



TAXATION PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

D2: FINANCIAL MANAGMENT

FRIDAY 18 DECEMBER 2015

TOTAL MARKS – 100; TIME ALLOWED: THREE (3) HOURS

INSTRUCTIONS TO CANDIDATES

1. You have fifteen (15) minutes reading time. Use it to study the examination paper carefully so that you understand what to do in each question. You will be told when to start writing.
2. This question paper consists of **FOUR (4)** questions of Twenty Five (25) marks each. You must attempt all the **FOUR (4)** questions.
3. Enter your Student number and your National Registration Card number on the front of the answer booklet. Your name must **NOT** appear anywhere on your answer booklet.
4. Do **NOT** write in pencil (except for graphs and diagrams).
5. **Cell Phones** are **NOT** allowed in the Examination Room.
6. The marks shown against the requirement(s) for each question should be taken as an indication of the expected length and depth of the answer.
7. All workings must be done in the answer booklet.
8. Present legible and tidy work.
9. Graph paper (if required) is provided at the end of the answer booklet.
10. Formulae, Present Value, and Annuity tables are provided at the end of this question paper.

Attempt all FOUR (4) Questions

QUESTION ONE

- (a) The management of Mukaka Ltd is considering two mutually exclusive investment projects (A and B). Project A involves an initial investment of K100,000 with a residual value of K5,000 at the end of five years. Project B will initially cost K85,000 with a nil residual value at the end of five years.

Profits after depreciation for project A are forecast at K20,000 per annum. This figure is estimated to increase by K5,000 per annum beginning from year two until the end of the project. Project B is estimated to result in a K20,000 loss after depreciation in year one and profits after depreciation of K30,000 per annum for each of the next three years. The profit after depreciation for the 5th year is estimated to be 50% higher than the previous year. Mukaka Ltd uses the straight line method of depreciation. The company cost of capital is 10% and both projects are expected to last for five years.

Required:

Calculate for each project;

- (i) The Accounting Rate of Return (ARR)
- (ii) The payback period
- (iii) The Net Present Value (NPV)

Advise Mukaka Ltd which projects it should invest in under each alternative appraisal method (i), (ii) and (iii) above. (19 marks)

- (b) Mukaka Ltd management is considering financing the selected project from internal sources. This is due to the fact that Mukaka Ltd is a small unlisted company and it is likely to encounter difficulties in obtaining finance from external sources.

Required:

Discuss two (2) advantages of three internal sources of finance that Mukaka Ltd can use to finance the selected project. (6 marks)

[Total: 25 Marks]

QUESTION TWO

Burma Plc has the following projected financial information for the next four years:

Year	1	2	3	4
Earnings before tax (K'm)	75.3	78.1	81.2	84.5

Burma Plc expects the earnings after tax to grow by 4% annually after the fourth year. The company has in issue one hundred million ordinary shares and an 11.5% bank loan with ten years to maturity. The company has just paid its annual dividend of 50 ngwee per share. Burma expects its dividend to grow by 4.5% per year. Burma has an asset beta of 0.89. The risk free rate is 6.2% and equity premium of 8%. The capital structure is represented by 75% equity and 25% debt. Burma Plc pays corporate tax at the rate of 30% per year.

Required:

- (a) Calculate the current weighted average cost of capital of Burma Plc. (6 marks)
- (b) Estimate a range of values per share for Burma Plc using the cash flow valuation models. (11 marks)
- (c) Discuss the usefulness of ratio analysis as an assessment tool for corporate failure. (8 marks)

[Total: 25 Marks]

QUESTION THREE

Bamako Ltd has the following capital structure.

	K'000
Ordinary shares of K5 each.	5,000
5% debentures of K100 each	1,000
Preference shares of K2.5 each	<u>625</u>
Total	<u>6,625</u>

The ordinary shares and debentures are quoted at K8 and K70 each respectively. The preference shares are quoted at K3 each. The cost of ordinary shares is estimated at 12% while the cost of preference shares is estimated at 14%. The debentures are redeemable at K90 each in five years' time.

