

**BONDO UNIVERSITY COLLEGE**  
**SCHOOL OF BUSINESS AND LEGAL STUDIES (MAIN CAMPUS)**  
**BACHELOR OF BUSINESS ADMINISTRATION YEAR 3 SEMESTER 1**  
**ABA 303 FINANCIAL MANAGEMENT**  
**JANUARY-APRIL 2013**  
**DURATION: 3 HOURS**

**Instructions:**

Answer question **ONE** and any other **TWO** question.

**QUESTION ONE**

- a) A firm may adopt a conservative policy or an aggressive policy in financing its working capital needs. Clearly distinguish between:
- i) A conservative policy and (3 marks)
  - ii) An aggressive policy. (3 marks)
- b) Identify and briefly explain the three main forms of agency relationship in a firm. (6 marks)
- c) Identify and explain three methods of handling risks in capital budgeting. (6 marks)
- d) Kiwanda Limited is considering the purchase of a new machine. Two alternative machines, Pesi TZO and Upesi MO2, which will cost Sh.6,000,000 and Sh.7,000,000 respectively are available in the market. The company's cost of capital is 12%. The cash flow after taxation of each machine are as follows:

Year	Cash flow	
	Pesi TZO Sh.	Upesi MO2 Sh.
1	600,000	1,800,000
2	1,800,000	2,400,000
3	2,000,000	3,000,000
4	3,000,000	1,800,000
5	2,400,000	1,600,000

**Required**

- i. Compute the net present value of each machine. (8 marks)
- e) Describe the factors that determine the working capital needs of a manufacturing firm. (4 marks)

## QUESTION TWO

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

State of the 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 expected rate of return (3 marks)
- ii. Compute the variance and standard deviation of each project (12 marks)
- iii. Compute the co-efficient of variation for each project (3 marks)
- iv. Which is a better project? Why? (2 marks)

## QUESTION THREE

(a) Distinguish between the following terms as used in the management of working capital:

- (i) Overtrading and overcapitalization. (4 marks)
- (ii) Factoring and pledging of debtors (4 marks)

(b) The following information relates to Mafuta Safi Limited:

	Shs. '000'
Purchase of raw materials	6,700
Usage of raw materials	6,500
Sale of finished goods (all on credit)	25,000
Cost of sales (finished goods)	18,000
Average creditors	1,400
Average raw materials stock	1,200
Average work in progress	1,000
Average finished goods stock	2,100
Average debtors	4,700

Assume a 365 days year.

### Required:

The length of the operating cash cycle (12 marks)  
**(Total: 20 marks)**

## QUESTION FOUR

Ushindi Limited presented the following financial statements on 30 June 2004.

**Income statement for the year ended 30 June 2004**

	<b>Sh.</b>
Sales (all on credit)	4,000,000
Operating profit	440,000
Less: debenture interest	<u>40,000</u>
	400,000
Corporation tax	<u>176,000</u>
	224,000
Ordinary dividends proposed	<u>107,200</u>
Retained profit	<u>116,800</u>

**Balance Sheet as at 30 June 2004**

	<b>Shs.</b>	<b>Shs.</b>	<b>Shs.</b>
<b>Fixed assets:</b>			
Freehold property (Net book value)			480,000
Plant and machinery (Net book value)			800,000
Motor vehicle (Net book value)			200,000
Furniture and fittings			<u>200,000</u>
			1,680,000
<b>Current assets:</b>			
Stock		1,000,000	
Debtors		400,000	
Investments		<u>120,000</u>	
		1,520,000	
<b>Current liabilities</b>			
Trade creditors	238,400		
Bank overdraft	878,400		
Corporation tax	176,000		
Dividend payable	<u>107,200</u>	<u>(1,400,000)</u>	<u>120,000</u>
			<u>1,800,000</u>
<b>Financed by:</b>			
Authorized share capital: 800,000 Sh.1 ordinary shares			<u>800,000</u>
Issued and fully paid: 400,000 Sh.1 ordinary shares			400,000
Capital reserve			200,000
Revenue reserve			800,000
Loan capital: 400,000 Sh.1 10% debentures			<u>400,000</u>
			<u>1,800,000</u>

**Additional information:**

- An analysis of the industry in which the company operates reveals the following industrial averages:

Current ratio 1.5:1

Quick ratio 0.8:1

- The purchases for the year were Sh.2,160,000 while the cost of sales was Sh.3,000,000.

3. The market price of the company's shares as at 30 June 2004 was Sh.5.

**Required:**

(a) Compute the following ratios for Ushindi Limited:

- (i) Return on capital employed (2 marks)
- (ii) Turnover of capital (2 marks)
- (iii) Operating expenses ratio. (2 marks)
- (iv) Accounts receivable turnover in days (2 marks)
- (v) Dividend yield. (2 marks)
- (vi) Price earnings ratio (2 marks)
- (vii) Market value to book value ratio (2 marks)
- (viii) Current ratio (2 marks)

(b) Compare the company's liquidity performance with that of the industry. (4 marks)

**(Total: 20 marks)**

**QUESTION FIVE**

(a) Although profit maximization has long been considered as the main goal of a firm, shareholder wealth maximization is gaining acceptance amongst most companies as the key goal of a firm.

**Required:**

- (i) Distinguish between the goals of profit maximization and shareholder wealth maximization. (4 marks)
- (ii) Explain three limitations of the goal of profit maximization.(6 marks)

(b) Explain three key roles of a capital markets regulator in your country. (6 marks)

(c) Highlight the importance of the following terms in investment appraisal:

- (i) Internal rate of return (IRR) (2 marks)
- (ii) Payback period. (2 marks)

**(Total: 20 marks)**