



MASENO UNIVERSITY

UNIVERSITY EXAMINATIONS 2012/2013

FIRST YEAR FIRST SEMESTER EXAMINATIONS FOR THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION (CITY CAMPUS - EVENING)

MBA 811: FINANCIAL MANAGEMENT

Date: 24th July, 2013

Time: 5.30 – 8.30 p.m.

INSTRUCITONS

- ◆ Answer ANY FOUR questions
- ◆ All questions carry equal marks.
- ◆ Show all your workings.
- ◆ Do not write on the question paper.

QUESTION ONE

- a) Explain the significance of financial forecasting in a business decision making process. **(5 marks)**
- b) The following is the capital structure of ABC Ltd as at 31st December, 2012.

	Kshs
Ordinary share capital Kshs.10 par value	400,000,000
Retained earnings	200,000,000
10% preference share capital Kshs.20 par value	100,000,000
12% debenture Kshs.100 par value	<u>200,000,000</u>
	<u>900,000,000</u>

Additional information:

1. Corporate tax rate is 30%.
2. Preference shares were issued 10 years ago and are still selling at par value MPS = Par value.
3. The debenture has a 10 year maturity period. It is currently selling at Kshs.90 in the market.
4. Currently the firm has been paying dividend per share of Kshs.5. The DPS is expected to grow at 5% p.a. in future. The current MPS is Kshs.40.

Required:

- (i) Determine and interpret the WACC of the firm. **(6 marks)**
- (ii) Explain why market values and not book values are used to determine the weights. **(2 marks)**
- (iii) Explain the major weakness associated with WACC when used as the discounting rate, in capital budgeting decisions. **(2 marks)**

QUESTION TWO

- a) Explain the importance of sound liquidity management decisions in a modern limited liability company. **(5 marks)**
- b) The risk free rate is 15% and the expected rate of return on the market portfolio is 20%. The expected returns for four securities are listed below together with their expected betas:

Security	Expected Return	Expected beta
X	17%	1.2
Y	15%	0.8
Z	15.5%	1.1
C	17%	1.6

Required:

- i) With support of relevant computations, identify the securities that are over-valued and undervalued. **(6 marks)**

- ii) If the risk free rate were to rise to 18% and the expected return on market portfolio rose to 24%, determine whether the securities will be over-valued and under-valued. (4 marks)

QUESTION THREE

- a) A speaker addressing an international conference on Risk and Return Measurements: Theory and Challenges observed that coefficient of variation resolves conflicting recommendations by expected return and standard deviation. Do you agree? Explain your answer. (6 marks)
- b) As a portfolio analyst at MBA Limited you are conducting an analysis of four alternative investment projects. Each project has a holding period of one year. The estimated rates of return for three alternative states of the economy are shown in the table below:

State of the Economy	Probability of each state occurring	Rate of return if state occurs			
		A	B	C	M
Recession	0.2	10	6	22	5
Average	0.6	10	11	14	15
Boom	0.2	10	31	-4	25

Required:

Calculate the expected return, variance, standard deviation and coefficient of variation for each project and comment on the statistics. (9 marks)

QUESTION FOUR

- a) Discuss the importance of capital budgeting decisions in a business organization listed on an organized securities exchange market. (5 marks)
- b) ABC Ltd. is considering the following two mutually exclusive projects.

	Project X	Project Y
Investment outlay	Kshs.110,000	Kshs.110,000
Cash inflows		
Year 1	31,000	71,000
Year 2	40,000	40,000
Year 3	50,000	40,000
Year 4	70,000	20,000

The cost of capital associated with this firm is 10 % per annum and the re-investment rate is 14 % per annum.

Required:

Carry out financial feasibility analysis of the projects on the basis of:

- i. Net Present Value. (5 marks)
- ii. Modified Net Present Value. (5 marks)

QUESTION FIVE

a) Here below are some of the principles of good corporate governance practice. Explain each principle and show how it is expected to contribute to improving, corporate governance for business enterprises in Kenya.

- i) Election of directors by shareholders (2 marks)
- ii) Use of interlocking directorship (2 marks)
- iii) Multiple directorship (2 marks)
- iv) Inclusion of independent outside directors on the boards (2 marks)
- v) Staggered boards (2 marks)

b) Discuss the reasons motivating the increasing interest in corporate governance. (5 marks)

QUESTION SIX

a) Discuss any five factors determining capital structure decisions of a limited liability company. (5 marks)

b) The following financial statements relate to the ABC Company:

Statement of Financial Position as at 31st March 2013

Assets	Kshs.	Liabilities & Net worth	Kshs.
Cash	28,500	Trade creditors	116,250
Debtors	270,000	Notes payable (9%)	54,000
Stock	<u>649,500</u>	Other current liabilities	100,500
Total current assets	948,800	Long term debt (10%)	300,000
Net fixed assets	<u>285,750</u>	Net worth	<u>663,000</u>
	<u>1,233,750</u>		<u>1,233,750</u>

Income Statement for the year ended 31 March 2013

	Kshs
Sales	1,972,500
Less cost of sales	<u>1,368,000</u>
Gross profit	604,500
Selling and administration expenses	<u>498,750</u>
	105,750
Earnings before interest and tax	<u>34,500</u>
Interest expense	71,250
	<u>28,500</u>
Estimated taxation (40%)	<u>42,750</u>
Earnings after interest and tax	

Required:

Calculate and interpret the following ratios:

- | | |
|---------------------------------|-----------|
| i) Inventory turnover ratio | (2 marks) |
| ii) Times interest earned ratio | (2 marks) |
| iii) Total assets turnover | (2 marks) |
| iv) Net profit margin | (2 marks) |