

# The introduction of mamee double decker



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Mamee-Double Decker (M) Berhad is a unique brand of good taste and fine quality. The company is recently listed in the Kuala Lumpur Stock Exchange (KLSE). The company manufactures many products which are Mamee Monster, Mamee Instant and Sllrrrp Noodles, Mister Potato Chips, Mister Potato Crisps and so on. All these products are already household names.

The most famous product of the company is Mamee Monster. Mamee Monster is something like noodles with a pack of seasoning powder. This product consists of two flavours which are chicken and barbeque. Besides these two flavours, there is another new flavor like satay flavor. Between these three flavours, barbeque is the tastiest and many kids like it including us. Mamee Monster consists of jumbo pack; the jumbo packs are a new product and it includes two flavours like barbeque and the new one- curry flavour. These two flavours can stimulate our taste buds.

Besides this honored, the company also promotes a new product which is Mister Potato Rice Crisps. This new product can compete with other brands as well like Jacker and Pringles. Why do I say so? It is because this Mister Potato Rice Crisps is low fat and healthier compared with other potato chips. Jacker is good taste but salty and same goes to Pringles. This new product consists of four flavours such as, original, flame grilled bbq, hot and spicy as well as sour cream and onion. For people who like chili can try hot and spicy flavor. For those who do not like heavy flavour can try original flavour.

In addition, Mamee-Double Decker (M) Berhad also has a product which is instant noodles-Mamee Sllrrrp. For these instant noodles have a variety of

flavours such as ayam kampung, asam laksa, kari berapi and kari extra pedas. Any of the flavours will make people sllrrrp, sllrrp, sllrrrp when eating.

Overall, Mamee-Double Decker (M) Berhad is a good quality brand and no doubt it can win the heart of the public range from kids and adults to old folks. This company is a very successful company and earns much profit from previous until now.

## **Mamee Lekor**

After a thorough consideration, we as Mamee-Double Decker (M) Berhad's corporate finance advisors had decided to increase their shareholders' wealth by introducing a new product – keropok lekor. What is keropok lekor? This is it.

The easiest way to describe Keropok Lekor is to call it as fish sausage. Its main ingredients are fish (Ikan Parang/Kembong/Selayang), sago flour, salt and water. We named our new product (keropok lekor) as Mamee Lekor. It can be served in crispy type or soft chewy type according to preferences. D: New folderMmuGamma 1st SemBBF 2124 FM 2keropok\_lekor. jpgD: New folderMmuGamma 1st SemBBF 2124 FM 211. jpg

Keropok lekor is originated from Kuala Terengganu, Malaysia and it is a popular and most visible fried snack in Terengganu. Lots of local there know how to make this keropok lekor. Therefore, there are many stalls in Malaysia that sells keropok lekor. However, there is none in hypermarket, cinemas and petrol station. This keropok lekor become very popular that we can find it in other states of Malaysia such as Johor and Melaka. Perhaps, we could

not find this type of snacks in country other than Malaysia because keropok lekor is a local Malay delicacy and specialty of Malaysia.

Mamee-Double Decker (M) Berhad introduces Mamee Lekor in two forms. First, the mini ball sized fried keropok lekor which packaging in a small plastic bag like Mamee Monster. Another one is raw keropok lekor. D: New folderMmuGamma 1st SemBBF 2124 FM 2keropak\_lekor. jpg

The fried keropok lekor in mini packing contains 10 mini balls of keropok lekor which sells RM1. 50 per pack. The above picture is for illustration purpose only. To be more attractive, we will shape it into mini balls to attract customers. We also produce raw keropok lekor in 700g per pack which sells at RM10. This fried mini keropok lekor will expire in 4 to 5 days after production. How we are going to handle this situation? We will follow the Gardenia's distribution strategy. We will send our workers to send new keropok lekor and collect back the expired one. Our workers are going to the retail store and supermarkets to send and collect Mamee Lekor 2 times per week. This is to ensure that our products are fresh before reaches to our customers and consumers.

