

JARAMOGI OGINGA ODINGA UNIVERSITY OF SCIENEC & TECHNOLOGY

(KISII LEARNING CENTRE)

UNIVERSITY EXAMINATIONS 2014

SECOND YEAR FIRST SEMESTER FOR THE DEGREE OF MASTER OF
BUSINESS ADMINISTRATION

MBA811 :FINANCIAL MANAGEMENT

DATE:

TIME:.....

INSTRUCTIONS

1. Answer any FOUR questions
2. Each Question carries 15 marks
3. Do not write anything on this question paper

QUESTION ONE(15 MARKS)

- a) Explain the recurring finance functions (8marks)
- b) Briefly explain the importance of capital budgeting in a business organization. (3 marks)
- c) There are two competing shares M and K. The shares managed to sell at Kshs420 in July 2013. The shares are expected to receive dividends of Kshs8.50 each and they are expected to sell for Kshs510 and Kshs380 for M and K respectively.

Required:

Determine the returns of M and K and comment on the results (4marks)

QUESTION TWO (15 MARKS)

- a) Define marginal cost of capital and explain the factors that affect it (6marks)
- b) IterioLtd.'s capital is composed of debentures (35%), Ordinary shares (45%) and Preference shares (20%). The company wishes to measure its overall cost of capital to be able to make a decision in regard to new investment opportunities in the near future. The company has provided the following information and requires your guidance regarding the opportunity.

The company can sell 11% preference shares at Kshs100 par value. The cost of issuing and selling preference shares is expected to be 4% of the price of the share.

The company's ordinary shares are currently trading at Kshs80 per share and expects to have available Kshs225000 in retained earnings in the coming year. Once these retained earnings are exhausted the company will use new ordinary shares as its form of ordinary share financing. The shares have to be underpriced by 5% per share and underwriting expense is expected to be 5% per share

The company can raise an unlimited amount of debt by Kshs1000, 10% debentures on which annual interest will be made. To sell the issue of debt an average of Kshs30 discount has to be made and a floatation cost of Kshs20 per debenture must be paid.

The company expects to pay cash dividends of Kshs6 per share the following year and the dividends have been growing at an annual rate of 8% which is expected to persist in the future.

Required:

- (i) Calculate the specific cost of each source of financing (6marks)
- (ii) Determine the company's overall cost of capital (3marks)

QUESTION THREE (15 MARKS)

The following information relates to three machines in which the opportunity cost is 10%.

Year	MACHINES		
	P	Q	R
0	Kshs360000	Kshs360000	Kshs360000
1	160000	240000	180000
2	200000	60000	60000
3	20000	120000	60000
4	20000	0	60000

- (i) Determine the NPV of each machine and advise the prospective investor on his intention of investment. (8marks)
- (ii) Highlight the similarities between NPV and IRR and with illustrative examples show how NPV is superior to IRR (7marks)

QUESTION FOUR (15 MARKS)

- a) Although profit maximization has long been considered as the main goal of financial management, wealth maximization is gaining acceptance amongst most companies as the key goal of financial management.
- (i) Distinguish between the goals of profit maximization and shareholder wealth maximization. (4marks)
- (ii) Explain three limitations of the goal of profit maximization. (3marks)
- b) A firm X provides you with the following information

	<u>Kshs</u>
Sales revenue	640,000
Variable cost	480,000
Fixed costs	80,000
Variables cost per unit	6
Selling price per unit	8
Initial sales in units	80,000
New sales	96,000

Determine the firm's

- i. Degree of Operating Leverage (DOL) (3marks)
- ii. Degree of Financial Leverage (DFL) (3 marks)
- iii. Degree of Combined Leverage (DCL) (2marks)

QUESTION FIVE (15 MARKS)

- a) Highlight the limitations of Break-Even Analysis as a tool for financial planning (4marks)
- b) Jaber Cycle Mart has estimated that fixed costs per month are Ksh 240,000 and variable cost per Kshs of sales is 0.60.
Required:
- (i) What is the break-even point per month in sales? (2marks)
- (ii) What levels of sales are needed for a monthly profit of Ksh 60,000? (2marks)
- (iii) For the month of July the Jaber anticipates sales of Kshs1,200,000. What is the expected level of profit? (2marks)
- c) A company has provided sales and purchases for 3 months of the year 2013 as follows:

	Sales (Kshs)	Purchases (Kshs)
Jan	500,000	250,000
Feb	400,000	200,000
Mar.	600,000	300,000

80% of the sales are collected in the month of sale and 20% the following month. 20% of the purchases are paid for in the month of purchase and 80% are paid in the first month after purchase. The desired cash balance each month is Kshs100, 000.

Required:

Prepare a cash budget for the three months for this company (5marks)

QUESTION SIX (15MARKS)

- a) Explain the following terms
- i. Systematic risk (1½marks)
- ii. Aggressive securities (1½marks)
- iii. Risk Premium (1½marks)
- b) A prospective investor wishes to invest in either Company A or B or portfolio. You have been provided with the following information in relation to the two companies

Economic state	Probability of economic state	Return of A	Return of B	Return of market
Boom	0.2	15%	18%	24%
Average	0.3	12%	14%	22%
Recession	0.5	10%	16%	18%

Required:

- i. Determine the beta of each security and portfolio beta if the prospective investor wishes to invest in the two securities A and B in equal proportions (9marks)
- ii. Advice the investor on which security to invest in. (1½marks)