JARAMOGI OGINGA ODINGA UNIVERSITY OF SCIENCE AND TECHNOLOGY

SCHOOL OF BUSINESS & ECONOMICS

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

3RD YEAR 1ST SEMESTER 2015/2016 ACADEMIC YEAR

MAIN CAMPUS RESIT

COURSE CODE: ABA 303

COURSE TITLE: FINANCIAL MANAGEMENT

EXAM VENUE: lab 1 **STREAM: (BBA)**

DATE: O6/5/16 **EXAM SESSION: 9.00 – 11.00 AM**

TIME: 2 HOURS

Instructions:

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

QUESTION ONE

a. Mama Star Enterprises is a distributor or air filters to retail shops. It buys its filters from several manufacturers. Filters are ordered in lot sizes of 100 and each order costs Sh.400 to place. Demand from retail shops is 200,000 filters per month and the carrying cost is Sh.10 per filter per month.

Required

i. Compute the optimal order quantity with respect to number of lot sizes" (3 marks)

ii. If a safety stock of 2,000 filters is desired calculate the total relevant costs (3 marks)

iii. A certain manufacturer offers a discount of 2% for purchases of 50 lot sizes or more. Determine whether the discount should be taken. (Assume that each filter costs Sh.100). (10 marks)

b. Briefly explain the yardsticks used in ratios analysis. (5 marks)

c. Discuss the advantages of cash budgeting as a means of managing organizations cash. (5 marks)

d. Enumerate the assumptions underlying the economic order quantity model (4 marks)

QUESTION TWO

a) Company ABC Limited is considering the purchase of a new machine. Two alternative machines, Pesi and Upesi, which will cost Sh.8, 000,000 each 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 pay back 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 (2 marks)

iv. Advise the management which machine to invest in and why (1 mark)

b) Explain the limitations of the goal of profit maximization. (5 marks)

QUESTION THREE

a) Mr. Onyango has an investment capital of Sh.1, 000,000. He wishes to invest in two securities, A and B in the following proportion; Sh.200, 000 in security A and Sh.800, 000 in security B.

The returns on these two securities depend on the state of the economy as shown below:

State of Economy	**Probability**	**Returns on Security A**	**Returns on Security B**
Boom	0.4	18%	24%
Normal	0.5	14%	22%
Recession	0.1	12%	21%

Required:

i. Compute the expected portfolio return (2marks)

ii. Determine the correlation coefficient between security A and security B (6 marks)

iii. Calculate the portfolio risk (2 marks)

b) Within a business organization context, discuss the problems that might exist in the agency relationships between:

i. Shareholders and managers (5 marks)

ii. Shareholders and creditors (5 marks)

QUESTION FOUR

a) Distinguish between debt and equity capital. (10 marks)

b) 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)

c) Describe the factors that determine the working capital needs of a manufacturing firm. (4 marks)