



**TECHNICAL UNIVERSITY OF MOMBASA**  
***Faculty of Business and Social Studies***

DEPARTMENT OF BUSINESS STUDIES

UNIVERSITY EXAMINATIONS FOR DEGREE IN  
BACHELOR OF BUSINESS ADMINISTRATION  
BACHELOR OF COMMERCE

**BFI 4301: FINANCIAL MANAGEMENT**

SPECIAL/SUPPLEMENTARY EXAMINATIONS

**SERIES: FEBRUARY 2015**

**TIME: 2 HOURS**

**INSTRUCTIONS:**

- Answer Question **ONE (Compulsory)** and any other **TWO** questions.
- Do not write on the question paper

***This paper consists of Three printed pages***

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**QUESTION 1 (Compulsory)**

- a) What is Financial Management? **(3 marks)**
- b) Distinguish between profit maximization and wealth maximization. **(5 marks)**
- c) Within a business finance context, discuss the problems that might exist in the relationships (sometimes referred to as agency relationships)  
Between:
  - i) Shareholders and government. **(3 marks)**
  - ii) Shareholders and Auditors. **(3 marks)**
- d) Discuss any **THREE** methods/models of computing cost of capital. **(6 marks)**

e) The following is the capital structure of XYZ Ltd as at 31<sup>st</sup> December 2013.

	Sh. (Millions)
Ordinary share capital sh. 10 par value	400
Retained earnings	200
10% Preference share capital Sh. 20 par value	100
12% debenture sh. 100 per value	<u>200</u>
	<u>900</u>

**Additional information**

1. Corporate tax is 30%
2. Preference shares were issued 10 years ago and are still selling at par value MP = Par value
3. The debenture has a 10 year maturity period. It is currently selling at sh. 90 in the market.
4. Currently the firm has been paying dividend per share of sh. 5. The DPs is expected to grow at 5% p.a in future. The current MP is sh. 40.

**Required:**

- a) Determine the WACC of the firm. **(4 marks)**
- b) Explain why market value and not book value are used to determine the weights. **(2 marks)**
- c) What are the weaknesses associated with WACC when used as the discounting rate, in project appraisal. **(4 marks)**

**QUESTION 2**

- a) Taru Sisal Estate intends to purchase a machine worth sh. 1,500,000 which will have a residue value shs. 200,000 after 5 years useful life. The saving in cost resulting from the use of this machines are:

	<b>Sh.</b>
Year 1	800,000
Year 2	350,000
Year 3	-
Year 4	680,000
Year 5	775,000

Using NPV method, advise the company whether this machine should be purchased if the cut off rate is 14% and acceptable saving in cost is 12% of the cost of the investment. **(12 marks)**  
 NB. Assuming that the salvage will be realized.

- b) Discuss the advantages and disadvantages of payback period. **(8 marks)**

### QUESTION 3

- a) What practical problems are faced by Finance Managers in capital budgeting decisions. (4 marks)
- b) Describe the features of long-term investment decisions. (3 marks)
- c) KK Ltd has six project available for investment as follows:

Project	Initial capital	NPV @ 15	Cost of capital
1	60	21	
2	15	9	
3	20	9	
4	55	15	
5	30	20	
6	40	-2	

The firm has sh. 100 million available for investment.

#### Required:

Identify which projects should be undertaken using PI and NPV ranking. Comment on your answer. (12 marks)

### QUESTION 4

ABC Ltd Makes cash payments of sh. 10,000 per week. The interest rate on marketable securities is 12% and everytime the company sells marketable securities, it incurs a cost of sh. 20.

#### Required:

- a) Determine the optimal amount of marketable securities to be converted into cash everytime the company makes the transfer. (5 marks)
- b) Determine the total cost of maintaining the cash balance per year. (5 marks)
- c) Determine the firms average cash balance. (5 marks)
- d) Determine the total number of transfers from marketable securities to cash per year. (5 marks)

### QUESTION 5

- a) In relation to the financing of a firm's differentiate the following terms:
- i) Financial structure from capital structure. (5 marks)
  - ii) Systematic risk and unsystematic risk. (5 marks)
- b) i) What is financial planning? (2 marks)
- ii) Discuss the characteristics of a sound financial plan. (8 marks)