Ignore taxation

Required:

- (a) Calculate the weighted average cost of capital of Bamako Ltd. (13 marks)
- (b) The efficient market hypothesis attempts to explain share price movements on a stock exchange market. There are generally three forms of market efficiency.
- Discuss the Three (3) forms of market efficiency. (6 marks)
- (c) One of the most important objectives of a business is to make profits and enhance the wealth of shareholders. However non-financial objectives can also be important for a profit making entity.
- Explain Three (3) non-financial objectives of a profit making company. (6 marks)
- [Total: 25 Marks]**

QUESTION FOUR

- (a) Evaluate Five (5) sources of finance that are available to Small and Medium Enterprises (SMEs) in Zambia to finance non-current assets. (10 marks)
- (b) A private equity fund, Nova Ltd acquired 80% of the ordinary share capital of a Zambian SME, Post Microfinance Ltd on 31 December 2014 for K78 million. Its net assets on the acquisition date were K85 million.
- Calculate the goodwill that will arise on the acquisition:
- (i) If the Non-Controlling Interest (NCI) is valued using the proportion of net assets method.
- (ii) If the NCI is valued using the fair value method, and the fair value of the NCI on the acquisition date is K19 million. (10 marks)
- (c) Explain any Five (5) possible ways Post Microfinance Ltd would benefit or be disadvantaged by obtaining a listing on a stock exchange, such as LuSE. (5 marks)

[Total: 25 Marks]

END OF PAPER

Formula Sheet

Economic order quantity

$$= \sqrt{\frac{2C_n D}{C_H}}$$

Miller – Orr Model

Return point = Lower limit + $\left(\frac{1}{3} \times \text{spread}\right)$

$$\text{Spread} = 3 \left[\frac{\frac{3}{4} \times \text{transaction cost} \times \text{variance of cash flows}}{\text{interest rate}} \right]^{\frac{1}{3}}$$

The Capital Asset Pricing Model

$$E(r_i) = R_f + \beta_i (E(r_m) - R_f)$$

The asset beta formula

$$\beta_a = \left[\frac{V_e}{(V_e + V_d(1 - T))} \beta_e \right] + \left[\frac{V_d(1 - T)}{(V_e + V_d(1 - T))} \beta_d \right]$$

The Growth Model

$$P_0 = \frac{D_0(1+g)}{(r_e - g)}$$

Gordon's growth approximation

$$g = b r_e$$

The weighted average cost of capital

$$\text{WACC} = \left[\frac{V_e}{V_e + V_d} \right] k_e + \left[\frac{V_d}{V_e + V_d} \right] k_d(1 - T)$$

The Fisher formula

$$(1+i) = (1+r)(1+h)$$

Purchasing power parity and interest rate parity

$$s_1 = S_0 \times \frac{(1+h_e)}{(1+h_b)} \qquad f_0 = S_0 \times \frac{(1+i_e)}{(1+i_b)}$$

Present Value Table

Present value of 1 i.e. $(1 + r)^{-n}$

Where r = discount rate
 n = number of periods until payment

Periods (n)	Discount rate (r)										
	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	
1	0.990	0.980	0.971	0.962	0.952	0.943	0.935	0.926	0.917	0.909	1
2	0.980	0.961	0.943	0.925	0.907	0.890	0.873	0.857	0.842	0.826	2
3	0.971	0.942	0.915	0.889	0.864	0.840	0.816	0.794	0.772	0.751	3
4	0.961	0.924	0.888	0.855	0.823	0.792	0.763	0.735	0.708	0.683	4
5	0.951	0.906	0.863	0.822	0.784	0.747	0.713	0.681	0.650	0.621	5
6	0.942	0.888	0.837	0.790	0.746	0.705	0.666	0.630	0.596	0.564	6
7	0.933	0.871	0.813	0.760	0.711	0.665	0.623	0.583	0.547	0.513	7
8	0.923	0.853	0.789	0.731	0.677	0.627	0.582	0.540	0.502	0.467	8
9	0.914	0.837	0.766	0.703	0.645	0.592	0.544	0.500	0.460	0.424	9
10	0.905	0.820	0.744	0.676	0.614	0.558	0.508	0.463	0.422	0.386	10
11	0.896	0.804	0.722	0.650	0.585	0.527	0.475	0.429	0.388	0.350	11
12	0.887	0.788	0.701	0.625	0.557	0.497	0.444	0.397	0.356	0.319	12
13	0.879	0.773	0.681	0.601	0.530	0.469	0.415	0.368	0.326	0.290	13
14	0.870	0.758	0.661	0.577	0.505	0.442	0.388	0.340	0.299	0.263	14
15	0.861	0.743	0.642	0.555	0.481	0.417	0.362	0.315	0.275	0.239	15
(n)	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%	
1	0.901	0.893	0.885	0.877	0.870	0.862	0.855	0.847	0.840	0.833	1
2	0.812	0.797	0.783	0.769	0.756	0.743	0.731	0.718	0.706	0.694	2
3	0.731	0.712	0.693	0.675	0.658	0.641	0.624	0.609	0.593	0.579	3
4	0.659	0.636	0.613	0.592	0.572	0.552	0.534	0.516	0.499	0.482	4
5	0.593	0.567	0.543	0.519	0.497	0.476	0.456	0.437	0.419	0.402	5
6	0.535	0.507	0.480	0.456	0.432	0.410	0.390	0.370	0.352	0.335	6
7	0.482	0.452	0.425	0.400	0.376	0.354	0.333	0.314	0.296	0.279	7
8	0.434	0.404	0.376	0.351	0.327	0.305	0.285	0.266	0.249	0.233	8
9	0.391	0.361	0.333	0.308	0.284	0.263	0.243	0.225	0.209	0.194	9
10	0.352	0.322	0.295	0.270	0.247	0.227	0.208	0.191	0.176	0.162	10
11	0.317	0.287	0.261	0.237	0.215	0.195	0.178	0.162	0.148	0.135	11
12	0.286	0.257	0.231	0.208	0.187	0.168	0.152	0.137	0.124	0.112	12
13	0.258	0.229	0.204	0.182	0.163	0.145	0.130	0.116	0.104	0.093	13
14	0.232	0.205	0.181	0.160	0.141	0.125	0.111	0.099	0.088	0.078	14
15	0.209	0.183	0.160	0.140	0.123	0.108	0.095	0.084	0.074	0.065	15