Also, we produce raw keropok lekor to fulfill some households' demands. They can cut it into the thickness they prefer and fry or steam it. The main difference between the raw and ready fried mini packed keropok lekor is that the raw keropok lekor can keep for longer period. On the other hand, the ready fried mini packed keropok lekor can only last within 5 days. Some household may buy the raw keropok lekor and kept in their freezer and fried it whenever they want to eat. Since raw keropok lekor can be kept in a long

period which is around one year, we plan to export it to other countries. We plan to export 700g of raw keropok lekor per pack to other countries selling at RM12 each. The selling price is slightly higher than in Malaysia because it already included the cost that related to export activities. We decided to export to Australia, Hong Kong and Singapore. We export more to Australia because it is the largest and fastest growing export market compared to other countries. It has highest export rate of snack and confectionary from Mamee-Double Decker. We also export to Singapore and Hong Kong because we want to introduce Mamee Lekor to Western and Asian countries as well.

Why we produce keropok lekor? This is because it is a local traditional delicacy which not available in other countries. It is a specialty to foreigners because their countries do not have this food. So, we can monopolize Mamee Lekor in other countries. Besides, according to research, Mamee Double-Decker (M) Berhad 's snacks and confectionery occupied the highest demand compared to other catrgories. So we produce Mamee Lekor which is a kind of snacks to boost the demand.

We will start our project by reaching out the children because no children dislike snacks and they like to try on new things. So, we decided to distribute Mamee Lekor to school canteens. It is packed in a mini package same as Mamee Monster. It is cute and can attract children to try it. It is also convenient to consume. Moreover, in order to expand new market, we will distribute our Mamee Lekor to all cinemas such as Golden Screen Cinemas and MBO Cinemas. Most of the people will carry a packet of snacks or a big box of popcorn into the theatre. As our Mamee Lekor is also a kind of snacks, we believe that the demand will be higher in cinemas. Also, Mamee Lekor

can be a substitute good for those who do not like popcorn or other snacks for health conscious.

As Our Mamee Lekor is made from fish and fried with unsaturated oil, it is high protein, monosodium glutamate (MSG)-free and less oily. Why we want to promote healthy lifestyle? It is to follow Mamee-Double Decker (M) Berhad's step. The company wants to produce products that are MSG-free, artificial colouring-free and oil-free. We produce keropok lekor in a healthy way to help consumers to consume without worries while maintaining a balance and healthy lifestyle.

## **Initial Investment**

When we wanted to produce the Keropok Lekor, we used 3 types of machine like cartridge system, frying machine and packaging machine. The machines and the usages are shown below:

Cartridge system is used to blend the filled up fish with some ingredients. This machine is the key in making Keropok Lekor and was the first step to produce the better product. The retail price of this type of machine is RM 15,000 each. It is a franchised system, so the price is fixed. We prepare keropok lekor from fish meat grounded with sago and salt; these are then rolled and made into the shape of long tubes similar to sausages by this machine. C: UsersPublicPicturesSample Picturesmoto\_0117. jpg

The frying machine is used to fry Keropok Lekor after it was shaped into mini size by our labours. This machine has many functions such as continuous fines removal for increased oil life and automatic oil level control. It is easy to clean. Its superior oil temperature control helps to maintain fryer quality <https://assignbuster.com/the-introduction-of-mamee-double-decker/>

stability. The cost of purchasing the machine is RM 6, 000 each. [http://img.diytrade.com/cdimg/432764/3809036/0/1181816403/Gas\\_Frying\\_Machine.jpg](http://img.diytrade.com/cdimg/432764/3809036/0/1181816403/Gas_Frying_Machine.jpg)  
[http://i03.i.aliimg.com/photo/104903103/Horizontal\\_Packaging\\_Machine\\_v0.jpg](http://i03.i.aliimg.com/photo/104903103/Horizontal_Packaging_Machine_v0.jpg)

As shown the horizontal packaging machine. After the Keropok Lekor had been steam and fried, the packaging and leballing process happen. It is to keep keropok lekor last longer and maintain the taste. This machine costs RM 13, 000 each.

