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KIBABII UNIVERSITY

UNIVERSITY EXAMINATIONS

2020/2021 ACADEMIC YEAR

FIRST YEAR SECOND SEMESTER

**MAIN
SPECIAL/SUPPLEMENTARY EXAMINATION**

**FOR THE DEGREE OF MASTERS OF BUSINESS
ADMINISTRATION**

COURSE CODE: MBA808

COURSE TITLE: FINANCIAL MANAGEMENT

DATE: 24TH FEBRUARY, 2021 TIME: 9.00AM – 12NOON

INSTRUCTIONS TO CANDIDATES

Answer Question One in Section A and Any other THREE (3) Questions in Section B

TIME: 3Hours



KIBU observes ZERO tolerance to examination cheating

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QUESTION ONE

- a) Working capital may encompass gross working and net working capital. Demonstrate your understanding of any two working capital management techniques(4mks)
- b) A company has its core mandate of production and distribution of its products. It may not be in a position to collect its book debts and employs the services of other parties called factors. Clearly highlight the advantages of using factors. (4mrks)
- c) Under time Value for money a shilling today is better than a shilling tomorrow. In three key statements describe why we need money now rather than later. (6mks)
- d) Explain four factors that might be considered when establishing an effective credit policy in an organization (4mks)
- e) Chigiri Ltd is a private company which intends to be listed in the securities exchange. The company has recently made a dividend issue of sh. 3.20 per share. This dividend is expected to grow at the rate of 15% per annum for 2 years and then drop to 12% per annum for the next 3 years. Thereafter, the dividend will grow at 6% per annum indefinitely. The required rate of return is 11%.

Required:

The intrinsic value of the share

(6mrks)

- f) Highlight three agency costs that might arise in the principal – agent relationship between shareholders and managers (6mks)
- g) Discuss the goals of financial management and state which is the best goal (10mks)

QUESTION TWO

- a) A firm is considering the following investment projects

Project	Cash flows (sh)			
	Year0	Year 1	Year 2	Year 3
A	(1,000,000)	500,00	500,000	-
B	(1,000,000)	-	650,000	850,000
C	(1,000,000)	300,000	500,000	1,000,000
D	(1,000,000)	800,000	400,000	400,000

The firm's opportunity cost of capital is 15%.

Required:

- i) Rank the projects using payback period method (5mrks)
- ii) Rank the projects using net present value method (5mrks)
- b) Highlight four factors that could be taken into account when making dividend decisions (4mrks)
- c) Manjewa Limited maintains a minimum cash balance of sh.2, 000,000. The standard deviation of its daily net cash flow is estimated at sh.22, 000. The transaction cost of buying and selling of marketable securities is sh.60 per transaction. The rate of interest for the marketable security is 5%.

Assume 365 days in a year.

Required:

Using **Miller-Orr cash management model**, determine:

- i) The Return point (3mrks)
 - ii) The Upper Cash limit (3mrks)
- (Total 20mrks)**

QUESTION THREE

- a) Describe instances in which the interest of the management of a company might conflict with those of the shareholders and suggest mechanisms for their resolution (9 mrks)
 - a. Project X requires an initial investment of Ksh.1, 000, 000. Its expected cashflows are Ksh.400, 000 every year for 5years. The risk free rate is 5% and the market return is 14%. The firm is indifferent between a certain amount of Ksh.362, 694 and the expected cashflow of Ksh.400, 000 at the end of the 5th year. The Beta factor of the market is 1.2
- The Risk Adjusted Discount Rate is given by $RADR = R_f + B(R_m - R_f)$.
- Required: Determine the NPV of the Project using
- i) Certainty Equivalent method (4mrks)
 - ii) Risk Adjusted Discount Rate (4mrks)
- b) What are the assumptions of William Boumals model of cash management?(3mrks)

QUESTION FOUR

Airtime Company Ltd is in the mobile phone industry. The company's balance sheet as at 31.12.2019 is given below

Liabilities and Equity	Sh000	Assets	Sh000
			32,500
Current liabilities	12,500	Current asset	
18% Bonds (sh1000 par)	16,000	Net fixed assets	42,875
10% Pref shares	6,250		
Ord Shares (Sh10 par)	12,500		
Retained Earnings	<u>28125</u>		
	<u>75,375</u>		<u>75,375</u>

1. The bonds are now selling at sh950 in the market and will be redeemed 10years from now.
2. By the end of the last period the company had declared and paid sh 5 as dividend per share. The dividends are expected to grow at an annual rate of 10% in the foreseeable future, currently the company's shares are trading at sh38 per share at the local security exchange.
3. The preference shares were floated in 2008 and their prices have remained constant.
4. Most banks are lending money at an interest rate of 22% per annum.
5. The corporation rate of tax is 30%.

Required. Calculate the market weighted average cost of capital for the firm.
(20mks)

(Total 20 mrks)

QUESTION FIVE

- a. In evaluating investment appraisals profits may not be preferred but liquidity through cashflows ,explain. (5mks)
- b. NB and K Ltd is analyzing a project whose cost is sh12million. The project is estimated to have an economic useful life of 6 years and a nil residual value. Earnings before depreciation and tax expected from the project are as follows

Year	EBDT (SH000)
1	16,000
2	16800
3	17600
4	18400
5	20000
6	20800

The required rate of return is 20% and the corporation rate of tax is 30%.depreciation on straight line method.

Required.

- i) After tax cash flows (5mrks)
- ii) Net present value of the project and decision made. (5mrks)
- iii) Internal rate of rate of return of the project and decision made. (5mks)
- (Total20mks)**