Annuity Table

Present value of an annuity of 1 i.e. $\frac{1 - (1 + r)^{-n}}{r}$

Where r = discount rate
 n = number of periods

Periods (n)	Discount rate (r)										
	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	
1	0.990	0.980	0.971	0.962	0.952	0.943	0.935	0.926	0.917	0.909	1
2	1.970	1.942	1.913	1.886	1.859	1.833	1.808	1.783	1.759	1.736	2
3	2.941	2.884	2.829	2.775	2.723	2.673	2.624	2.577	2.531	2.487	3
4	3.902	3.808	3.717	3.630	3.546	3.465	3.387	3.312	3.240	3.170	4
5	4.853	4.713	4.580	4.452	4.329	4.212	4.100	3.993	3.890	3.791	5
6	5.795	5.601	5.417	5.242	5.076	4.917	4.767	4.623	4.486	4.355	6
7	6.728	6.472	6.230	6.002	5.786	5.582	5.389	5.206	5.033	4.868	7
8	7.652	7.325	7.020	6.733	6.463	6.210	5.971	5.747	5.535	5.335	8
9	8.566	8.162	7.786	7.435	7.108	6.802	6.515	6.247	5.995	5.759	9
10	9.471	8.983	8.530	8.111	7.722	7.360	7.024	6.710	6.418	6.145	10
11	10.37	9.787	9.253	8.760	8.306	7.887	7.499	7.139	6.805	6.495	11
12	11.26	10.58	9.954	9.385	8.863	8.384	7.943	7.536	7.161	6.814	12
13	12.13	11.35	10.63	9.986	9.394	8.853	8.358	7.904	7.487	7.103	13
14	13.00	12.11	11.30	10.56	9.899	9.295	8.745	8.244	7.786	7.367	14
15	13.87	12.85	11.94	11.12	10.38	9.712	9.108	8.559	8.061	7.606	15
(n)	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%	
1	0.901	0.893	0.885	0.877	0.870	0.862	0.855	0.847	0.840	0.833	1
2	1.713	1.690	1.668	1.647	1.626	1.605	1.585	1.566	1.547	1.528	2
3	2.444	2.402	2.361	2.322	2.283	2.246	2.210	2.174	2.140	2.106	3
4	3.102	3.037	2.974	2.914	2.855	2.798	2.743	2.690	2.639	2.589	4
5	3.696	3.605	3.517	3.433	3.352	3.274	3.199	3.127	3.058	2.991	5
6	4.231	4.111	3.998	3.889	3.784	3.685	3.589	3.498	3.410	3.326	6
7	4.712	4.564	4.423	4.288	4.160	4.039	3.922	3.812	3.706	3.605	7
8	5.146	4.968	4.799	4.639	4.487	4.344	4.207	4.078	3.954	3.837	8
9	5.537	5.328	5.132	4.946	4.772	4.607	4.451	4.303	4.163	4.031	9
10	5.889	5.650	5.426	5.216	5.019	4.833	4.659	4.494	4.339	4.192	10
11	6.207	5.938	5.687	5.453	5.234	5.029	4.836	4.656	4.486	4.327	11
12	6.492	6.194	5.918	5.660	5.421	5.197	4.988	4.793	4.611	4.439	12
13	6.750	6.424	6.122	5.842	5.583	5.342	5.118	4.910	4.715	4.533	13
14	6.982	6.628	6.302	6.002	5.724	5.468	5.229	5.008	4.802	4.611	14
15	7.191	6.811	6.462	6.142	5.847	5.575	5.324	5.092	4.876	4.675	15