How many factories we have? We are going share some spaces in the existing Mamee-Double Decker factories rather than building extra factories. We choose to share capacity with factories in Selangor, Perak, Johor and Sarawak. This is the strategic location as we can cater the demands of North, East, West, and South of Malaysia.

There are 2 cartridge system, 2 frying machines and 1 packaging machine in each factory. We use 2 cartridge machine because one machine is not big enough to blend big amount of filled fish and other ingredient. When we use two of them together, the maintenance cost will become lower when some of the parts broken. Timing on processing will also reduce 20% compare to big cartridge machine. Other than that, we use 2 frying machines because we need to save cost especially in introducing the new product. The bigger and more technologically advance machine will cost higher. So we use 2 cartridge system and frying machine instead of the sophisticated one. The machines we use are expected to be able to serve large amount of production. Lastly, for an newly introduced project, we expect that 1

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packaging machine is enough to cater our production. It produces around 70 to 100 packs of keropok lekor per hour. With one packaging machine only, we can save our budget and consume less space.

We are going to promote our new product by advertising on The Star[1]newspaper. Why we choose to advertise on The Star rather than other newspapers? According to Audit Bureau of Circulations from 1 July 2008 to 30 June 2009, The Star newspaper is the most famous newspaper in Malaysia in term of readership. It has between 290, 000 to 300, 000 readers. Moreover, The Star newspaper is an English-language newspaper which is readable for all races, for instance Malays, Chinese, Indian and others, in Malaysia.

Additionally, we need to buy new vans to implement our distribution network strategy. Each second hand van would cost us RM 80, 000 each. We plan to buy 2 vans for each factory. We will hire driver to run our distribution network to distribute and collect back our keropok lekor.

## **Year 1**

In first year, we expect to sell 1, 200 packs of Mini ball keropok lekor and raw keropok lekor each day. That means each factory has to produce 300 packs of Mini keropok lekor and raw keropok lekor respectively.

Total quantity produce of mini and raw keropok lekor = 300 packs per day x 4 factories x 30 days per month x 12 months per year = 432, 000 packs repectively.

Sales



Mini keropok lekor

Raw keropok lekor

Cash inflow in year 1

Unit selling price

RM 1. 50

RM 10. 00

Quantity produce

432, 000

432, 000

Sales volume

RM 648, 000

RM 4, 320, 000

**RM 4, 968, 000**

The main ingredients of keropok lekor are ikan parang/kembong/selayang, sago flour, salt and water. The ingredient costs of mini and raw keropok lekor are RM 0. 80 and RM 5. 00 each while the packaging costs are RM 0. 20 and RM 0. 10 respectively. Packaging cost of mini keropok lekor is higher than raw keropok lekor because the packaging design will be more colourful and attractive. Also, we need labours to help us shape mini keropok lekor and fry it. Each labour cost is RM 800 per month. Each driver will have to travel 2

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times per week to distribute and collect mini keropok lekor. Each trip will cost RM 150 including petrol cost. So, each driver costs us RM 150 x 2 times per week x 4 times per month x 12 months x 4 factories = RM 57, 600.

### Costs

Mini keropok lekor

Raw keropok lekor

Ingredient + packaging

$(RM0.80 + RM0.20) \times 432,000 = RM 432,000$

$(RM5 + RM0.10) \times 432,000$

= RM 2, 203, 200

Labor

6 labours X RM 800 X 12 months x 4 factories = RM 230, 400

Driver

2 drivers x RM 57, 600 = RM 115, 200

Cash outflow

$(RM 432,000 + RM 2,203,200 + RM 230,400 + RM 115,200) = RM 2,980,800$

Net operating cash flow in year 1 = RM 4, 968, 000 – RM 2, 980, 800

**= RM 1, 987, 200**

## **Year 2**

Year 2, we estimate that our production will increase 5% as demand increases. Since first year's production is 864, 000 units (432, 000 units for mini and raw keropok lekor respectively), year 2 our productions will be 907, 200 units (864, 000 + 5%). That means production for each type is 453, 600 units.

