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**University Examinations 2016/2017**

FIRST YEAR SECOND SEMESTER EXAMINATION FOR THE DEGREE OF MASTER IN BUSINESS ADMINISTRATION

**BFA 5176: FINANCIAL MANAGEMENT**

**DATE: DECEMBER 2016 TIME: 3HOURS**

**INSTRUCTIONS:** *Answer question* ***one*** *and any other* ***three*** *questions*

**QUESTION ONE (30 MARKS)**

1. Discuss the main classification of investment projects (5 marks)
2. Differentiate between hard and soft capital rationing (5 marks)
3. The following projects with their respective cash flows have been submitted for inclusion in 2015 Meru LTD capital budget.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Year | A | B | C | D | E | F |
| 0 | 250,000 | 250,000 | 500,000 | 500,000 | 500,000 | 125,000 |
| 1 | 0 | 50,000 | 175,000 | 0 | 12,500 | 57,500 |
| 2 | 25,000 | 50,000 | 175,000 | 0 | 37,500 | 50,000 |
| 3 | 50,000 | 50,000 | 175,000 | 0 | 75,000 | 25,000 |
| 4 | 50,000 | 50,000 | 175,000 | 0 | 125,000 | 25,000 |
| 5 | 50,000 | 50,000 | 175,000 | 0 | 125,000 |  |
| 6-9 per year | 50,000 | 50,000 |  | 500,000 | 125,000 |  |
| 10 | 50,000 | 50,000 |  |  | 125,000 |  |
| 11-15 per year | 50,000 | 50,000 |  |  |  |  |
| IRR | 14% | ? | ? | ? | 12.6% | 12% |
|  |  |  |  |  |  |  |

**Required:**

1. Compute IRR for projects B,C And D (5 marks)
2. Compute payback reciprocals for each project (7 marks)
3. If 16% is the minimum desired rate of return, compute the NPV and rank all the projects (8 marks)

**QUESTION TWO (10 MARKS)**

Uchumi limited is planning marketing campaigns in there different markets. The estimated profits and the probability of occurrence are provided below.

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Nakuru market | | | Nanyuki market | | | Meru market | | |
| Condition | Profit | Pi | Condition | Profit | Pi | Condition | Profit | Pi |
| Fair | 10,000 | 0.4 | Fair | 5,000 | 0.2 | Fair | 16,000 | 0.5 |
| Normal | 18,000 | 0.5 | Normal | 8,000 | 0.6 | Normal | 20,000 | 0.3 |
| Excellent | 25,000 | 0.1 | Excellent | 12,000 | 0.2 | Excellent | 25,000 | 0.2 |

**Required:**

1. Compute the expected value and the standard deviation resulting from the advertising campaigns in each of the markets (5 marks)
2. Rank the three markets according to relative risk (5 marks)

**QUESTION THREE (10 MARKS)**

1. Explain the difference between weighted average cost of capital (WACC) and marginal cost of capital (3marks)
2. Achievers LTD has presented the following capital structure as at 1st July 2014

|  |  |
| --- | --- |
| Details | Million of Shs |
| Ordinary share capital (shs 20 par) | 100 |
| Preference share capital (shs 10 par) | 160 |
| Share premium | 150 |
| Retained earnings | 550 |
| Long term debt | 640 |
|  | **1600** |

Additional information:

* The company can borrow a shs 200 million additional long term debt at pre tax cost of 13%. Any additional debt can be obtained at 16% pre tax cost
* The company can raise 400 million through a bond issue. Each bond will have a face value of shs, 1,000 but will be issued at shs 687. The coupon rate of the bond will be 10% and a maturity period of 20 years
* Expected net profit before tax for the year is shs 700 million
* Annual growth rate is 5.5% and is expected to remain constant
* The company expects to pay an ordinary dividend of sh 10 per share for the year ending 30th June 2015
* The corporate tax rate is 30%

**Required:**

Determine the cost of capital for long term debt, bonds additional debt, preference share capital and retained earnings (7 marks)

**QUESTION FOUR (10 MARKS)**

1. Differentiate between financial structure and capital structure (2 marks)
2. Explain the main capital structure theories (4 marks)
3. Discuss the main dividend policy theories (4 marks)

**QUESTION FIVE (10 MARKS)**

1. Within a financial management context discuss the problems that might exist in the relationships (sometimes referred to as agency relationships) between
2. Shareholders and managers, and
3. Shareholders and creditors

How might a company attempt to minimize such problems (3 marks)

1. A project has the following cashflows

**Year 1 year 2**

***Cashflow probability Cashflow Probability***

60,000 0.3 50,000 0.3

60,000 0.5

70,000 0.2

80,000 0.4 60,000 0.3

80,000 0.5

100,000 0.2

100,000 0.3 80,000 0.3

100,000 0.5

120,000 0.2

The projects initial cash outlay cash is sh 100,000 with a cost of capital of 12%

Required:

Determine:

1. A decision tree to depict the investment decision (5 marks)
2. Compute the projects expected monetary value (EMV) (2 marks)