



TECHNICAL UNIVERSITY OF MOMBASA
Faculty of Business & Social Studies
DEPARTMENT OF BUSINESS STUDIES

UNIVERSITY EXAMINATIONS FOR
MASTERS IN BUSINESS ADMINISTRATION

BMF 5101: FINANCE MANAGEMENT

SPECIAL/SUPPLEMENTARY EXAMINATIONS

SERIES: MARCH 2015

TIME: 3 HOURS

INSTRUCTIONS:

– Answer any **FOUR** questions.

This paper consists of Two printed pages

QUESTION 1

- a) Discuss the reasons why ordinary share capital is attractive despite being risky. **(5 marks)**
- b) ABC Ltd needs to varie funds for inventory to Ksh. 40 million the fund is needed for 6 months and the possibilities available are as follows:
- A warehouse loan at 18% annualized with an 80% advance against the vale of the inventory. Warehouse costs are sh. 350,000 for a period of 6 months. The residual financing requirement which is sh. 40 million less the amount advanced will need to be financed by forgone cash discounts on payable the discount terms are 5/20 net 60, the company feels it can postpone payment until the 10th day without adverse effect.
 - A bank loan from the company bank for sh. 40 million at 22% interest rate in addition a 10% compensating balance will have to be maintained by the company
 - Establish a one year line of credit, with a commitment fee of 5% on total borrowing and 17 percent in pa.

Required:

Which is the cheapest option for the company show all your workings.

(20 marks)

QUESTION 2

- a) Discuss the goals of Financial Management and state which is the most valued goal by the shareholders. **(10 marks)**
- b) ZZZ Ltd is considering three possible capital projects. Each project has 1 year life and the project depends on the next year state of economy. The returns are as shown:

| | Project | A | B | C |
|--------------|--------------------|-----------------------|----------|----------|
| State | Probability | Rate of return | | |
| Recession | 0.25 | 10% | 9% | 14% |
| Average | 0.50 | 14% | 13% | 12 |
| Boom | 0.25 | 16% | 18% | 10% |

Required:

- i) Compute each projects expected rate of return.
- ii) Compute the variance and standard deviation of each project.

(15 marks)

QUESTION 3

Discuss why leasing is not a popular mode of financing business entities. Briefly explaining the ideal conditions for lease finance. **(25 marks)**

QUESTION 4

- a) The traditional approach to the valuation and leverage assumes that there is an optimal capital structure and that firms can increase total value through the judicious use of leverage. Discuss. **(15 marks)**
- b) Does Modigliani-Miller (MM) hypothesis relationship on leverage and cost of capital support your argument in part (a) above. **(10 marks)**

QUESTION 5

- a) A company offers to pay dividend in form of new shares which are worth more than the cash alternative which is also offered. Why might the shareholders prefer a current cash dividend to a future capital gain? **(15 marks)**
- b) How can a company gearing affect the dividend yield? **(10 marks)**