Besides, as Mamee Double-Decker (M) Berhad generated about 30% of its sales from the export markets which cover more than 80 countries across all continents, we plan to expand market and export raw keropok lekor to other countries. Each pack of raw keropok lekor, we will charge RM 12 which slightly higher than RM 10 to cover any expenses incur in export activities. In this year, we will export 100, 000 units to Australia, 60, 000 units to Hong Kong and 36, 000 units to Singapore. In other words, we will export 25000, 15000 and 9000 units to these 3 countries in every 3 months.

Why do we export more products to Australia? As Australia is the largest and fastest growing export market which contributed 18% of the total export sales in financial year 2009, we decided to export more products to the country. Other than Western country, we also export to Asian country such as Hong Kong. It not only helps to expand our market, but also introduce keropok lekor such a traditional cuisine to both Western and Asian countries. Besides, Singapore is our neighbour country and knows our cultures more as well as it contributed 9% of total export, so we choose to export to Singapore rather than other countries.

Sales

Mini keropok lekor

Raw keropok lekor

Export raw keropok lekor

Cash inflow in year 2

Unit selling price

RM 1. 50

RM 10. 00

RM 12. 00

Quantity produce

453, 600

453, 600

196, 000

Sales volume

RM 680, 400

RM 4, 536, 000

RM 2, 352, 000

**RM 7, 568, 400**

Due to increase in production, we have to add in additional 2 labours, 1 driver, 1 cartridge system, 1 packaging machine and 1 frying machine in each factory.

## Costs

Mini keropok lekor

Raw keropok lekor

Export (raw keropok lekor

Ingredient + packaging

 $(RM0.80 + RM0.20) \times 453,600$ 

= RM 453, 600

 $(RM5 + RM0.10) \times 453,600$ 

= RM 2, 313, 360

 $(RM7 + RM0.10) \times$ 

196, 000

= RM 1, 391, 600

## Labor

8 labours X RM 800 X 12 months x 4 factories = RM 307, 200

Driver

3 drivers x RM 57, 600 = RM 172, 800

Cartridge system

RM 15, 000 x 1 unit x 4 factories = RM 60, 000

Packing machine

RM 13, 000 x 1 unit x 4 factories = RM 52, 000

Frying machine

RM 6, 000 x 1 unit x 4 factories = RM 24, 000

Cash outflow

RM 453, 600+ RM 2, 313, 360+ RM 1, 391, 600+ RM 307, 200+ RM 172, 800+ RM 60, 000+ RM 52, 000+ RM 24, 000 = RM 4, 774, 560

Net operating cash flow in year 2 = RM 7, 568, 400 – RM 4, 774, 560

**= RM 2, 793, 840**

### **Year 3**

We estimate that our sales in this year keep increasing and probably reach maturity. Our expected production excluding export will increase from 907, 200 to 950, 400 units which increases around 5 % of year 2's production. In other words, production for mini and raw keropok lekor is 475, 200 units respectively.

Additionally, we expect export rate of keropok lekor will increase 4 %, which is from 196, 000 to 204, 000 units. In this year, we have to add in more technologically advance machine to cater the increase in production. We will purchase more innovative cartridge system, packing machine and frying machine to improve productivity. We also hire 2 more labours and 1 more driver to help us run our business smoother. The additional driver can help us widen our distribution network to other places. We expect that the cost of labour will become slightly higher which is from RM 800 to RM900. It is to increase their motivation to work and maybe due to inflation.

