TECHNICAL UNIVERSITY OF MOMBASA

School of Business

UNIVERSITY EXAMINATION FOR:

BACHELOR OF COMMERCE

BFI 4300-FINANCIAL MANAGEMENT

END OF SEMESTER EXAMINATION

SERIES: **DECEMBER 2016**

TIME: 2 HOURS

Instructions to Candidates

You should have the following for this examination

-Answer Booklet, examination pass and student ID

This paper consists of FIVE questions. Attempt Question ONE (Compulsory) and any other Two questions

Do not write on the question paper.

QUESTION 1

(a)-Within a financial management context, discuss the problems that might exist in the relationships (Sometimes referred to as agency relationships) between

(i) Shareholders and managers, and
(ii) Shareholders and creditors

How might a company attempt to minimise such problems? **(10 marks)**

(b) "The finance manager spends most of his time making managerial finance decisions as opposed to routine functions". Discuss. **(10 marks)**

C Highlight some of the short term sources of funds for an organization. **(10 marks)**

QUESTION 2

.The Zeda Company Ltd. is considering a substantial investment in a new production process. From a variety of sources, the total cost of the project has been estimated at Sh.20 million. However, if the investment were to be increased to Sh.30 million, the productive capacity of the plant could be substantially increased. Due to the nature of the process, it would be exorbitantly expensive to increase capacity once the equipment is installed.

Once of the problems facing the company is that there is a considerable degree of uncertainty regarding demand for the product. After some research which has been conducted jointly by the marketing and finance departments, some data has been produced. These are shown below:

	Investment A (Sh.20 m)			Investment B (Sh.30m)	
	Year	Demand Probability	Annual Net Cash Flow	Demand Probability	Annual Net Cash Flow
			Sh.(million)		Sh.(million)
1.	1 - 4	0.4	6	0.3	10
	5 – 10	0.4	5		7
2.	1 - 4	0.4	6	0.5	8
	5 – 10		2		4
3.	1 – 10	0.2	2	0.2	1

Cost of capital for the firm is 10%.

REQUIRED:

(a) Prepare a statement which clearly indicates the financial implications of each of the two alternative investment scenarios. **(12 marks)**

(b) Comment on other matters which the management should take into account before reaching the final decision. **(8 marks)**

PVIFA: 10% 5 years = 3.79
PVIFA: 10% 10 years =6.14
PVIFA: 10% 10 years =0.62

QUESTION 3

.In a mixed economy, two of the objectives of a government could be;

(a) To minimise its borrowing requirements; and
(b) To reduce the taxation of incomes.

Required

(a) Identify the general economic effects of these policies on private sector businesses. **(10 marks)**

(b) S Ltd. is engaged in large-scale retail business. From the following particulars you are required to calculate the working capital requirement:
Project annual sales Ksh. 208 Million
% of net profit on cost of sales 33%
Average credit period allowed to Drs. 6 weeks
Average credit period allowed to Crs. 3 weeks
Average stock (in term of sales) 6 weeks
Add 10% to allow for contingencies.

(10 marks)

QUESTION 4

Umma Ltd and Lemma Ltd are identical in every respect except that Umma is unlevered while Lemma has Sh 10 million of 5% loan stock outstanding. You are also informed that:

- All of MM assumptions are satisfied
- There are no corporate or personal taxes
- Earnings before interest and taxes (EBIT) is Sh 2 million
- The cost of equity to Umma is 10% p.a.

Required:

(a) What market value would MM estimate for each firm? (4marks)
(b) What is the cost of equity for Lemma? (3marks)
(c) What is the market value of Lemma's equity? (3marks)
(d) What is the weighted average cost of capital for each firm? (3 marks)
(e) Suppose the market value of the assets of Umma is Sh 20 million and the market value for those of Lemma is Sh 22 million.
Are these equilibrium valuations? Use these figures to explain how equilibrium is established. (7 marks)

QUESTION 5

(a)From the following selected operating data, determine the degree of operating leverage.

Which company has the greater amount of business risk? Why?

	Company A	Company B
	Ksh	ksh
Sales	25,00,000	30,00,000
Fixed costs	7,50,000	15,00,000

Variable expenses as a percentage of sales are 50% for company A and 25% for company B. **(10 marks)**

b ABC Ltd. has a capital of Ksh. 10,00,000 in equity shares of Ksh. 100 each. The shares are currently quoted at par. The company proposes to declare a dividend of Ksh. 10 per share at the end of the current financial year. The capitalization rate for the risk class to which the company belongs is 12%.

What will be the MP of the share at the end of the year, if

(i) A dividend is not declared. **(3 marks)**

(ii) A dividend is declared. **(3 marks)**

(iii) Assuming that the company pays the dividend and has net profits of Rs. 5,00,000 and makes new investments of Ksh. 10,00,000 during the period, how many new shares must be issued? Use the MM Model. **(4 marks)**