D2: FINANCIAL MANAGEMENT
SUGGESTED SOLUTIONS
DECEMBER 2015 EXAMINATIONS

SOLUTION ONE

Project A- ARR

Year	Profits
1	20,000
2	25,000
3	30,000
4	35,000
5	40,000
Total	150,000

Average profit = $150,000/5 = 30,000$

Average investment $(100,000 + 5000) /2$

$=105000 /2 = 52500$

ARR= $30,000 /52500 \times 100$

$= 57.14\%$

PROJECT B –ARR

Year	Profits
1	(20,000)
2	30,000
3	30,000
4	30,000
5	45,000
Total	115,000

Average profits = $115,000/5 = 23,000$

Average investment $(85,000 + 0) /2 = 42,500$

$$\begin{aligned} \text{ARR} &= 23,000 / 42,500 \times 100 \\ &= 54.1 \% \end{aligned}$$

THE PAY BACK PERIOD

Annual depreciation	project A	project B
	$(100,000 - 5,000) / 5$	$(85,000) / 5$
	= 19,000	= 17,000

Profit before depreciation

	Project A	project B
1	20,000 + 19,000 = 39,000	(20,000) + 17,000 = (3000)
2	25,000 + 19,000 = 44 000	30,000 + 17,000 = 47,000
3	30,000 + 19,000 = 49,000	30,000 + 17,000 = 47,000
4	35,000 + 19,000 = 54,000	30,000 + 17,000 = 47,000
5	40,000 + 19,000 = 59,000	45,000 + 17,000 = 62,000

PAY BACK PERIOD

	Project A			Project B	
	Year	Cash flow	Balance	Cash flow	Balance
Initial cost	0	(105,000)	(105,000)	(85,000)	(85,000)
Profits	1	39,000	(66,000)	(3000)	(88,000)
	2	44,000	(22,000)	47,000	(41,000)
	3	49,000	27,000	47,000	6,000
	4	54,000	81,000	47,000	53,000
	5	59,000	140,000	62,000	115,000
Pay back	project A 2years and 22/ 49 2.45 years			Project B 2years and 41/ 47 2.87years	

NET PRESENT VALUE

Project A

	0	1	2	3	4	5
Cost	(105,000)					
Profit before dep		39,000	44,000	49,000	54,000	59,000
Residual value	-	-	-	-	-	5,000
Net cash flow	(105,000)	39,000	44,000	49,000	54,000	64,000
DF 10%	1	0.909	0.816	0.757	0.683	0.621
PV	(105,000)	35,451	36,344	36,799	36,882	39,744
NPV		80,200				

Project B

	0	1	2	3	4	5
Cost	(85,000)					
Profit before depreciation		(3000)	47,000	47,000	47,000	62,000
DF 10%	1	0.909	0.826	0.751	0.683	0.621
PV	(85,000)	(2727)	38822	35297	11611	38502
NPV		36,505				

Summary result of above Appraisal methods:

	Project A	project B	decision
ARR	57.14%	54.1%	project A
Pay back	2.45 years	2.87 years	project A
NPV	80,200	36,505	project A

b) Internal sources

- i) Sale of assets which are currently not being used in the company
- ii) Sale of assets which are currently being used and then leasing them back from the buyer
- ii) Use of retained earnings

TWO BENEFITS

- i) Retained earnings has no immediate cost except the impact on shareholders if the dividends are affected
- ii) Sale of assets which are not being utilized will release funds which are currently tied up in fixed assets.