Sales

Mini keropok lekor

Raw keropok lekor

Export raw keropok lekor

Cash inflow in year 3

Unit selling price

RM 1. 50

RM 10. 00

RM 12. 00

Quantity produce

475, 200

475, 200

204, 000

Sales volume

RM 712, 800

RM 4, 752, 000

RM 2, 448, 000

**RM 7, 912, 800**

Costs

Mini keropok lekor

Raw keropok lekor

Export (raw keropok lekor

Ingredient + packaging

$(RM0.80 + RM0.20) \times 475,200$

= RM 475, 200

$(RM5 + RM0.10) \times 475,200$

= RM 2, 423, 520

$(RM7 + RM0.10) \times$

204, 000



= RM 1, 448, 400

Labor

10 labours X RM 900 X 12 months x 4 factories = RM 432, 000

Driver

4 drivers x RM 57, 600 = RM 230, 400

Cartridge system

RM 20, 000 x 1 unit x 4 factories = RM 80, 000

Packing machine

RM 20, 000 x 1 unit x 4 factories = RM 80, 000

Frying machine

RM 10, 000 x 1 unit x 4 factories = RM 40, 000

Cash outflow

RM 475, 200+ RM 2, 423, 520+ RM 1, 448, 400+ RM 432, 000+ RM 230, 400+ RM 80, 000+ RM 80, 000+ RM 40, 000 = RM 5, 209, 520

Net operating cash flow in year 3 = RM 7, 912, 800 – RM 5, 209, 520

**= RM 2, 703, 280**

This year, although expected sales increases, net operating cash flow decreases. This is because we plan to do expansion by adding more

technologically advance machines. This is logic as whenever a firm manages to cover up their initial investment, what they might do is to do expansion.

## **Year 4**

Out of expectation, probably the demand for our keropok lekor might go down. Perhaps there is new competitors exist in market. Who knows they envy of our high sales volume and might want to compete with us? With our 3 years brand recognition, perhaps our sales would not drop too badly. So, our expected production will be 920, 000 units which are 3% less than previous year. Production of mini and raw keropok lekor will be 460, 000 units respectively. As production decreases, we do not have to hire much driver for distribution network. We will cut down 1 driver to cut expense of RM 57, 600. However, we will remain our existing labours. As we believe that, whenever there is an obstacle, we will find out a way to curb it and boost future sales as well as production. Thus, we do not want to loss any well- trained and loyal labour. Still, in order to handle any possible changes in future, we have a pessimistic view that the cost of ingredient will increase. We predict that the unit cost of mini keropok lekor will increase from RM0. 80 to RM0. 90 while raw keropok lekor will increase from RM5 to RM 5. 50.

On the other hand, our export rate will keep on increasing. We expect our production will be 210, 000 units which is 3% higher than in year 3. Why do we forecast that the export rate will increase? Why not decrease? Because, even if foreign competitor wants to compete with us, they might need some times to figure out how to produce such a Malay local cuisine which is available in Malaysia only. This is our local special food, so of course there is some “ recipe” that other countries do not know. Also, since there is a

decrease in Malaysia's sales and an increase of export rate, we do not have to add in any new machine.

Sales

Mini keropok lekor

Raw keropok lekor

Export raw keropok lekor

Cash inflow in year 4

Unit selling price

RM 1. 50

RM 10. 00

RM 12. 00

Quantity produce

460, 000

460, 000

210, 000

Sales volume

RM 690, 000

RM 4, 600, 000

RM 2, 520, 000

**RM 7, 810, 000**

Costs

Mini keropok lekor

Raw keropok lekor

Export (raw keropok lekor

Ingredient + packaging

$(RM0.90 + RM0.20) \times 460,000$

= RM 506, 000

$(RM5.50 + RM0.10) \times 460,000$

= RM 2, 576, 000

$(RM7.50 + RM0.10) \times$

210, 000

= RM 1, 596, 000

Labor

10 labours X RM 900 X 12 months x 4 factories = RM 432, 000

Driver

3 drivers x RM 57, 600 = RM 172, 800

Cash outflow

RM 506, 000 + RM 2, 576, 000 + RM 1, 596, 000 + RM 432, 000 + RM 172, 800 = RM 5, 282, 800

Net operating cash flow in year 4 = RM 7, 810, 000 – RM 5, 282, 800

**= RM 2, 527, 200**

### **Year 5**

Assume that there is a drop in sales, of course we will take some actions to increase the sales back. In this year, we plan to open kiosk in hypermarket. Together there will be one kiosk in Melaka, Kuala Lumpur, Penang and Johor Bahru respectively. Rental of each kiosk is expected to be RM 800. We will hire 2 workers to help us operate the kiosk. Since we sell freshly cooked keropok lekor on the spot, we will need to purchase one frying machine for each kiosk. We also need some budgets for setup cost.

