira (domestic currency of the exporter). In this way, only the exporter will be able to avoid exchange risk, the burden of risk will now shift on the foreign customer. However if the Nigerian exporter decides to take on the exchange rate risk, he will invoice the foreign customer in foreign currency (e.g. $, £ as the case may be).

vi **Leading and lagging**: accelerating (leading) and delaying(lagging) international payments by modifying credit terms

d. The following reasons can motivate a country like America to carry out trade with Nigeria.

i The climatic condition of countries determines the kind of crops they grow. The tropical countries can easily grow mangoes, pawpaw, cassava, beans, cotton and other tropical products. While the cold regions grow apples, potatoes asparagus and other assorted temperate fruits amongst others.

ii Some countries of the world are naturally endowed with certain products. For instance, Australia and Argentina have lands for cattle so they specialise in meat production. Japan has a large population of skilled labour and technical know-how. They naturally produce technical industrial products like motor cars, ocean liners, electronics, cameras etc. Nigeria and other organisation of petroleum exporting countries are well known for petroleum oil exploration from the bowels of the earth, a God given natural resource.

iii A few countries are self-sufficient in many products with spares that they can exploit the international market with e.g. Nigeria is self-sufficient in the production of cassava. As expected Nigeria now takes order for the export of cassava products.

iv Meeting orders in international trade now translates to more jobs creation locally.

v As a result of mass production for international trade, it has led to lower unit of cost of production or economies of scale

vi Exports generally provide the foreign currency needed to buy capital goods to facilitate further domestic production,

vii The regime of taxation in some countries encourages capital flight to more stable and less tax imposing countries.

viii The more prosperous countries still import those things they can conveniently produce because of the law of comparative advantage.

c. Difference between the Eurocurrency market and the Eurobond market.

Euro currency market: this consists of banks that accept deposits and make loans in foreign currency most especially short and medium term finances. The market deals with short/medium term banking and financial activities.

While
Euro bond market: this is the market where long term finance is raised. Specifically, bonds are sold outside the country in whose currency they are denominated.

Solution to Question 4

a. The benefits that comes with Microfinance include
1. **Reduction of Vulnerability:** One of the most important benefits of microcredit programmes is their ability to reduce vulnerability among the poor. Microcredit programmes help borrowers to insure themselves against crises by building up assets. Such assets can be sold if necessary. They can also be used as security or proof of credit worthiness when dealing with businessmen or more traditional lending agencies. Finally, the diversification of assets can reduce the risk of catastrophic

loss. A family that relies on sharecropping could easily be bankrupted by a single crop loss, whereas a family with a diversified base of crops and livestock or handicraft income could survive until the next harvest.

2. **Increased Consumption:** Another benefit of microcredit programmes is the increase in household consumption. Even small increases in consumption and increased regularity in consumption can lead to better health and nutrition, and enhance the ability to make long-range plans for the family.

3. **Reduced Income Poverty:** Microcredit programmes also reduce income poverty. This means that borrowers actually tend to make more money over time. Once the cycle of poverty has been arrested and some stability provided, many borrowers go on to make profitable investments and even lift themselves out of poverty all together.

4. **Micro-clusters:** The main selling point for clustering is the collective efficiency it produces. microcredit-funded business ventures are frequently plagued by the problems of size and isolation. With microcredit clusters however, these problems are partly overcome. Traders are attracted by the possibility of making bulk sales. The close proximity of a number of businesses in the same line of work also allows for labour sharing, order sharing and subcontracting within a cluster. Other major advantages include the ease of sharing information and technological innovations within clusters.

b. Two techniques employed by SME'S in project appraisal
The two techniques are Accounting Rate of Return (ARR) and Pay Back Period(PBP)

Reason for preferring ARR

a. It is simple to calculate and understand.
b. It uses readily available accounting data.
c. It present the analysis in term of familiar percentage
d. It is use to compare the performance of many companies.

Reasons for Preferring PBP

a. It is simple to calculate and understand.
b. It is the least affected by uncertainty.
c. It serves as a first screening process.
d. It is use in risk analysis in that the technique believes that the higher the payback period of a project, the riskier it is.

c. **The Small and Medium Enterprises Equity Investment Scheme (SMEEIS) was introduced in June 2001 to stimulate economic growth. The objective of the scheme are:**

1. Developing local technology and generating employment.

2. To facilitate the flow of funds from banks for the establishment of new, viable SME projects, expansion of existing industries and rehabilitation of dying ones.

