



MASENO UNIVERSITY

UNIVERSITY EXAMINATIONS 2016/2017

**FOURTH YEAR SECOND SEMESTER EXAMINATIONS FOR THE
DEGREE OF BACHELOR OF SCIENCE IN AGRICULTURAL
ECONOMICS AND AGRIBUSINESS MANAGEMENT WITH
INFORMATION TECHNOLOGY**

MAIN CAMPUS

AAB 403: FINANCIAL MANAGEMENT

Date: 3rd August, 2017

Time: 8.30 - 11.30 am

INSTRUCTIONS:

- Answer question ONE and any other THREE questions.



AAB 403 – FINANCIAL MANAGEMENT

STREAMS: Y4S2 BSc Agricultural economics, BSc Agribusiness management with IT

DAY:

TIME: 3 HOURS

Instructions:

Answer question one and any other three questions

Question one

- a) Explain the term “agency costs” and give three examples of such costs (5 marks)
- b) Identify and briefly explain three main forms of agency relationships in a firm (5 marks)
- c) Describe four non-financial objectives that a company might pursue, which may have the effect of limiting the achievement of the financial objectives (5 marks)
- d) Although profit maximization has long been considered as the main goal of a firm, shareholder wealth maximization is gaining acceptance amongst most companies as the key goal of a firm

Required

- i. Distinguish between the goals of profit maximization and shareholders wealth maximization (5 marks)
- ii. Explain limitations of the goal of profit maximization (5 marks)

Question two

A company is considering an investment proposal to install new milling machine. The project will cost Kshs.50,000. The facility has a life expectancy of five years and no salvage value. The company tax rate is 30% and no investment tax credit is allowed. The firm uses straight line depreciation method. The estimated cash flow before tax [CFBT] from the proposed investment is as follows:

Year	Cash flow before tax (Ksh)
1	10000
2	11000
3	14000
4	15000
5	25000

Compute the following and advice accordingly.

(15 marks)

- Payback period
- Average rate of return
- Internal rate of return
- Net present value at 10% discount rate
- Profitability index at 10% discount rate

Question three

A successful private company with capital of Ksh.5 million wishes to raise additional permanent capital in order to meet increasing business opportunities. Explain the methods open to it, giving the advantages and disadvantages of each.

(10 marks)

- The use of trade credit in business dealings has been very important and is likely to increase in importance in future.

You are required to explain

- Under what circumstances an organization will find it convenient to use trade credit
(3 marks)
- What factors determine the source of financing from the point of view of the buyer
(2 marks)

Question four

- Distinguish between a capital market and a money market (10 marks)
- Outline the services that each market renders to the business community (5 marks)

Question five

An investment company wants to raise additional capital from the following sources.

- Issue 100,000 ordinary shares of Ksh.10 at Ksh.15 each
- Issue 100,000, 10% preference shares of Ksh.10 at Ksh.12 each

- Issue 100,000, 15% bond with a face value of Ksh.100 at Ksh.90 each
- To get a medium-term loan of Ksh.5,000,000 from a financial institution at an interest rate of 20% per annum

The company will pay an annual dividend to ordinary shares of 14% and corporate tax of 5%

Required

- a) Determine the total amount of capital that the company will raise (5 marks)
- b) Determine the average cost of additional capital i.e. the weighted average cost of capital (10 marks)