SOLUTION TWO

a)

1. Cost of equity

$$B_a = B_e \times V_e / V_e + V_d(1-t)$$

$$0.89 = B_e \times 0.75 / 0.75 + 0.25(0.7)$$

$$B_e = 1.1$$

$$K_e = 6.2\% + 1.1(8\%) = 15\%$$

2. Cost of debt = $11.5\% \times (1 - 0.3) = 8.1\%$

3. WACC = $15\% \times 0.75 + 8.1\% \times 0.25 = 13.3\%$ say 13%

b)

1. Using the Discounted cash flow method

Year	1	2	3	4
	K'm	K'm	K'm	K'm
Earnings before tax	75.3	78.1	81.2	84.5
Taxation @30%	<u>(22.59)</u>	<u>(23.43)</u>	<u>(24.36)</u>	<u>25.35)</u>
Net cash flow	52.71	54.67	56.84	59.15
Discount@13%	<u>0.885</u>	<u>0.783</u>	<u>0.693</u>	<u>0.613</u>
Present value	46.65	42.81	39.39	36.26

Total PV for 1-4 year = **K165.11million**

Cash flow beyond yr 4 = $59.15(1.05) / 0.15 - 0.05 = K621.1\text{million} \times 0.613$

= K380.7million

Total value of Company = K545.8million

Value per share = $K545.8\text{m} / 100\text{m} = K5.5$ per share

Workings

1. Using the dividend valuation method

$$P_0 = K0.5 (1.045) / 0.15 - 0.045 = K5 \text{ per share}$$

The range is from K5 per share to K5.5 per share

- c) Ratio analysis is a useful technique in assessing the performance of a company. This information is required by company stakeholders such as investors, suppliers, management, and financial institutions e.t.c. Financial ratios can also be used to assess the risk factor involved for an investor and to predict the bankruptcy of a company. The liquidity and gearing ratios for example could be used for assessing whether the company is going through a financial distress. These ratios are assumed to be of greater importance in assessing if a business can pay back debt. The analysis that an investor gets from these ratios affect the decision making of their investment into any business.

Although ratio analysis can be a very useful technique, it has limitations.

- i) Meaningful information is derived from ratio analysis by comparing ratios over time within the same business to assess whether a business is improving or declining or similar businesses (industrial average). However, comparable information may not be available. Sometimes industrial averages are used, which may hide wide variations in figures.
- ii) Ratio analysis is normally based on the financial statements which are historical such that the information becomes out of date if the business has recently undergone substantial changes.
- iii) Basing the decisions solely on ratio analysis can be catastrophic because there other items of information that are not contained in the financial statements.

SOLUTION THREE

NPV at 10%

Year			DF (10%)	PV
0	market price	(70)	1	(70)
1 – 5	interest (5% x K 100)	5	3.791	19
5	redemption	90	0.621	56
		NPV		5

NPV at 15%

Year				DF (15%)	PV
0	market price	(70)		1	(70)
1 -5	interest	5		3.352	16.76
5	redemption	90		0.497	44.73
				NPV	(8.51)

$$\begin{aligned} \text{IRR} &= 10\% + 5 / (5 + 8.51) \times (15 - 10 \%) \\ &= 10 + 5 / 13.51 \times 5 \\ &= 11.9 \% \end{aligned}$$

WACC

Source	market value	cost	cost x market value
Ordinary shares	8,000	0.12	960
Preference shares	17,500	0.14	2,450
Debentures	700	0.119	83.3
	26,200		3,493.3

$$\text{WACC} = 3,493.3 / 26,200 \times 100\% = 13.3 \%$$

THREE FORMS OF MARKET EFFICIENCY

Weak form

Under the weak form, share prices reflect all available information about past changes in share prices

Semi strong form

Under this form share prices reflect;

- All relevant information about past price movements and their implications and
- All knowledge which is available publicly

Strong form

Share prices reflect all information whether publicly available or not:

- From past price changes

- From public knowledge or anticipation
- From specialists `insider knowledge

NON FINANCIAL OBJECTIVES

- Customer satisfaction
- Welfare of employees
- Welfare of management
- Provision of good quality service
- Responsibility to suppliers

SOLUTION FOUR

(a)

Matching of funding

A general principle of financing is that the funding term should match the asset life. Therefore, Non-current assets should normally be financed using long-term sources of funds.

Possible finance sources

The finance needs of SMEs will vary, with the size and type of non-current assets, ranging from photocopiers to new buildings, and therefore the relative amount of funds required, and the most appropriate form of funding will also vary. However, the following sources of finance could be considered by a small business.