3. Promote indigenous entrepreneurship and ensure output expansion, income re-distribution and production of intermediate goods meant to strengthen inter and intra-industrial linkages.

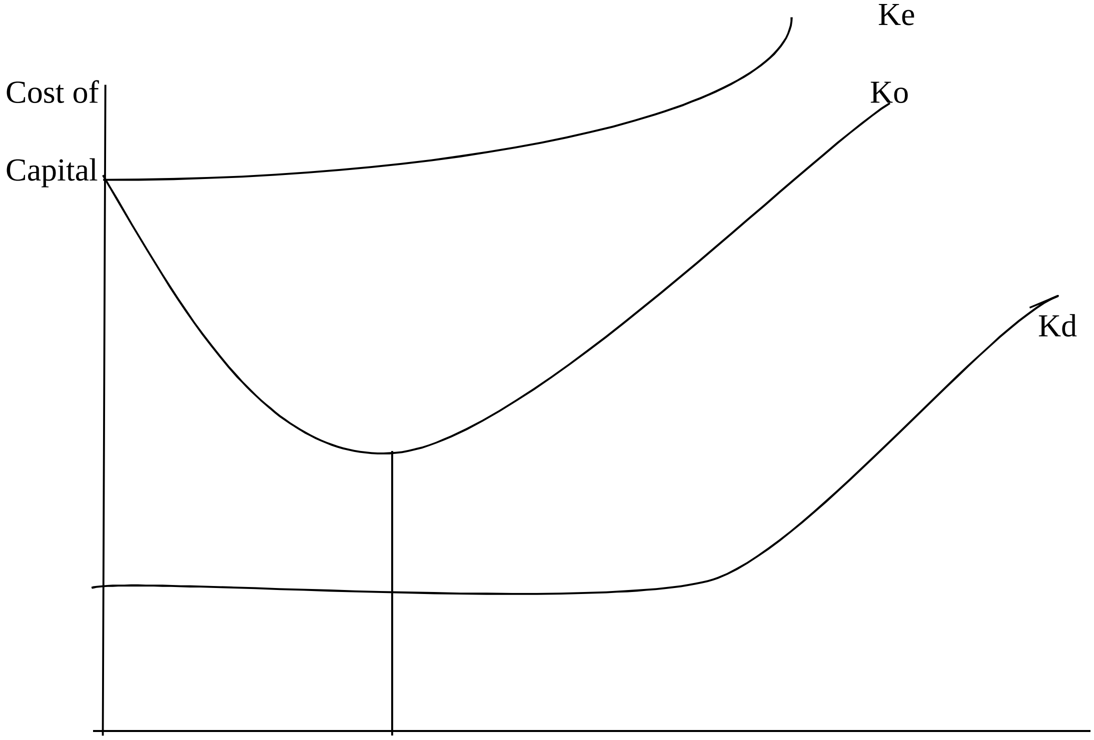
Solution to Question 5

(a) The Pure Traditional Approach

The traditional Approach is a modification to the net income approach. It is sometimes regarded as a middle of the road position between the net income approach (NI) and the net operating income approach (NOI). The traditional approach assumes that the value of the firm can be increased or the cost of capital reduced through judicious use of debt. The approach suggests that the value of the firm increases or the cost of debt decreases initially within a reasonable limit of debt after which further increase in debt reduces the value of the firm or increases the cost of capital. Thus, in the traditional approach, an optimal capital structure exists and it occurs when the market value of the firm is maximum and the cost of capital is minimum. The views of the traditional approach can be described in three stages as follows:

1. The cost of equity is assumed to be constant or rise slightly with an increase in debt. The cost of debt is constant and cheaper than the cost of equity. Because of the cheapness of the cost of debt, the overall cost of capital falls as debt increases.
2. As the level of debt increases because of the added financial risk the cost of equity will now be increasing in a way that offsets the advantage of cheap debt finance. The increase in the cost of equity will make the increase in debt to have a negligible effect on the overall cost of capital or the value of the firm. Within that range at a specified point the firm will attain optimal capital structure.
3. Beyond a certain limit of leverage, investors will perceive a higher degree of financial risk. The increase in the cost of equity will be more than offset the cheap debt finance. The weighted average cost of capital will now start increasing. The added financial risk will later cause the cost of debt to increase. The overall effect will cause the overall cost of capital to increase further with leverage. The increase in the cost of capital means a decrease in the value of the firm.