With the above strategy, we believe that we able to boost our sales for at least 2%. Our expected production will be 940, 000 units which is 470, 000 units for each type of keropok lekor. Furthermore, we predict that our export rate of keropok lekor will grow at a decreasing rate which is 1% only. Our expected export rate will be 212, 000 units. We are going to hire 2 more labours to help us to run our business to avoid supply shortage and to employ any future strategy. We need 1 more driver to widen our distribution network, and send raw keropok lekor to our kiosk to ensure there is no shortage problem. No additional machine is required as we already added in technologically advance machines in previous year which able to cater higher production.

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Sales

Mini keropok lekor

Raw keropok lekor

Export raw keropok lekor

Cash inflow in year 5

Unit selling price

RM 1. 50

RM 10. 00

RM 12. 00

Quantity produce

470, 000

470, 000

212, 000

Sales volume

RM 705, 000

RM 4, 700, 000

RM 2, 544, 000

**RM 7, 949, 000**

## Costs

Mini keropok lekor

Raw keropok lekor

Export (raw keropok lekor

Ingredient + packaging

 $(RM0.90 + RM0.20) \times 470,000$ 

= RM 517, 000

 $(RM5.50 + RM0.10) \times 470,000$ 

= RM 2, 632, 000

 $(RM7.50 + RM0.10) \times$ 

212, 000

= RM 1, 611, 200

Labor

12 labours X RM 900 X 12 months x 4 factories = RM 518, 400

Driver

4 drivers x RM 57, 600 = RM 230, 400

4 Kiosk Expenses

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## Calculations

Total

Rental

RM 800 x 4 kiosks x 12months

RM 38, 400

Workers

RM 800 x 2workers x 4 kiosks x 12 months

RM 76, 800

Frying machine

RM 3000 x 4 kiosks

RM 12, 000

Setup

RM 1, 500 x 4 kioks

RM 6, 000

Total expenses for kiosks

RM 133, 200

Cash outflow in year 5



RM 517, 000 + RM 2, 632, 000 + RM 1, 611, 200 + RM 518, 400 + RM 230, 400 + RM 133, 200 = RM 5, 642, 200

Net Operating cash flow in year 5 = RM 7, 949, 000 – RM 5, 642, 200

**= RM 2, 306, 800**

Although expected sales increases, net operating cash flow slightly decreases, it is due to the investment in kiosks. Yet, we believe that next year's sales and net operating cash flow will increase simultaneously.

RM 1, 987, 200 RM 2, 793, 840 RM 2, 703, 280 RM 2, 527, 200 RM 2, 306, 800

o 1 2 3 4 5 year

RM 1, 140, 000

The time line above depicts the conventional cash flow of our project. There is only one cash outflow for initial investment in year 0. From year 2 to 5, there is positive net operating cash flow. The net cash flow rises from year 1 to 2 because we export raw keropok lekor to other countries and increase revenues. In year 3, the sales keep on increasing but net cash flows drop as we do expansion by purchasing additional machines for technology advancement. During year 4, we predict that there will be new competitors exist to compete with us. Our sales drop slightly but net cash flow increases, because we try to cut cost and do not need to add in new capital. The next year, we employ a new strategy which is to open kiosk in hypermarket to sell freshly fried keropok lekor. We predict that our sales will increase slightly. But why net cash flow descend? Because we need some costs on operating

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the kioks. In short, our net cash flow throughout the year is up and down, but we manage to keep it at positive level. From other point of view, there will be up and down, because when any unfavourable things incur, we try to solve it and up the net cash flow again.

## **Cost of Capital**

The cost of capital acts as a link between Mamee Double-Decker (M) Berhad's long term investment decisions (keropak lekor project) and the wealth of their owners as determined by investors in the marketplace. It is the "magic number" that is used to decide whether a proposed investment will increase or decrease the firm's stock price. The cost of capital is the rate of return that Mamee Double-Decker (M) Berhad must earn on the keropak lekor project in which it invests to maintain the market value of its stock.

