

## **THE ASSIGNMENT (WORTH 100% OF THE GRADE)**

Dear Writer:

***\* Note that this is a fictional case focused on understanding management accounting; you are not expected to comment in any way on aspects such as the market feasibility or the actual rates of tax in Switzerland.***

### **Financial Management - Final Assessment**

You have been asked by your 59-year-old father-in-law Felix to help him assess a new venture. It is Friday night, and he needs the work finished by Sunday, in preparation for an early Monday morning meeting, so you know that he will not be able to give you any more information than he already has (and you will be unable to contact him over the weekend), and therefore you should rely on your own assumptions and estimates for some of the analysis if necessary.

Felix, who was educated in London, now lives in Zurich, Switzerland, and recently took early retirement (from a chocolate firm he joined 25 years ago), leaving the company with a lump sum (after tax) payment of CHF 900,000. Surprisingly, rather than being depressed by his new state of independence, he is excitedly contemplating a new career as a retailer of natural pearls. He is confident that he can set up a business to import pearls from Tahiti and sell them in Zurich. His wife, who he met at business school, is pleased with his passion for this possible new venture but concerned that it might turn into a financial disaster. She has suggested that he **develop a financial plan to evaluate the venture and its viability.**

After a couple of hours with Felix you have assembled the following information from him:

- Orohena Pearls (owned by a business school roommate of Felix), an established supplier of Tahitian Pearls, located close to Pape'ete in Tahiti, is prepared to give him exclusive rights to sell their products in Switzerland for a six-year period in exchange for an upfront payment for those rights;
- Single, undrilled, pearls sell in Tahiti for an average of 14,800 XPF each and Orohena Pearls (OP) is prepared to sell them to Felix at a 35% discount to this price (XPF is the international code for CFP francs the currency used in Tahiti and other parts of French Polynesia)
- OP would ship to Felix on receipt of payment for each order;
- Felix has found out that air freight (including insurance) from OP via courier would cost on average XPF 1,800 per pearl, and that the time from him placing an order to receiving the goods in Zurich would be three weeks (including the preparation and packing time in Tahiti); he would also have to pay the courier cost to OP on ordering;
- Felix plans to order from OP monthly and intends to maintain a minimum stock of four weeks' worth of sales to ensure that he will be able to supply a suitable range of pearls to customers;
- He will buy racking and a special safe at a total cost of CHF 5,700 to store the pearls, and has found a small commercial room nearby that he can rent for CHF 850 per month, payable monthly in advance, plus a security deposit of three month's rent (refundable in full if there is no damage to the premises);

- He will also install an alarm system at an initial cost of CHF 5,500, plus a CHF 100 per month monitoring fee;
- Felix will sell the pearls by internet only, and is planning to spend CHF 8,000 with a website designer to develop the site;
- He has already spent CHF 9,000 on a market study that told him that once established, demand would be about 250 pearls per month, although in the first year sales would start at only 30 in the first month before building up slowly to the full level at the end of the first year, after which they would remain constant;
- The above study assumed an average selling price in Switzerland of CHF 270 per pearl (ignore any impact of VAT/sales taxes in your calculations);
- Packaging and shipping within Switzerland would average CHF 15 per pearl, and Felix is not currently intending to charge that to the customer;
- All internet sales would be by credit card, with the credit card company taking 1.2% per sale and remitting the total monthly to Felix fifteen days after the end of each calendar month;
- Felix believes that two students could run the operation part time at a total monthly cost to him (including employer's social charges) of CHF 3,600 each;
- Felix believes that if necessary he could borrow up to an additional CHF 75,000 at 6% p.a.;
- The effective overall marginal tax rate on profit from a company set up to undertake this activity would be 40%, payable one year in arrears; Felix has also told you that he can invest any available cash at an after tax 4% per annum.

Felix also has a friend, Paula, who owns two jewellery shops in the Zurich area. Paula is interested in the venture and has agreed that if Felix can incorporate the pearls into pendants, she would give him a one year contract to purchase 30 pendants per month. She would pay Felix CHF 170 cash for each pendant (to be paid on delivery to Paula), and these sales would be in addition to the internet sales outlined above (and would start immediately). To do this Felix would need to purchase a small drill and jig (costing CHF 550) to hold the pearl while drilling, as well as silver chains and clasps at a cost of CHF 25 per set, plus CHF 7.50 for a presentation box for the pendant. He would also hire an assistant specifically to make and deliver the pendants at an additional cost of CHF 350 per month.