Leverage and the Cost of Capital Under the Traditional Approach



5(b).	**Alpha Plc**	**Beta Plc**
	N	N
Equity	2,400,000	1,250,000
Debt	-	1,500,000
	2,400,000	2,750,000 (1 mark)
	N	N
EBIT	360,000	360,000

Less Interest   150,000
360,000   210,000 (1 mark)

Cost of equity = dividend / Market Value   360,000 x 100 / 2,400,000   210,000 x 100 / 1,250,000

Ke	=	15%	16.8% (1 mark)
Kd		10%	
Kw		15%	360,000 / 2,750,000 = 13.09% (1 mark)

Switching

Obi percentage holding in Beta Plc   62,500 / 1,250,00 x 100 = 5% (1 marks)

Obi current Income in Beta Plc = 5% x 210,000 = N10,500 (1 marks)

Current stake could be sold for 62,500 x N1 = 62,500 (1 marks)

Total amount require to invest in Alpha Plc = 5% x 2,400,000	=	120,000 (1 marks)
Amount at hand		62,500
Amount to borrow		57,500 (1 marks)

Income expected at Alpha Plc 5% x 360,000	=	18,000 (1 marks)
Less 10% x 57,500	=	5,750 (½ marks)
Net Income from Alpha	=	12,250 (1 marks)
Less income from Beta Plc	=	10,500
Gain from Switching	=	1,750 (1marks)

Total (11 ½ marks)

Solution to question 6

Secured Home Plc

(a) BALANCE SHEET POST – RECONSTRUCTION

Fixed assets	**N'000**	**N'000**
Property (180,000 x 60%)		108,000
Plant (140,000 x60%) + 50m)		134,000
		242,000

Current assets

Stocks	100,000	
Debtors (40,000 x 90%)	72,000	
		172,000
		414,000
Ordinary shares (See below)	96,000	
14% Unsecured debentures (200,000 x 50%)	100,000	196,000
Trade creditors (120,000 x 50%)	60,000	
Bank overdraft (140,000 + 9,000)	158,000	218,000
		414,000

(5 ½ marks)

Ordinary shares are made up as follows:	**N'000**
Original shareholder (200,000 x10%)	20,000
Preference shares (40,000 x 10%)	4,000
Issued to debenture holders	40,000
	64,000
Right issue one for two (64,000 x 50%)	32,000
	96,000

(¼ mark each for a tick, 5 Marks, ½ mark for Heading, total 5 ½ marks)

1. In case of immediate liquidation where there is no secured creditor

Proceed from forced sales	**N'000**
Property	70,000
Plant	50,000
Stock	60,000
Debtors	60,000
Available to all outstanding shareholders	240,000
All creditors	
14% Unsecured debenture	200,000
Trade creditors	120,000
Bank overdraft	140,000
	460,000

The ratio of sharing 240/460 = 52.18k If means that the maximum any creditor would receive would be 52.18k of every N1.

a. The unsecured debenture would receive .5218 x N200, 000 = N104,360m. to lose N95,640m

b. The trade creditor would receive = .5218 x 120,000 = N62,616. To lose N57,384.
c. Bank over to receive .5218 x 140,000 = N73, 052. To lose N66,948. (2 ½ marks)

IN A CASE OF RECONSTRUCTION

If reconstruction takes place, the company will make annual profit of N55m which will be allocated as follows

	N'000
Profit before interest	55,000
Less: Interest	
14% N100m Unsecured debenture	(14,000)
Bank overdraft (18% x 158,000)	(28,440)
Profit available as dividend	12, 560

DPS = N12,560m

96m shares i.e. 13k per share

i. **The Ordinary shareholders -**
The original shareholders will become minority holders (15%). They will be expected to inject N10m more by way of rights issue and will claim dividend of 13k per share on 30m shares. i.e. N3, 900,000. Their new investment of N10m has yielded a return of 39%. That is, 3,900/N10m. This is better than nothing in the event of immediate liquidation.