In this project, we will use Mamee Double-Decker (M) Berhad's retained earnings to cover our new project. Cost of retained earnings is a cost of internally generated funds. It is an imputed or opportunity cost or the dividends given up by the common stockholders. It is the rate that investors can earn elsewhere on investments of comparable risk.

Why we choose to use cost of retained earnings rather than issuing new shares or bonds? The main reason is that we notice Mamee Double-Decker (M) Berhad is proposing share buy-back. According to research, they plan to buy back the shares by using their retained earnings. So, why do we still want to use its retained earnings to support our new project? This is because we cannot issue additional shares or bonds to raise capital. Mamee Double-Decker (M) Berhad proposed share buy-back is to reduce number of shares

outstanding and increase their share price. So, we do not want to do the opposite way. Moreover, Mamee Double-Decker (M) Berhad is very strong. It holds RM 43, 457, 000 cash, deposit and bank balances without borrowing any long term debt. It finances itself with cash only. That is why we do not want to raise capital by issuing bond which is a type of long term debt.

Although tax is deductible when we issue bonds/debts/loans, we do not want to break the rules and rise their financial risk. They do not finance themselves with any debt, perhaps they want to reduce their risk for no need to pay out coupon payment and principal to their debtors.

Besides, we choose to raise capital by using retained earnings because our initial investment only takes 9% of their overall retaining earnings. Their retained earnings in financial year 2009 are RM 83, 977, 000 while our initial investment is RM 1, 140, 000. Our payback period shows that we could cover it up within 1 year. Yet, without being over optimistic, there is always something unfavourable happen, so we predict that we could cover up the initial investment within 2 years.

### **Cost of retained earnings= $D1 / P0 + g$**

The dividend per share from year 2000 to 2009 is shown below:

Year

Dividend per share

Year

Dividend per share

2000

5. 5 cents

2005

14 cents

2001

5. 5 cents

2006

20 cents

2002

5. 5 cents

2007

25 cents

2003

6. 0 cents

2008

5 cents

2004

10 cents

2009

7 cents

Input

Function

-5.5

PV

7.0

FV

9

N

Growth of dividends

= 2.71% (by using financial calculator)

According to Bloomberg Businessweek[2], expected dividend in 2010 is RM 0.10 while share price of Mamee Double-Decker (M) Berhad is RM 3.70.

$$\text{Cost of retained earnings} = (\text{RM } 0.10 / \text{RM } 3.70) + 2.71\% \\ = 5.41\%$$

In short, our cost of raising capital by using Mamee Double-Decker (M) Berhad's retained earnings is 5.41%. The cost of capital will be applied when calculating NPV of the company.

## Payback Period

Payback period can be defined as the amount of time required for a firm to recover its initial investment in a project, as calculated from cash flow.

Payback period which also calculated as:

$$\text{Payback period} = \text{RM } 1,140,000 / \text{RM } 1,987,000$$

$$= 0.57 \text{ years}$$

Basically, payback period is used by small firms to evaluate most projects or small projects in larger firms. The computation is simple and easy to apply.

By measuring how quickly the firms get to recover from its initial investment, payback period gives implicit consideration to the timing of cash flows. Many firms use payback period as a decision criterion to other decision as it can be viewed as a measure of risk exposure. The longer the firm must wait to recover its invested fund, the greater the possibility of a calamity. So, the shorter the payback period, the lower the firm's exposure to such risk.

Payback period cannot be specified in light of wealth maximization goal because it is not based on discounting cash flows to determine whether they add to the firm's value. Payback period is viewed as an unsophisticated

capital budgeting technique because it does not explicitly consider the time value of money.

The calculation above shows that payback period for our new project is one year. Why is it so short? It is because our cash inflow in year 1 which is RM 1, 987, 200 is higher than the initial investment which is RM1, 140, 000. So, we get to cover back our initial investment and have an extra of RM 847, 200 of revenue in year one. We should be glad that we able to pay back the initial investment within one year but please do not forget that it does ignore the time value of money.

In finance, we always mention time value of money. But, do we really know what does it mean? Well,