**JARAMOGI OGINGA UNIVERSITY OF SCIENCE AND TECHNOLOGY**

**SCHOOL OF BUSINESS AND ECONOMICS**

**UNIVERSITY EXAMINATION**

**FOR DEGREE OF BACHELOR OF BUSINESS ADMINISTRATION WITH IT**

**3$^{RD}$ YEAR 2$^{ND}$ SEMESTER 2019/2020 ACADEMIC YEAR**

**KISUMU CAMPUS**

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**COURSE CODE: ABA 303**

**COURSE TITLE: FINANCIAL MANAGEMENT**

**DATE:1/12/20**

**TIME: 3.00 HOURS EXAM SESSION-3-6 PM**

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**INSTRUCTIONS:**

1. **Answer Question ONE (Compulsory) and ANY other 2 Questions**

1. **Candidates are advised to write on the text editor provided, or to write on a foolscap, scan and upload alongside the question.**
2. **Candidates must ensure that they submit their work by clicking 'FINISH AND SUBMIT ATTEMPT' button at the end.**

**QUESTION ONE (30 MARKS)**

a) Discuss in details differences between

i) Debt Capital and Equity Capital (6 marks)

ii) Money market and Capital market (6 marks)

b) Enumerate the significance of the Cost of Capital and how it is influenced (7 marks)

c) Assuming an Interest Rate of 10%

**Determine:**

i) The future value of Kshs: 500,000 invested now for a period of 10 years (2 marks)

ii) The future value at the end of eight years of an investment of Kshs: 100,000 now and Kshs: 50,000 two years from now. (3 marks)

iii) The future value at the end of fifteen years of an investment of Kshs: 2, 000,000 at the end of each of the first five years and withdrawal of Kshs: 800,000 per year at the end of years six through fourteen. (6 marks)

(Present value; Future value and Future value annuity tables are attached)

**QUESTION TWO (20 MARKS)**

a) Identify the objectives of working capital management and discuss the central role of working capital management in financial management (8 marks)

b) Suggest and discuss any three policies that a Limited Company may be using in the management of the working capital (6 marks)

c) 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)

**QUESTION THREE (20 MARKS)**

a) Company ABC Limited is considering the purchase of a new machine. Two alternative machines, Pesi and Upesi, which will cost Sh.8, 000,000each are available in the market. The company's cost of capital is 12%. The cash flow after taxation of each machine are as follows:

**Cash flow**

| **Year** | **Pesi** | **Upesi** |
|---|---|---|
| | **Sh.** | **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 |

Assume that the company's cost of capital is 12%.

**Required:**

i) Determine the Payback period for each machine (4 marks)

ii) Compute the net present value of each machine. (8 marks)

iii) Calculate the profitability index of each machine (3marks)

iv) Advise the management which machine to invest in and why (2 mark)

**b)** Explain the limitations of the goal of profit maximization. (3 marks)

**QUESTION FOUR (20 MARKS)**

a) Discuss the following approaches to capital structure theory:

i) The Modigliani and Miller (MM) (4 marks)

ii) The Net Income Approach (3 marks)

iii) The Net Operating Income Approach (2 marks)

iv) The Traditional Approach (2 marks)

**b)** ABC Ltd belongs to a risk class for which the appropriate capitalization rate is 10%. It currently has outstanding 5000 shares selling at Kshs: 100 each. The firm is contemplating the declaration of dividend of Kshs: 6 per share at the end of the current financial year. The company expects to have net income of Kshs: 50,000 and has a proposal for making new investments of Kshs: 100,000.

**Required:**

Show that under the MM hypothesis, the payment of dividend does not affect the value of the firm. (9 marks)

**QUESTION FIVE (20 MARKS)**

a) Discuss limitations of Ratio Analysis (5 marks)

b) Explain in details the yardsticks used in ratios analysis (5 marks)

c) XYZ Company Limited whose net income was Kshs: 100,000 and Kshs: 200,000 for the year ended 2015 and 2016 respectively is a manufacturing company based in Nairobi, Kenya. The following information was extracted from the company's books of accounts for the year ended December 2016 and December 2015:

| Sr. No. | Item | 31st Dec 2016 (Kshs) | 31st Dec 2015 (Kshs) |
|---|---|---|---|
| i | Share Capital | 100,000 | 100,000 |
| ii | Current Tax Payable | 5,000 | 2,000 |
| ii | Cash and Cash Equivalents | 8,000 | 10,000 |
| iv | Intangible Assets | 60,000 | 50,000 |
| v | Trade Receivables | 25,000 | 30,000 |
| vi | Long-Term borrowings | 35,000 | 50,000 |
| vii | Property, Plant and Equipment | 130,000 | 120,000 |
| viii | Revaluation Reserve | 15,000 | 10,000 |
| ix | Current Portion of Long-Term borrowings | 15,000 | 15,000 |
| x | Goodwill | 30,000 | 30,000 |
| xi | Trade and other payables | 35,000 | 25,000 |
| xii | Inventories | 12,000 | 10,000 |
| xiii | Retained Earnings | 50,000 | 40,000 |
| xiv | Short-Term borrowings | 10,000 | 8,000 |

**Required:**

Calculate the following financial ratios of XYZ Company as @ $31^{st}$ December 2016

i) Current Ratio
ii) Debt-Assets Ratio
iii) Debt-Equity Ratio
iv) Return on Assets
v) Return on Equity

(10 marks)