(i) Retained earnings

Relatively small asset purchases, such as a new computer, can often be financed using cash arising from retentions, and thus no additional external funds will be required.

(ii) Leasing and hire purchase

These can also be considered for smaller assets. They can be used to spread the cost of the asset over its useful life. The types of asset finance available include:

- **Operating leases** - these are generally for a period less than the economic life of the asset. The risks and rewards of ownership remain with the lessor. However, in areas where there is a fast rate of technological change, such as computers, they have the advantage of giving flexibility to the lessee.
- **Finance leases** - these generally cover the whole economic life of the asset, and the risks and rewards of ownership are transferred to the lessee.
- **Hire purchase** - this is a form of installment credit, whereby the ownership of the goods passes to the customer on payment of the final credit installment.

(iii) Secured loan

Depending on the nature of the asset, it may be possible to obtain a secured bank loan (either medium or long-term) against an existing or the asset being purchased. Loans from the Citizen Economic Empowerment Commission (CEEC) are an example of a

government initiative to help small businesses. The CEEC finances non-current assets based on viable business proposals.

(iv) Mortgage finance

This may be appropriate if the assets being acquired are land or buildings.

(v) Grants

A grant is a sum of money given to an individual or business for a specific project or purpose. A grant usually covers only part of the total costs involved. Grants to help with business development may be available from a variety of non-governmental organisations involved in business development, such as regional development agencies and some charitable organisations. These grants may be linked to business activity or a specific industry sectors such as agriculture or youth or women empowerment.

(vi) Venture capital

This form of finance may be appropriate for larger and established SMEs to finance expansion of their businesses and entry into new markets. Venture capital is essentially risk capital, and has the advantage that new equity funds are provided, generally for a restricted time period at the end of which the investor will seek an exit from the business. The benefit of this is that in the longer term the ownership structure of the business is unchanged.

(vii) Business angels

The company may have difficulty in obtaining equity finance, because of liquidity problems or because shareholders will find it difficult to sell their shares. SMEs may therefore grow by getting financing in form of either equity or debt from wealth family members, friends and individuals.

(b) (i)

	K' million
Parent holding(investment) at fair value	78
NCI value at acquisition (20%x 85m)	17
	95
Less: fair value of net assets at acquisition	(85)
Goodwill on acquisition	10

(b)(ii)

	K 'million
Parent holding(investment) at fair value	78
NCI value at acquisition	19
	97
Less: fair value of net assets at acquisition	(85)
Goodwill on acquisition	12

(c)

Potential benefits would include:

Share transferability

As a listed company, its shares would be more liquid and therefore easier to transfer, which can facilitate Investment in the company.

Cost of capital

Shares in listed companies are perceived to be less risky than those in unlisted companies due to their marketability. This lower risk means that the returns required by shareholders will also be lower. As a result, the cost of capital for the listed company may be lower.

Company profile

Companies which are listed on a stock exchange have a higher profile among investors and the wider business community than unlisted companies. This higher profile may help to establish new contacts or to develop business opportunities.

Credit rating

A listed company would usually be viewed by the business community as being more creditworthy than an equivalent unlisted company. This may make it easier for the listed company to obtain loans or finance its expansion.

Share price

Shares that are traded on a stock exchange are closely scrutinized by investors who look at all the available information when assessing their worth. This results in efficiently priced shares, which will give confidence to investors when buying or selling shares.

Possible disadvantages would include:

Initial cost

The costs of floating a company on a stock exchange can be high. There will be fees paid to professional advisers, such as lawyers and accountants, and also underwriting fees which can often account for a large percentage of the total cost incurred.

Regulatory cost

After the initial listing, there are ongoing regulatory requirements that listed companies have to meet. Many of these regulations are there to ensure greater transparency of the company to its shareholders and this causes some of these additional costs.

Control

To obtain a stock exchange listing, a company must normally make a substantial amount of its share capital available to new investors. This would mean a loss of control for the existing shareholders of Post Microfinance Ltd.

Public scrutiny

Listed companies attract attention from investors and the media, which is rarely given to unlisted companies. Any negative press may have adverse effects on the company. Director decisions may also be heavily scrutinized and questioned by outsiders.

Takeover target

The existence of a public market for a company's shares means that a listed company is much more vulnerable to takeover than an unlisted company. This is particularly the case where there has been a fall in the share price and the shareholders are unhappy with the current level of returns.

END OF SOLUTION