The Preference shareholders –

In the event of a forced sale they would receive nothing. But if a reconstruction takes place the preference share holders would have their 40m preference shares reduced to 4m ordinary shares and they would have to N2m in a right issue, so that their total holding in the company would be 6m shares on which they would receive 13k each on 6m shares. i.e. N780, 000. It means they also have made a return of 39% on the N2m they newly invested. 780/2000. 39%

ii. **The Secured debenture holders –**
The conversion of their N200m debenture for 40m ordinary shares & 14% 100m Unsecured loan stock means an instant loss of N60m in their value. Additionally, they will

need to inject N20m by way of right issue summing up to N60m thereby holding 62.5% of the equity base of the company which will enable them have firm control of the company. Their earnings will be as follows:

	N	
Interest on 14% N100m debenture	14,000	
Dividend (13k x N60m)	7,800	
		21,800

Undoubtedly, if they are successful convinced, this scheme places them better.

iv. **The bank –**

If the company went into liquidation, the bank would be owed N140m and would be ranked with other creditor depending on the income available to all creditors. However, in a reconstruction, the bank overdraft is increase to N158m. I wonder if any bank would accept to give a dying company an overdraft but a new interest rate of 18% which is undoubtedly an incentive will put the bank in a position to receiving annual interest of 18% x N158m = N28,440m per annum. In an immediate liquidation where there are no secured creditor, they would get .5218 x N140m = N73.05m. The bank will have to give it serious consideration if they want to take the risk of getting N73.05m now or continue to get N28.4m annually.

v. **The trade creditor**

The amount they are being owed N120m is to be written down by 50% to have N60m outstanding. They lose N60m instantly. They are however assured of repayment of the N60m in the foreseeable future. If compared to their position in a liquidation where there are no secured debenture, they would rank with other creditors to get .5218 of a naira and that would place them at .5218x N120m = N62.616m which is better than N60m in the future so they may not opt for the reconstruction. (2 marks each, total 10 marks).

BFN 428 MARKING GUIDE FOR 2014 2015 SECTION

Suggested Solutions

a. Macroeconomic shocks affect output, prices, or both.
b. Demographic shocks affect all pension schemes by affecting market prices and quantities and pension claims.
c. Political risks affect all pension schemes because all depend critically—albeit in different ways—on effective government.
d. Management risk can arise through incompetence or fraud, which imperfectly informed consumers generally cannot monitor effectively.
e. Investment risk: private and public pension accumulations held in the stock market until retirement is vulnerable to market fluctuations.
f. Annuities market risk: for a given pension accumulation, the value of an annuity depends on remaining life expectancy and on the rate of return the insurance company can expect over those years (and is thus also a form of investment risk).

a. The risk that the invested fund at normal retiring age will be insufficient to fund the benefits. This is wholly "investment risk" and is carried by the employer or sponsor of a "defined benefits" scheme. When the benefits are not defined, the employer or sponsor carries no investment risk; it is the employees who, unwittingly, carry the investment risk. They do not know in advance what level of pension they will get.
b. The risk of death or disability before normal retiring age, if the scheme offers enhanced benefits at that time. This is "mortality risk" and may apply to a defined contribution scheme as well as to a defined benefit scheme. Often it is reinsured with a life insurance company either in whole, or in part
c. The risk that retired employees and their spouses will survive, on average, longer than expected after retirement – the "survivorship risk". This is coupled with investment risk, as retirement can last a long time and the benefits (pensions) sometimes rise by fixed percentages annually.

2. a. Information processing Problem: because of uncertainty about the future—individuals are not well-informed because nobody is well-informed (fully informed).

b. Second, they are imperfectly informed in the face of risk.

c. A third type of imperfect information can arise with complex products like DC pensions, which are based on an array of financial institutions and financial instruments.

d. With an information-processing problem, in contrast, matters are too complex for agents to make rational choices, even if the necessary information is provided. The problem can arise

i. where the time horizon is long, as with pensions,
ii. where the good or service involves complex probabilities, including, for example, life expectancy (the failure in this case is an inability to process probabilities),

iii. where the information is inherently complex, as with complicated pension products, or

iv. where the use of the information requires sophisticated analysis. Some ignorance—information problems—can be reduced by public education.

b. Valuation problems: assets ("defined benefits" funds)

a. The fund was not "mature", where the current pension payments are far lower than the contributions and investment income needed to secure future pensions, using estimates of future survivorship. Actuarial valuations should take place every three years and, should always be based on the value, discounted to the present, of the accumulation of estimated future flows of both income (for assets) and pensions payable (for liabilities). Market values of investments should not be used.

b. It should be noted that income based estimates of the present value of assets, in the case of a scheme which is not "mature", are seeking wholly or partly to avoid taking snapshots, either of the present or of the future.

