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**MAASAI MARA UNIVERSITY**

**REGULAR UNIVERSITY EXAMINATION**

**2017/2018 ACADEMIC YEAR**

**THIRD YEAR SECOND SEMESTER**

**SCHOOL OF BUSINESS AND ECONOMICS**

**BACHELORS OF SCIENCE IN AGRICULTURAL ECONOMIS AND RESOURCE MANAGEMENT.**

**COURSE CODE: ARE 253**

 **COURSE TITLE: FINANCIAL MANAGEMENT IN AGRICULTURE**

**DATE : 20TH  AUGUST,2018 TIME:2.30 P.M- 4.30 P.M**

**INSTRUCTIONS TO CANDIDATES:**

***Answers question ONE and any other three****.*

**QUESTION ONE**

1. Kenya Cooperative Creameries(KCC) is an entity that processes milk supplied by daily farmers in Kenya. The day-to-day management of KCC rests on the hands of the board of directors. In your view, does agency relationship exist between the farmers and the board of directors of KCC and how does it arise? **(4 marks)**
2. Discuss the various causes of agency problem that may arise between the dairy farmers and the board of management of KCC. **(6 marks)**
3. ABC, a large-scale farming enterprise is considering the purchase of a new machine for its operations. Two alternative machines, Ford and Holland, which will cost Sh.9,000,000 and Sh.10,000,000 respectively are available in the market. The anticipated cash flows after taxation of each plant are as follows:

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Year | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| Ford | 1,6 m | 2.8 m | 3.9 m | 2.9 m | 1.7 m | 1.5 m | 1.0 m |
| Holland | 1.9 m | 3.4 m | 4.7 m | 2.8 m | 2.2 m | 1.5 m | 1.2 m |

**Required;** Assuming theenterprise intend to finance the purchase by acquiring a bank loan at an interest rate of 10%, for each plant compute;

1. Payback period **(2 marks)**
2. The net present value (NPV). **(6 marks)**
3. Profitability Index. **(4 marks)**
4. Based on your computation above which plant is better and why? **(3 marks)**

**QUESTION TWO**

1. i. In the recent past there has been mass importation of contraband sugar that flooded the Kenyan market. In the context of financial management does the importation have adverse effects on the local sugar firms in the achievement of their overall finance goals? (Support your response with reasons). **(4 marks)**

ii. Assuming you are among the team of finance managers in Mumias sugar company, suggest measures that can be undertaken to mitigate against the adverse effects contemplated in a(i.) above. **(3 marks)**

1. The management of Kakuzi, a company involved in a range of agricultural activities intend to raise additional capital to finance it activities. It is considering to go for debt instead of equity. The management has approached you for advice concerning its intention. Discuss considerations that you are likely to advice the company to take into account when deciding to use debt finance. **(8 marks)**

**QUESTION THREE**

The following is the capital structure of company XYZ as at 31/12/2017.

|  |  |
| --- | --- |
| Ordinary share capital Sh.10 par valueRetained earnings10% preference share capital @ Sh.20 par value12% debenture @ Sh.100 par value | Sh.‘’000”400,000200,000100,000200,000900,000 |

**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 years’ maturity period. It is currently selling at Sh.90 in the market.

4. Currently the firm has been paying dividend per share of Sh.5. The DPS is expected to grow at 5% p.a. in future. The current MPS is Sh.40.

**Required**

a) Compute the cost of each capital component. **(8 marks)**

b) Determine the WACC of the firm**. (5marks)**

c) Outline the weaknesses associated with WACC when used as the discounting rate, in project appraisal. **(2 marks)**

**QUESTION FOUR**

a)i Explain why proper working capital management is important for the financial success of a corporate body.  **(3 marks)**

ii. Explain five factors which determine the firm’s working capital needs. **(5 marks)**

b) At a recent seminar on “Gender Empowerment in Business’ the invited financial analyst, James Mwangi advised the participants that extending credit is one of the comer stone of modern business. Anne Mburu, the managing director of Sasini Limited took note of this important fact. After the seminar, she authorized a review of the credit system of her company. The following data relate to the current state of affairs.

1. Annual sales of the company are Sh.50,000,000
2. Credit sales are 25 per cent of all sales
3. Bad debts average 2% of all credit sales
4. Average collection period for debtor is 40 days
5. The company’s cost of capital is 14% per annum
6. Net profit on sales is 15%.

Based on these facts, she is recommending a thorough restructuring of the credit policy of the company. The expected outcome of this action will be as follows:

1. Increase in total sales by 30 per cent
2. Credit sales will be 40 per cent of all sales
3. Average collection period will decrease to 35 days
4. Bad debts will increase to 3 per cent of credit sales
5. An additional part time credit control assistant will be hired for Sh.50,000 per annum.

**Required**

The effectiveness or otherwise of the proposed revamping of credit policy. (Show all your workings). **(7 marks)**

**QUESTION FIVE**

1. Discuss five reasons that underlie mergers and acquisitions. **(6 marks)**
2. The following information is on a company in the agricultural processing business:

|  |  |
| --- | --- |
| 10% preference shares (Sh.10 par)Ordinary share capital (Sh.10 par)Retained profits15% debentures | 40,000,00040,000,00080,000,00070,000,000150,000,000120,000,000270,000,000 |

i) Calculate the gearing ratio for the above company. **(2 marks)**

ii) If the company’s net profit (before interest and tax) is Sh.2,000,000,000 and assuming a dividend payout ratio of 60% of the earnings, compute the dividend per share (DPS). **(5 marks)**

iii) If the market price per share now is Sh.80, compute the dividend yield. **(2 marks)**

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