



**JARAMOGI OGINGA ODINGA UNIVERSITY OF SCIENCE AND TECHNOLOGY**  
**SCHOOL OF BUSINESS & ECONOMICS**  
**UNIVERSITY EXAMINATION FOR MASTER OF BUSINESS ADMINISTRATION**  
**1<sup>ST</sup> YEAR 2<sup>ND</sup> SEMESTER 2023/2024 ACADEMIC YEAR**  
**MAIN CAMPUS**

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**COURSE CODE: MBA 811**

**COURSE TITLE: FINANCIAL MANAGEMENT**

**EXAM VENUE:**

**DATE: 02/05/2024**

**EXAM SESSION: 9.00 – 12.00 NOON**

**DURATION: 3 HOURS**

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**INSTRUCTIONS**

- 1. Answer any FOUR questions**
- 2. Show ALL your workings and be as NEAT as possible.**
- 3. Candidates are advised not to write on the question paper**
- 4. Marks allocated to each question are shown at the end of the question.**

### QUESTION ONE ( 15 MARKS)

- a) Discuss the term "agency theory" as applied in financial management. (4 marks)
- b) Financial management practices in government departments are different from financial management practices in industrial or commercial companies.  
**Required:** Citing two reasons, justify the above statement. (4 marks)
- c) A project is expected to cost sh 20 million and have an estimated economic life of 5 years with nil residual value. Earnings before depreciation and tax expected over 5 years are as follows;

Year	Cashflow sh''000)
1	10,000
2	12,000
3	14,000
4	16,000
5	20,000

The corporation tax rate is 50% and depreciation is on a straight-line basis.

**Required:** Calculate the payback period for the project. (7 marks)

### QUESTION TWO (15 marks)

- a) Kenya Caps Ltd. has the following cost structure which is considered optimal

	sh. "000,000"
Ordinary share capital sh.10 par value	700
Retained earnings	400
10% preference share capital sh.20 par value	100
12% debenture sh. 100 par value	200
	<hr/> <b>1,400</b> <hr/>

#### Additional information

1. Corporate tax rate is 30%
2. Preference shares were issued 12 years ago and are still selling at par value MPS= Par value.
3. The debenture has a 12 year maturity period. It is currently selling at sh. 90 in the market.
4. Currently the firm has been paying dividend per share of sh 10. The DPS is expected to grow at 5%p.a in future. The current MPS is sh.60.

Required

- a) Determine Weighted Average Cost of Capital (WACC) of the firm and explain why market values and not book values are used to determine the weights. (10 marks).
- b) Kutembeza Ltd. is considering investing in a project which is expected to operate for the next four years after which it will have no salvage value. The plant will cost ksh 60,000 and yield the following uncertain cashflows.

Year	Cashflow	Certainty equivalent coefficients
0	(60,000)	1.00
1	24,000	0.90
2	19,000	0.70
3	18,000	0.50
4	8,000	0.30

The risk-free discount rate is given as 12%.

Required: Compute the Net Present Value for the project. (5 marks)

### QUESTION THREE (15 marks)

A small manufacturing company was established on 1<sup>st</sup> November 2023. The working capital available on 1<sup>st</sup> December 2023 was sh. 300,000.

The data given below relates to each of the months of December, January, February and March.

	SHS.
Direct materials	40
Direct wages	30
Variable production overhead	15
Variable production cost	85

Fixed overhead estimated at shs. 480,000 per annum is expected to be incurred in equal amounts each month from 1<sup>st</sup> December.

Production will commence in December and Sales on 1<sup>st</sup> January. The estimated sales for the first four months are;

Year, 2024	Units	Sales value shs.
January	6,200	651,000
February	6,800	707,200
March	5,400	594,000
April	6,000	630,000

### Additional information

1. Stocks, finished goods: 75% of each month's invoiced sales units to be produced in the month of sale and 25% of each month's invoiced sales units to be produced in the previous month.
2. Stocks, direct materials: 50% of direct materials required for each month's production to be purchased in the previous month. Direct materials to be paid for in the month following purchase.
3. Direct wages to be paid 75% in the month used and 25% in the following month.
4. Variable production overhead: 40% to be paid in the month of usage and the balance in the following month.
5. Fixed overhead: 30% to be paid in the month in which it is incurred and 40% in the following month, the balance represents depreciation of fixed assets.
6. Payments to be received from customers as follows;