Felix remembers lectures on discounted cash flow analysis at business school (although he admits that he does not remember them well, unlike his wife who was a distinction student). He has asked you to prepare a financial analysis while he is away to help him with the decision, making clear any assumptions that you make; the analysis should not exceed 25 pages (everything included), and **should include**:

- ***A summary of all assumptions and estimates that you have made for your analysis, including justifications where appropriate;***
- ***A break even analysis;***
- ***A Profit and Loss Statement for the first year of operations and Balance Sheet at the end of the first year;***
- ***Monthly cash flow for the first year of operation;***
- ***Annual cash flow for each further year;***
- ***A clear explanation, in plain English, of how much cash the venture will need to get started;***
- ***Any sensitivity analysis that you think would be helpful;***
- ***The most that Felix could offer OP as an upfront fee for the exclusive rights for the six year period (which does not include any pearl purchases) which would leave him no better or worse off than if he had not undertaken the venture, and the amount you suggest he should actually offer them;***

- **Conclusions and recommendations;**
- **A critical reflection of the method you have chosen to decide whether the venture is attractive or not, and what, if anything, you would do differently in any future financial analysis of this type, and why?**

Felix has explained that he is going to be out of town for a wedding so will be unable to provide any assistance at all, but as he pointed out before leaving “you will find this easy with computers and the internet to help”.

Your report should demonstrate skills of critical reflection, effective communication and balanced judgement; note that this is not a market report. Scripts that are excessively long (i.e. exceeding the page limit) will not be read beyond the point of the limit; there is no minimum word limit. Do not put your name on the paper.

The overall structure (**within** the 25 page limit as above) should be as follows:

- 1. Cover Page (1 page)**
- 2. Table of Contents/List of Exhibits (1 page)**
- 3. Executive Summary**
- 4. Main Report**
- 5. Critical Reflection**
- 5. List of References.**

The data in your answer should be *clearly laid out in tabular format* so that your approach and answer are both plainly evident.

Submissions should be machine readable in **MS-Word format only**; submit only one file, and **include** any *Excel analysis as images, not embedded files*.

Grading Percentage is based on:

- **Assumptions, estimates and sensitivity analysis: 25%**
- **Cash flow and financial viability analysis: 25%**
- **Other financial details (P&L Statement, Balance Sheet, break even, etc): 35%**
- **Critical reflection: 10%**
- **Referencing and presentation: 5%**

**SEE THE NEXT PAGE FOR GRADE SCALE RUBRIC.....**

**THE PROFESSOR WILL GRADE BASED ON THIS GRADE RUBRIC (JPG, BELOW):**

<b>Criteria and Weighting</b>	<b>70% and above (Distinction)</b>	<b>60% - 69% (Merit)</b>	<b>50% - 59% (Pass)</b>	<b>40% - 49% (Fail)</b>	<b>0% - 39% (Significant Fail)</b>
<b>Assumptions, estimates and sensitivity analysis (25%)</b>	Excellent - wide range of key and peripheral assumptions, demonstrating critical evaluation and understanding of the issues	Substantial selection of key and peripheral assumptions, demonstrating analysis and critical evaluation of a wide range of relevant issues for the professional context.	Good selection of key and peripheral assumptions with critical evaluation of significant issues for the professional.	Limited selection of assumptions; some recognition and critical analysis of issues of significance for the professional context.	Limited evidence demonstrating poor recognition of significance for the professional context.
<b>Cash flow and DCF analysis (25%)</b>	Excellent understanding of the theory and its application and subtleties	Good exploration of knowledge and theory relevant to the assignment. Analysis and evaluation of concepts are critical and fairly insightful.	Adequate exploration of knowledge and theory relevant to the assignment. Analysis and evaluation of concepts lacks criticality and insight.	Poor exploration of knowledge and theory relevant to the assignment. Analysis and evaluation of concepts are inadequate.	Very weak or missing exploration of knowledge and theory relevant to the assignment. Analysis and evaluation of concepts are non-existent.
<b>Other financial details (35%)</b>	Excellent understanding of the theory and its application and subtleties	Good exploration of knowledge and theory relevant to the assignment. Analysis and evaluation of concepts are critical and fairly insightful.	Adequate exploration of knowledge and theory relevant to the assignment. Analysis and evaluation of concepts lacks criticality and insight.	Poor exploration of knowledge and theory relevant to the assignment. Analysis and evaluation of concepts are inadequate.	Very weak or missing exploration of knowledge and theory relevant to the assignment. Analysis and evaluation of concepts are non-existent.
<b>Critical reflection (10%)</b>	Excellent understanding of the strengths and limitations of the required analysis, with clear ideas on areas of improvement	Good understanding of the strengths and limitations of the required analysis, with some ideas on areas of improvement	Adequate understanding of the strengths and limitations of the required analysis, with few ideas on areas of improvement	Unclear understanding of the strengths and limitations of the required analysis, with few ideas on areas of improvement	Weak or confused understanding of the strengths and limitations of the required analysis
<b>Referencing and presentation (5%)</b>	Excellent piece of writing, well-structured, coherent progression of argument, well-articulated and accurately referenced, with excellent summary and clear conclusions and recommendations	Well written, well-structured, coherent progression of argument, reasonably articulated and accurately referenced. Good summary, conclusions and recommendations	Fairly well written and structured, some coherence, some inaccuracies in referencing and minor issues with expression. Appropriate	Poorly written and structured, incoherent and inaccurately referenced. Lacks summary, conclusions and recommendations	Very weak piece of writing. Incoherent and poorly articulated. Inaccurately referenced. Lacks summary, conclusions and recommendations

THIS IS THE END OF THE ASSIGNMENT REQUIREMENTS.