

**W1-2-60-1-6**

**JOMO KENYATTA UNIVERSITY OF AGRICULTURE AND TECHNOLOGY**

**UNIVERSITY EXAMINATIONS 2018/2019**

THIRD YEARS FIRST SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR OF PROCUREMENT AND CONTRACT MANAGEMENT

**HPS 2307: FINANCIAL MANAGEMENT**

**DATE: AUGUST 2019 TIME: 2 HOURS**

INSTRUCTIONS: ANSWER QUESTION ONE (COMPULSORY) AND ANY OTHER

TWO QUESTIONS

**QUESTION ONE: 30 MARKS**

a. Distinguish between the following terms as used in financial

management.

i. Capital structure and financial structure. (2 marks)

ii. Further and forward contracts. (2 marks)

iii. Business risk and financial risk. (2 marks)

iv. Net present value and pay back period. (2 marks)

b. Discuss the objectives of a firm, stating their relevance in modern period.

(10 marks)

c. Discuss the uses and limitations of ratios. (4 marks)

d. Great Lakes Utilities is deciding if it should build an oil or a coal generating plant. It’s weighted average cost of capital is 8% for low-risk projects, 10% for projects of average risk and 12% for high-risk projects. Management believes that an oil plant is of average risk but that a coal plant is of high risk. The cash flows required to construct each plant are listed below.

The revenue, fuel costs and other operating costs are expected to be the same under both plans.

Construction Costs (Sh. “Millions”)

|  |  |  |
| --- | --- | --- |
| Year | Coal Plant Sh. | Oil Plant Sh. |
| 0 | 100 | 400 |
| 1 | 500 | 1,000 |
| 2 | 1500 | 1,000 |
| 3 | 1500 | 1,000 |
| 4 | 1500 | 1,500 |
| 5 | 1000 | 1,000 |
| 6 | 500 | 200 |

Required:-

Evaluate the project using the Net present value method, comment which type of plant should be constructed. (8 marks)

**QUESTION TWO: 20 MARKS**

a. State the different types of bond comments which bound holders may impose on shareholders to protect themselves. (10 marks)

b. Examine the relative advantages and disadvantages of venture capital over leasing. (10 marks)

**QUESTION THREE: 20 MARKS**

a. Identify and explain the various types of dividend policies. (6 marks)

b. ABC Ltd is considering three possible capital projects for next year. Each project has 1 year life, and project returns depend on next year state of the economy. The estimated return are shown in the table:-

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| State of Economy | Probability of  Occurrence | Rate of Return | | |
|  |  | A | B | C |
| Recession | 0.25 | 10% | 9% | 14% |
| Average | 0.50 | 14% | 13% | 12% |
| Boom | 0.25 | 16% | 18% | 10% |

Required:-

i. Compute each projects respected rate of return. (2 marks)

ii. Compute the variance and standard deviation of each project. (8 marks)

iii. Compute the co-efficient of variation for each project. (4 marks)

**QUESTION FOUR: 20 MARKS**

a. With in a financial context, discuss the problem that might exist in the relationships (sometimes referred to as agency relationships) between:-

i. Shareholders are managers and

ii. Shareholders are creditors

How might a company attempt to minimize such problems? (8 marks)

b. Briefly explain the following deviation and highlight their benefits:-

i. Future (2 marks)

ii. Forward (2 marks)

iii. Swaps (2 marks)

iv. Options (2 marks)

c. Explain fully the effect of the use of debt capital on the weighted average cost of capital of a company. (4 marks)

**QUESTION FIVE: 20 MARKS**

The director of Upendo Limited wish to use an alternative estimate of cost of capital. They prefer to use the capital asset pricing model. The following details have been provided.

|  |  |  |  |
| --- | --- | --- | --- |
| Portfolio or security | Variance of return % | Return% | Covariance of returns of security (A) with the market (M) |
| M | 0.3047 | 18.64 | 0.3047 |
| B | 0.374 | 16.45 | 0.2986 |
| C | 0.0 | 10.18 | 0.0 |
| D | 1.5876 | 30.20 | 0.5606 |
| E | 0.2043 | 15.47 | 0.3737 |
| U | ? | ? | 0.4571 |

Required:-

i Determine the beta coefficient of each portfolio/ security and interpret the results of each. (10 marks)

ii. Predict the cost of capital of Upendo Limited using the CAPM. (6 marks)

iii. Explain the assumption you have used in (ii) above. (4 marks)