



**JARAMOGI OGINGA ODINGA UNIVERSITY OF SCIENCE AND
TECHNOLOGY
SCHOOL OF BUSINESS AND ECONOMICS
UNIVERSITY EXAMINATION FOR THE DEGREE OF BACHELOR OF
BUSINESS ADMINISTRATION – WITH IT
3RD YEAR 1ST SEMESTER 2013/2014 ACADEMIC YEAR
MAIN**

COURSE CODE: BBM 3317/ABA 303

COURSE TITLE: FINANCIAL MANAGEMENT

EXAM VENUE:LR

STREAM: (BBA- Finance /Accounting)

DATE: 11/8/14

EXAM SESSION:11.30 – 1.30AM/PM

TIME: 2 HOURS

Instructions:

- 1.Answer question 1 (compulsory) and any other 2 questions .**
- 2.Candidates are advised not to write on the question paper.**
- 3.Candidates must hand in their answer booklets to the invigilator while in the examination room.**

QUESTION ONE.

- a) The international rate of return method is superior to the NPV method as we do not need required rate of return to calculate it. Discuss. **(5mks)**
- b) A project costs Ksh 16,000 and is expected to generate cash flows of ksh 8,000 ksh 7,000 ksh 6000 over its life of three years. Calculate the project internal rate of return **(5mks)**
- c) What are the limitations of traditional investment valuation methods of payback methods and accounting Rate of Return Visa Vis discounted cash flow models? **(5mks)**
- d) Explain the meaning and importance of each of the working capital items you know. **(5mks)**
- e) What is the advantage of cash planning? How does cash budget help in planning the firm's cash flow? **(5mks)**
- f) A company is currently selling 100,000 units of its product at ksh 50 per each. At the current level of production, the cost per unit is Kshs.45, variable cost per unit is ksh 40 .The company is currently extending one month's credit. The company forecasts that if it extents credit period to 2 months, then sales will increase by 25%.If the required rate of return is 20%, is the new policy desirable? **(5mks)**

QUESTION TWO

- a. Explain the basic financial management decisions that concern a modern financial manager. **(5mks)**
- b. What are agency relationship and problems? Do managers in large corporation provided with enough incentives to overcome agency theory problems? **(5mks)**
- c. What are the goals of financial management? Discuss some short comes of profit maximization as a goal. **(5mks)**

QUESTION THREE

- a. The valuation process for an equity instrument (common stock) involves finding the present value of an infinite series of cash flow on the equity discounted at an approximate equity rate. Discuss. **(5mks)**
- b. Explain the importance of a security 's required rate of return
- c. A stock paid a dividend at the end of the last year of ksh 3/50.Dividends have grown at a constant rate of 2% per year over the last 20 years and the growth is expected to grow into the future. The required rat of return is 10% p.a. What is the price of this stock?**(5mks)**

QUESTION FOUR.

- a. Explains the relationship between the required on an investment and its cost of capital.
- b. What are the two proportions of capital structures theory as per Modigliani and Miller (M&M)? Do you agree with this hypocrisy? Why? **(5mks)**
- c. Hama Bay Company has a weighted average cost of capital (adjusted for taxes) of 12%.It can borrow at 8%.Assume that he company that the company has target capital structure of 80% equity and the remainder debt .What will be the cost of equity? **(5mks)**

QUESTION FIVE

- a. Explain capital rationing process and its relationship with marginal cost of capital **(5mks)**
- b. A company is considering two mutually exclusive projects. Both require initial cash outlay of ksh 10,000 each and have a life of 5 years. The company's required rate of return is 10% and pays tax at 50% rate. The project is depreciated on a straight line basis. The net cash flows (before taxes) expected to be generated by the projects are as follows:

YEAR	1	2	3	4	5
Project 1 ksh	4,000	4,000	4,000	4,000	4,000
Project 2 ksh	6,000	3,000	2,000	5,000	5,000

Required:

- i. The payback of each project
- ii. The average rate of return for each project
- iii. The NPV and profitability index for each project
- iv. The IRR for each project

Which project should be accepted? Why?

(10mks)