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KIBABII UNIVERSITY

KNOWLEDGE FOR DEVELOPMENT

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UNIVERSITY EXAMINATIONS

2021/2022 ACADEMIC YEAR

SECOND YEAR FIRST SEMESTER

MAIN EXAM

FOR THE DEGREEOF BACHELOR OF COMMERCE

COURSE CODE: BCF 211/BBF211/BCF200/BBM200

COURSE TITLE: FINANCIAL MANAGEMENT

DATE:16TH MAY,2022 **TIME:9.00AM – 11.00AM**

INSTRUCTIONS TO CANDIDATES

1. Answer Question One in Section A and Any other TWO (2) Questions in Section B

2.Question **one** carries **30**marks and each of the other two questions carry **20** marks each.

TIME: 2 Hours

KIBU observes ZERO tolerance to examination cheating

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SECTION ONE (COMPULSORY)

QUESTION ONE

a) In the context of agency theory:
   i) Explain the "principal-agent problem (4 marks)
   ii) Explore four ways of addressing the principal- agent problem in a corporate concern (4 marks)
   iii) Indicate how the objective of wealth maximization differs from that of profit maximization for an entity listed on a security exchange (4 marks)

b) The following was the capital structure of Omega Ltd, an Agro based company on 31st December 2019.

Item	Sh.(million)
Ordinary share capital (sh.10 par)	10
12% preference share capital (sh.20 par)	4.8
10% debentures (sh.1,000 par)	3.6

Additional information:

i) The market prices per ordinary share, preference share and debenture were sh.45, sh.30 and sh. 1,200 respectively on 31st December 2019.
ii) The dividends per ordinary share for the year ended 31st December 2019 was sh. 8.00.and are expected to grow at an annual rate of 12%.
iii) The corporation tax is 30%

Required :

i) The cost of ordinary share capital (3 marks)
ii) The cost of 12% preference share capital (2 marks)
iii) The cost of 10 % debentures (3 marks)
iv) Market weighted average cost of capital (5 marks)
v) Suggest five uses of cost of capital to Omega Ltd as a liability company (5 marks)

SECTION B

QUESTION TWO

a) Explain five factors that may influence a company to raise equity finance rather than debt finance (5 marks)

b) ABC Ltd anticipates raising sh.50 million for the construction of a new plant. After due considerations, the finance manager proposed the following three financial plans
   i) Issue 5,000,000 ordinary shares at sh.10 each.
   ii) Issue 2,500,000 ordinary shares at sh.10 each and sh 250,000 debentures of sh.100 each bearing 8% rate of interest per annum.
   iii) Issue 2,500,000 ordinary shares at sh.10 each and 250,000 preference shares at sh.100 each bearing 8% rate of interest per annum.
   iv) The company's tax rate is 30%

Required:

i) Earnings per share (EPS) when the company earnings before interest and tax are 1 million, 2 million, 4 million, 6 million and 10 million under each of the three financial plans (12 marks)

ii) Advice the management on the best financial plan in (i) above (3 marks)

QUESTION THREE

a) Examine four principles of capital budgeting (4 marks)

b) A firm is considering the following investment projects that will each require an initial capital of sh. 1,000,000
The projects are to generate cash as shown below:

Project	Year 1	Year 2	Year 3
X	500,000	500,000	-
Y	-	650,000	850,000
Z	800,000	400,000	400,00

The firm's cost of capital is 15%.

Required:

i) Rank the projects using payback method (5marks)

ii) Rank the projects using Net present value (NPV) method (6marks)

c) Kibu Ltd , a furniture making company borrowed sh.1,000,000 from Bora Bank at an annual interest rate of 14% on reducing balance. The loan was repayable in annual installments over a period of four years. The installments were payable at the end of the year.

Required:

A loan amortization schedule (5 marks)

QUESTION FOUR

a) Explain three approaches that may be used by the company to finance its working capital needs (6 marks)

b) Biashara Ltd in an effort to promote its sales occasionally extends credit to its trust worth customers.
The company currently offers its customers 30 day's credit. Annual credit sales are sh.12 million. The contribution/sales ratio is 25% and bad debts are 1 % of annual sales.
The company has estimated that if it increased the credit period to 60 days, the annual sales would increase by 10 % but bad debts would increase to 1.5 % of the annual sales.

Additional information:

i) The company's cost of capital is 9%

ii) Assume the year has 360 days

Required:

Effect of increasing credit period to 60 days on the company profits (9 marks)

c) Enumerate five ways in which the dividend decision affects the wealth maximization goal of a public limited company (5 marks)

QUESTION FIVE

a) Distinguish between systematic and unsystematic risk (4 marks)

b) The following information relates to XYZ Ltd for the year ended 31st march 2020.

Fixed asset turnover	5.6 times
Current ratio	1.7
Debt /Equity ratio	1.5
Interest cover	3.2
Current liabilities	sh. 600,000
Total asset turnover	1.4 times
Margin	30%
Earnings before interest and tax/sales	5 %
Tax rate	30%

Required:

i) Income statement for the year ended 31st March 2020 (9 marks)

ii) A condensed statement of financial position as at 31st March 2020 (7 marks)