3.1 Sample Problems - *due: Monday, February 3 at the beginning of class*

Question 3.1.2 Agricultural Bank of China (ABC)

In August 2010, Agricultural Bank of China (ABC) completed its **initial public offering** (IPO) in Shanghai and Hong Kong, raising $22.1 billion. Despite the weak market sentiment in Asian stock markets and fears that Chinese bank shares were overvalued, investors poured money into China's third largest lender, with more than 325 million customers. ABC's flotation proved to be the world's largest ever, beating the previous record of $21.97 billion set by the IPO of China's largest bank, Industrial and Commercial Bank of China (ICBC) in October 2006.

(a) Define the term **initial public offering.** *[2 marks]*

(b) Comment on why ABC might have decided to float its shares on the stock market. *[4 marks]*

(c) Explain why investors might have been so keen to buy shares in ABC, despite the weak market sentiment in Asian stock markets at the time. *[4 marks]*

Question 3.1.3 Kellet School

In 2013, Kellett School in Hong Kong introduced record-breaking debentures up to the value of HK$10 million (US$1.29 million), being refundable when students eventually leave the school. Parents with more than one child at the school would get a small discount. Its school fees ranged from HK$123 500 to HK$168 800 (US$15 930 to US$21 775). The timing coincided with the school's move to a new HK$200 million (US$25.8 million) campus with its much improved facilities such as a large auditorium, swimming pool, Astroturf multisport areas, an extensive library and state-of-the-art classrooms.

Critics argued the enormous cost of education would diminish Hong Kong's international competitiveness by putting off highly skilled expats and their families coming to Hong Kong. Rival competitor Harrow International School offers non-interest bearing debentures of up to HK$3 million (US$387 000). Capital expenditure and the costs of land construction mean that debentures are common in international schools in Hong Kong.

Source: adapted from www.thestandard.com.hk

(a) Outline why Kellett School decided to sell debentures. *[2 marks]*

(b) Despite the high costs, suggest why most parents might agree to purchase the debentures. *[3 marks]*

(c) Explain the potential drawbacks to a school that chooses to raise finance through the sale of debentures. *[4 marks]*

(d) Examine two alternative sources of finance that Kellett School could have used to finance its capital expenditure. *[6 marks]*

Question 3.1.4 Tiffany Diamonds Ltd

Tiffany Diamonds Ltd has a forecast cash flow deficit of $140 000 in two months' time. It also has debtors totalling $180 000. The firm decides to use a **debt factoring** service that advances 80% of the debtor balance.

(a) Define the term **debt factoring**. *[2 marks]*

(b) Calculate and explain whether this decision would resolve the cash flow problem for the business. *[4 marks]*

Question 3.1.5 Wizz Air

In late 2013, Hungary low-cost airline carrier Wizz Air signed a **sale-and-leaseback** agreement with Chinese CDB Leasing Co. to finance six Airbus A320 aircraft. The deal raised $549 m to finance the airline's expansion plans with new routes to Barcelona, Bologna, Dortmund and Rome from 2014. Established in 2003, the airline flies to over 90 destinations in 32 countries. As is common with low-cost budget airlines, Wizz Air operates a buy on board system where food and beverages are paid for on board rather than included in the ticket price.

(a) Define the term **sale-and-leaseback**. *[2 marks]*

(b) Explain the advantages to businesses such as Chinese CDB Leasing Co. leasing assets to established organizations such as Wizz Air. *[4 marks]*

Question 3.1.6 MG Rover

In May 2000, four British businessmen, nicknamed the Phoenix Four, bought MG Rover from previous owners BMW for just £10 ($16.4). They each put in £60 000 ($98 200) of their own money but were also given £1 bn ($1.64 bn) in cash and assets from BMW, despite the owners losing £1 m ($1.64 m) each day from MG Rover! The British public saw the Phoenix Four as heroes, having saved the former British company from extinction.

However, five years later, the business announced 5000 job losses. The Phoenix Four were condemned for their gross mismanagement of MG Rover and for their extravagant financial rewards. MG Rover had struggled to survive in a highly competitive and rapidly changing industry. Whilst BMW retained the highly successful MINI, Range Rover was sold off (now owned by India's Tata Motors). MG Rover is now owned by Chinese firm Nanjing Automobile, having been bought out in 2005 for £53 m ($86.8 m).

(a) Describe why the members of the Phoenix Four might be classed as business angels. *[2 marks]*

(b) Explain the dangers outlined in the article concerning the use of business angels. *[4 marks]*

(c) Analyse how the profitability of a business, such as MG Rover, affects its ability to raise external sources of finance. *[6 marks]*