Valuation problems: liabilities ("defined benefits" funds).

In the case of a "defined contributions" pension scheme for a group, the liability to individual members is simply the present market value of the units bought previously with the contributions attributable to his employment and with the investment income on them. In the case of a funded "defined benefits" scheme the present value of the promises to pay to all the members in the future is estimated actuarially.

a. Liabilities change: as funds approach maturity; when the hierarchy becomes more or less peaked

b. when benefits are enhanced, e.g. by introducing a degree of inflation proofing of pensions in payment, or the reverse. Also, when benefits are enhanced, the effects on liabilities depend on whether or not back service or only future service counts.

c. the degree of security of the funding to meet the promised benefits. There are a number of levels of coverage of the investment risk, in the case of "defined benefits" pension funds.

3. *Consumption smoothing*

People seek to maximize their well-being not at a single point in time, but over time. Someone who saves does so not because extra consumption today has no value, but because he values extra consumption in the future more highly than extra consumption today. A teenager who saves for a flight ticket is making a judgement that she will get more enjoyment from the trip than from spending the money now. Similarly, most people hope to live long enough to be able to retire. Thus a central purpose of retirement pensions is consumption smoothing—a process which enables a person to transfer consumption from her productive middle years to her retired years, allowing her to choose her preferred time path of consumption over working and retired life.

Insurance

In a model of certainty, individuals save during their working life to finance their retirement. Important in the case of pensions is that people face a range of uncertainties, including how long they are going to live. Thus a pension based on individual saving faces the person with the risk of outliving those savings, or of consuming very little to prevent that happening. Though any one person does not know how long he is going to live, the life expectancy of a large group of people is better known. Thus, in principle, the members of the group could agree to pool their pension savings, with each person drawing a pension based on

(*a*) the group's life expectancy and

(*b*) the total amount he or she had contributed to the pool.

Objectives of Pensions Systems

a. *Poverty relief*
   Poverty relief targets resources on people who are poor on a lifetime basis, and thus unable to save enough. Poverty relief also has to address transient poverty. Such programmes can target all the elderly or may concentrate on those who have contributed to the pension system.
b. *Redistribution*
   Pension systems can redistribute incomes on a lifetime basis, complementing the role of progressive taxes on annual income. Lifetime redistribution can be achieved by paying pensions to low earners that are a higher percentage of their previous earnings thus subsidizing the consumption smoothing of lower earners.
c. *Consumption smoothing*
   People seek to maximize their well-being not at a single point in time, but over time. Thus a central purpose of retirement pensions is consumption smoothing—a process which enables a person to transfer consumption from her productive middle years to her retired years, allowing her to choose her preferred time path of consumption over working and retired life.
d. *Insurance* : In a model of certainty, individuals save during their working life to finance their retirement. Important in the case of pensions is that people face a range of uncertainties, including how long they are going to live. Thus a pension based on individual saving faces the person with the risk of outliving those savings, or of consuming very little to prevent that happening.
e. *Other Objectives: Why Retirement Savings is Patient Capital*
   Alongside these primary objectives, pension policy may have secondary goals, including economic development broadly and economic growth specifically. Badly designed pensions may create adverse labour-market incentives. Excessive public pension spending contributes to high tax rates, putting growth at risk. Conversely, pension arrangements can assist the operation of labour and capital markets and may encourage savings. There is debate about the relative weights accorded to old-age security and to these secondary objectives.

b. Basic difference between DB and DC Plans: Defined Benefit plans are pension plans based on particular benefits of the employee at the time of retirement. It is such that the benefit of the employee are based on the last salary, while Defined contribution plans are pension plans based on the contributions of the employee and the employer. The risks are borne by the employee who picks his own Pension fund administrator unlike the DB plans where the employer assumes the risks of performance or non-performance of the investment. Thus DC is preferred over DB plans for the following reasons:
   - The increased level of regulations of the DB plans are making them unpopular with the regulatory burdens
   - DC Plans are very portable since employee moves on with them
   - DC plans are more employee entered than DB