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**University Examinations 2015/2016**

FIRST YEAR FIRST SEMESTER EXAMINATION FOR THE DEGREE

OF

MASTER OF BUSINESS ADMNISTRATION

**BFA 5176: FINANCIAL MANAGEMENT**

**DATE: APRIL 2015 TIME: 3 HOURS**

**INSTRUCTIONS:** *Answer question* ***one*** *and any other* ***two***questions.

**QUESTION ONE (30 MARKS)**

1. Discuss the major functions of a Finance Manager in a profit making organization (8 marks)
2. Exactly 20 years from now, Kithegeca a former forest guard will start receiving a pension of sh 100, 000 per year. The payments will continue for 20 years. How much is the pension worth now assuming a cost of capital of 12% (7 marks)
3. Define agency relationship from the context of a public limited company and briefly explain how this arises. (8 marks)
4. Discuss the factors that would affect the dividend policies of a company. (7 marks)

**QUESTION TWO (15 MARKS)**

1. Manyatta Investments Company Ltd. wishes to raise funds amounting to Sh. 10 million to finance a project in the following manner:

Sh. 6 million from debt; and

Sh. 4 million from floating new ordinary shares.

The present capital structure of the company is made up as follows:

1. 600, 000 fully paid ordinary shares of Sh. 10 each
2. Retained earnings of Sh. 4 million
3. 200, 000, 10% preference shares of Sh. 20 each
4. 40, 000 6% long term debentures of Sh. 150 each.

The current market value of the company’s ordinary shares is Sh. 60 per share. The expected ordinary share dividends in a year’s time is Sh. 2.40 per share. The average growth rate in both dividends and earnings has been 10% over the past ten years and this growth rate is expected to be maintained in the foreseeable future.

The company’s long term debentures currently change hands for Sh. 100 each. The debentures will mature in 100 years. The preference shares were issued four years ago and still change hands at face value.

Required:

1. Compute the component cost of:
2. Ordinary share capital; (3 marks)
3. Debt capital (3 marks)
4. Preference share capital (3 marks)
5. Compute the company’s current weighted average cost of capital. (6 marks)

**QUESTION THREE (15 MARKS)**

Gachanja Ltd. wishes to make a choice between two mutually exclusive projects. Each of these projects requires Sh.400, 000, 000 in initial cash outlay. The details of the two projects are as follows:

Project A

This project is made up of two sub-projects. The first sub-project will require an initial outlay of Sh. 100,000, 000 and will generate Sh.25, 600, 000per annum in perpetuity. The second sub-project will require an initial outlay of Sh. 300, 000, 000 and will generate Sh. 85, 200, 000 per annum for the 8 years of its useful life. This sub-project does not have a residual value at the end of the 8 years. Both sub-projects are to commence immediately.

Project B

This project will generate Sh.87, 000, 000 per annum in perpetuity.

The company has a cost of capital of 16%.

Required:

1. Determine the Net Present Value (NPV) of each project (6 marks)
2. Compute the Internal Rate of Return (IRR) for each project (6 marks)
3. Advise Gachanja Ltd. on which project to invest in and justify your choice. (3 marks)

**QUESTION FOUR (15 MARKS)**

1. Consider the following four assets with the following distribution of returns.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Probability | Rate of return (%) | | | |
| Occurrence | A | B | C | D |
| 0.1 | 10.0% | 6.0% | 14.0% | 2.0% |
| 0.2 | 10.0 | 8.0 | 12.0 | 6.0 |
| 0.4 | 10.0 | 10.0 | 10.0 | 9.0 |
| 0.2 | 10.0 | 12.0 | 8.0 | 15.0 |
| 0.1 | 10.0 | 14.0 | 6.0 | 20.0 |

**Required:**

1. Compute the covariance of asset
2. A and B
3. B and C
4. B and D
5. Compute the correlation coefficient of the combination of assets in b above.

**QUESTION FIVE (15 MARKS)**

1. Discuss the four major objectives on a profit making entity (6 marks)
2. Makutano Limited wishes to expand its output by purchasing a new machine worth 170, 000 and installation costs are estimated at 40, 000/=.

In the 4th year, this machine will call for an overhaul to cost 80,000/=

Its expected inflows are:

|  |  |
| --- | --- |
|  | Shs. |
| Year 1 | 60,000 |
| Year 2 | 72,650 |
| Year 3 | 35,720 |
| Year 4 | 48,510 |
| Year 5 | 91,630 |
| Year 6 | 83,715 |

This company can raise finance to purchase machine at 12% interest rate.

Compute NPV and advise management accordingly. (9 marks)