JARAMOGI OGINGA ODINGA UNIVERSITY OF SCIENCE AND TECHNOLOGY

SCHOOL BUSINESS AND ECONOMICS

UNIVERSITY EXAMINATION FOR THE DEGREE OF BACHELOR OF BUSINESS ADMINISTRATION WITH IT

3rd YEAR 1ST SEMESTER 2022/2023 ACADEMIC YEAR

MAIN

COURSE CODE: BAB 1303

COURSE TITLE: FINANCIAL MANAGEMENT

DATE: 21/12/2022 SESSION...2.00 – 4.00

TIME: 2 HOURS. VENUE................................

INSTRUCTIONS

1. Answer Question 1 (Compulsory) and ANY other two questions
2. Candidates are advised not write on the question paper
3. Candidates must hand in their answer booklets to the invigilator while in the examination room

QUESTION ONE

(a) What economic advantages are created by the existence of:

(i) Primary markets. (5 marks)
(ii) Secondary markets (5 marks)
(iii) Portfolio management firms. (5 marks)

(b) Explain how the Capital Authority can ensure:

(i) faster growth and development of the Nairobi Stock Exchange or Stock Exchange in your country. (10 marks)

(ii) development of other stock exchanges in Kenya or in your country. (5 marks)

(Total: 30 marks)

QUESTION TWO

(a) You are given the following price quotations on a Treasury Bond for the close of trading on May 31 and June 30, 2000. As on June 30 this Treasury Bond has a 90-day remaining life.

Treasury bond information

	On May 31		**On June 30**	
Maturity	Bid	Asked	Bid	Asked
September 28	9.10%	9.00%	9.30%	9.25%

(i) On May 31, the Treasury Bond had a 120-day remaining life. On that day what percentage of par value would you pay to purchase the Treasury Bond?

(3 marks)

(ii) Assume you purchased the Treasury Bond on May 31 and later sold it on June 30. What rate of return did you earn during this one-month period? (4 marks)

(b) (i) What is a stock exchange index? (2 marks)

(ii) Outline four drawbacks of the Nairobi Stock Exchange index. (4 marks)

(c) (i) What is a Commercial Paper? (3 marks)

(ii) State and explain the advantages of using commercial paper by businesses to raise funds (4 marks)

(Total: 20 marks)

QUESTION THREE

(a) Describe in brief the greatest difficulties faced in capital budgeting in the real world.

(5 marks)

(b) Mumias Milling Company purchased a grinder 3 years ago at a cost of Sh.3.5 million. The grinder had a life of 8 years at the time of purchase. It is being depreciated at 15% per year on a declining balance. The company is considering replacing it with a new grinder costing Sh.7 million with an expected useful life of 5 years.

Due to increased efficiency, the profit before depreciation is expected to increase by Sh.400,000 a year. The old and new grinders will now be depreciated at 25% per year on a declining balance for tax purposes.

The salvage value of the new grinder is estimated at Sh.210,000. The market value of the old grinder, today, is Sh.4 million. It is estimated to have a zero salvage value after 5 years.

The company's tax is 30% and the after tax cost of capital is 12%.

Required

Should the new grinder be bought? Explain. (15 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Mwomboko Company Ltd currently operates with terms of net 30 days. The company has sales of Sh.12 million and its average collection period is 45 days. To stimulate demand, the company is considering the possibility of offering terms of net 60 days. If it offers these terms sales will increase by 20%. After the change the average collection period is expected to increase to 75 days with no difference in payments habits between old and new customers.

The company has variable costs of Sh.70 for every Sh.100 of sales. The required rate of return on receivables is 20%.

Required:

Should the company extend its credit period? (Assume a year has 360 days). (8 marks)

(b) Andreas Company Ltd. currently pays a dividend of Sh.2 per share and this dividend is expected to grow at an annual rate of 15% for the first 3 years then at a rate of 10% for the next 3 years after which it is expected to grow at a rate of 5% thereafter.

(i) What value would you place on the stock if an 18% rate of return were required? (7 marks)

(ii) Would your valuation change if you expected to hold the stock for only 3 years? Explain. (5 marks)

(Total: 20 marks)

QUESITON FIVE

The financial data given below shows the capital structure of Akabebi Company Limited.

10% Sh.1,000 debenture	4,900,000
Ordinary share capital (Sh.20)	18,000,000
Retained earnings	6,000,000
	28,900,000

The structure is considered optimum and the management would wish to maintain this level.

Akabebi Company Limited intends to invest in a new project which is estimated to cost Sh.16,800,000 with an expected net cash flow of Sh.3,000,000 per annum for 10 years. The management has proposed to raise the required funds through the following means:

1. Issue 100 10% debentures at the current market value of Sh.5,000 per debenture.
2. Utilise 60% of the existing retained earnings.
3. Issue 10% Sh.20 preference shares at the current market price of Sh.25 per share
4. Issue ordinary shares at the current market price of Sh.45 per share. Floatation cost per share is estimated to be 12% of the share value.

   The company's current dividend yield is 5% which is expected to continue in the near future. Corporation tax rate is 30%.

Required:

(a) Determine the current dividend per share. (3 marks)

(b) Determine the number of ordinary shares to be issued. (2 marks)

(c) Determine the marginal cost of capital for Akabebi Company Ltd based on the above information. (8 marks)

(d) Evaluate whether it is viable to invest in the proposed project (Round off your answer for cost of capital to the nearest 1) (2 marks)

(e) Explain clearly the sense in which depreciation is said to be a source of funds to business firms. (5 marks)

(Total: 20 marks)