



TECHNICAL UNIVERSITY OF MOMBASA

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*School of business*

**DEPARTMENT OF ACCOUNTING AND FINANCE**

UNIVERSITY EXAMINATIONS FOR DEGREE IN BACHELOR OF  
COMMERCE/BUSINESS ADMINISTRATION & MATHS, BACHELOR OF  
BUSINESS AND INFORMATION TECHNOLOGY AND FINANCE

**BFI 4301: FINANCIAL MANAGEMENT**

ORDINARY EXAMINATIONS

**SERIES; AUGUST 2024**

**TIME; 2 HOURS**

**Instructions;**

Answer question one and any other TWO questions  
**Do not write on this paper**

**Question One**

(a) PV Co, a large stock-exchange-listed company, is evaluating an investment proposal to manufacture Product W33, which has performed well in test marketing trials conducted recently by the company's research and development division. Product W33 will be manufactured using a fully-automated process which would significantly increase noise levels from PV Co's factory. The following information relating to this investment proposal has now been prepared:

- Initial investment sh.2 million
- Selling price (current price terms) sh.20 per unit
- Expected selling price inflation 3% per year
- Variable operating costs (current price terms) sh.8 per unit
- Fixed operating costs (current price terms) sh.170,000 per year
- Expected operating cost inflation 4% per year

The research and development division has prepared the following demand forecast as a result of its test marketing trials. The forecast reflects expected technological change and its effect on the anticipated life-cycle of Product W33.

Year	1	2	3	4
Demand (units)	60,000	70,000	120,000	45,000

It is expected that all units of Product W33 produced will be sold, in line with the company's policy of keeping no inventory of finished goods. No terminal value or machinery scrap value is expected at the end of four years, when production of Product W33 is planned to end. For investment appraisal purposes, PV Co uses a nominal (money) discount rate of 10% per year and a target return on capital employed of 30% per year. Ignore taxation

**Required:**

(a) Calculate the following values for the investment proposal:

(i) Net Present Value; **(5 marks)**

(ii) Internal rate of return; and **(3 marks)**

(iii) Return on capital employed (accounting rate of return) based on average investment. **(3 marks)**

(b) Briefly discuss your findings in each section of (a) above and advise whether the investment proposal is financially acceptable. **(4 marks)**

(c) Discuss how the objectives of PV Co's stakeholders may be in conflict if the project is undertaken. **(5 marks)**

(d) Determination of capital structure of a company is influenced by a number of factors explain six such factors. (10 marks)

**Question Two**

(a) (i) What is meant by Working capital? (3 marks)

(ii) Explain the determinants of working capital requirements. (8 Marks)

b) You are a student who has been deployed in the stores department to review efficiency and stock controls. You have ascertained the following information about the organisation's main raw material:

Minimum usage..... 100 units per day.

Maximum usage..... 800 units per day.

Average usage..... 400 units per day.

Total projected usage... 20,000 units per quarter.  
 Lead time..... 4 - 8 days.  
 Cost per order..... sh. 20.  
 Unit Cost..... sh. 25.  
 Carrying cost..... 6% of total materials cost per annum.

**Required:**

Calculate the following stock control ratios:

- (i) Economic order quantity. **(3 marks)**
- (ii) Annual stock cost **(6 marks)**

**Question Three**

(a) DD Co has a dividend payout ratio of 40% and has maintained this payout ratio for several years. The current dividend per share of the company is sh.0.50 per share and it expects that its next dividend per share, payable in one year's time, will be sh.0.52 per share. The capital structure of the company is as follows:

	sh. m	sh. m
Equity Ordinary shares (nominal value sh.1 per share)	25	
Reserves	<u>35</u>	60
Debt		
Bond A (nominal value sh.100) at 9%	20	
Bond B (nominal value sh.100) at 10%	<u>10</u>	<u>30</u>
		<u>90</u>

Bond A will be redeemed at nominal in ten years' time and current ex interest market price of the bond is sh.95

Bond B will be redeemed at nominal in four years' time and current ex interest market price of the bond is sh.102 DD Co has a cost of equity of 12%. the firms tax rate is 30%

**Required:**

Calculate the following values for DD Co:

- (i) Capital gearing using market values **(3 marks)**
- (ii) Market value weighted average cost of capital. **(5 marks)**
- (iii) Assume that the company made a profit before interest and tax of sh. 80,000, calculate the value of Equity of DD Co. **(6 marks)**

(b) Briefly explain three major decisions that a finance manager has to make **(6 marks)**

#### Question Four

- a) As a Finance expert, explain SIX practical steps to manage agency problem in public limited liability companies. **(6 marks)**
- b) Profit maximization is the core objective of shareholders in Public limited Liability Companies. Discuss **(8 marks)**
- c) Kenya's financial sector has witnessed a lot of financial innovations. Briefly explain four reasons for these innovations **(6 marks)**

#### Question Five

(a) **Miller and Modigliani** stated that, in a perfect capital market, the value of a company depended on its investment decision alone, and not on its dividend or financing decisions. Briefly explain the features of a perfect capital market. **(8 marks)**

(b) ABC Ltd. needs sh. 3,000,000 for the installation of a new factory. The new factory expects to yield annual earnings before interest and tax (EBIT) of sh.500,000. In choosing a financial plan, ABC Ltd., has an objective of maximizing earnings per share (EPS). The company proposes to issue ordinary shares and raising debt of sh. 300,000 and sh.1,000,000 of sh. 1,500,000. The current market price per share is sh. 25 and the number of shares on issue are 200,000. The tax rate is 50%. Funds can be raised at the following rates.

-up to sh. 300,000 at 8%

-over sh. 300,000 to sh 1,500,000 at 10%

-over sh. 1,500,000 at 15%

Assuming a tax rate of 35% advice the company on which financing structure to use.

**(12 marks)**