	<b>shs</b>
January	123,690
February	459,870
March	596,660

**Required:** Prepare a cash budget for the period. (15 marks)

### QUESTION FOUR (15 MARKS)

- a) Executive compensation plans hinder value creation in a company. Discussing three reasons, justify the above statement. (3 marks)
- b) Describe four ways that could be used to mitigate agency conflict between managers and shareholders. (3 marks)
- c) Discuss the conflicts that might arise among the objectives of working capital management. (3 marks)
- d) Enzibo Ltd. maintains a minimum cash balance of Sh. 1,500,000. The standard deviation of the daily cash is Sh.800, 000. The annual interest rate is 12%. The transaction cost of buying and selling of marketable securities is Sh.200 per transaction. Assume that one year has 365 days.

**Required:** Using the Miller-Orr cash management model, determine:

- i) The return point. (2 marks)
- ii) Average cash balance. (2 marks)
- iii) The upper cash limit. (2marks)

### QUESTION FIVE (15 MARKS)

Wide Trading Company Limited presented the following financial statements for the year ended 31 December 2023.

#### Income statement for the year ended 31 December 2023

	sh.	sh.
Sales		9,040,000
<b>Cost of sales</b>		
Opening stock	2,500,000	
Purchases	6,820,000	
	<u>9,320,000</u>	
Closing stock	(2,860,000)	(6,460,000)
Gross profit		<u>2,580,000</u>
Expenses		(2,640,000)
Net loss		<u>(60,000)</u>

#### Balance sheet as at 31 December 2023

	sh	sh
<b>Non current assets</b>		
premises	5,600,000	
Fixture and fittings (Net book value)	500,000	
Motor vehicle (Net book value)	<u>1,040,000</u>	7,140,000
<b>Current assets</b>		
Stock	2,860,000	
Debtors	<u>3,260,000</u>	
	<u>6,120,000</u>	
<b>Current liabilities</b>		
Trade creditors	2,900,000	
Bank overdraft	<u>2,800,000</u>	
	<u>5,700,000</u>	
Net current assets		<u>420,000</u>
Net assets		<u>7,560,000</u>
<b>Financed by:</b>		
Ordinary share capital		2,000,000
Retained profit		3,160,000
Long term loans		<u>2,400,000</u>
Capital employed		<u>7,560,000</u>

Assume a 360 – day year.

**Required:** Determine and interpret the ratios below;

- a) Operating cash cycle (5 marks)
- b) Quick ratio (2 marks)
- c) Current ratio (2 marks)
- d) Debt to equity ratio (2 marks)
- e) Net profit margin ratio (2 marks)
- f) Debtors turnover ratio (2 marks)

**QUESTION SIX (15 MARKS)**

- a) Kiwanda Ltd is a manufacturing company based in Mombasa. The firm is considering the acquisition of two separate machines to enhance its production capacity in order to meet the surge in demand for its products. The machines are mutually exclusive projects and hence investing in either of the machines excludes the other from being acquired. Capital is also limited and hence they cannot acquire both of them. Machine A requires costs of shs. 90,000 and Machine B costs of shs. 130,000. The machines have different production capabilities and hence the difference in their prices. The expected net returns from the machines is as follows;

Year	1	2	3	4	5
Machine A (SHS)	20,000	23,000	25,000	33,000	40,000
Machine B (SHS)	30,000	40,000	50,000	50,000	15,000

The salvage value for Machines A and B are shs 8,000 and 15,000 respectively.

**Required;** Given a discounting rate of 14%, advise on which machine Kiwanda Ltd. Should invest in, using the relevant discounting techniques. {**Hint:** Use at least three discounting techniques to arrive at your conclusion). (12 Marks)

- b) In periods of difficult global financial environment, raising of capital is a challenge necessitating the need for prudent and best use of scarce capital for projects.

**Required:** In reference to the above:

- i. Explain the term *capital rationing*. (2 marks)
- ii. Distinguish between *soft capital rationing* and *hard capital rationing* giving an example each. (3 marks)