



**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 2016/2017 ACADEMIC YEAR

KISII CAMPUS-PART TIME

COURSE CODE: ABA 303

COURSE TITLE: FINANCIAL MANAGEMENT

EXAM VENUE:

STREAM: (BBA)

DATE:

EXAM SESSION:

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 (30 MARKS) - COMPULSORY

- (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. Distinguish between the goals of profit maximization and shareholder wealth maximization. **(2 Marks)**
- (b) Suppose you purchase a 182-day T-bill for Ksh. 11750 and that the instrument has a face value of Ksh. 12,600. Determine;
- (i) the discount yield for this T-bill **(3Marks)**
 - (ii) the bond equivalent yield **(3Marks)**
- (c) Although financial ratios are a powerful bench mark tool for evaluating the financial position and performance of a firm, there are limitations to their use. Highlight any four such limitations of financial ratio analysis **(4 Marks)**
- (d) A certain firm has the following information;

	(Ksh.)
Sales revenue	320,000
Variable costs	240,000
Fixed costs	40,000
Selling Price	4
Variable cost per unit	3
Initial sales in units	40,000
New sales	48,000

Required, Determine the:

- (i) degree of operating leverage (DOL) **(3marks)**
 - (ii) the degree of financial leverage (DFL) **(3 marks)**
 - (iii) hence Degree of combined leverage (DCL) **(1mark)**
 - (iv)
- (e) Explain why it may be difficult for Small companies to raise debt finance in Kenya **(3 marks)**
- (f) (i) what is the relevance of capital budgeting for any investment ? **(2 marks)**
- (ii) Calculate the Internal Rate of Return (IRR) for the following stream of cash flows

Year	0	1	2
Cash flows	-100	100	20

- (iii). State any two advantages of internal rate of return (IRR) as a criterion for evaluating investment projects (4marks)
(2 marks)

QUESTION TWO (20 MARKS)

- (a)(i)What is financial forecasting? (1 Mark)

(ii) The balance sheet of Tumaini Company as at 31st Dec 2014 is given below:

Assets	(US \$)	Liabilities	(US \$)
Cash	10,000	Accounts payable	45,000
Debtors	45,000	Accrued expenses	15,000
Inventory	30,000	Notes payable	20,000
Fixed Assets	<u>55,000</u>	Share capital	15,000
Total	140,000	retained earnings	<u>50,000</u>
		Total	140,000

Current sales are Ksh.200,000. All assets, accrued expenses and accounts payable are expected to maintain current relationship to sales as sales volume increases. The sales are projected to grow by 50% in the year 2015. The company pays out 40% of its net profit and earns 6% after tax on sales.

Required:

- (i) Prepare a proforma balance sheet as at 31st Dec 2015 (7
Marks)
- (ii) Determine the percentage of external funds required (PEFR) (4 marks)

(b) The following financial statements related to the A B C company

Assets	shs.	Liabilities & net worth	sh
Cash	28,500	Trade credit	
	116,250	Notes payable (9%)	54,000
Debtors	270,000	other current liabilities	100,500
Stock	<u>649,500</u>	long term debt (10%)	300,000
Total current assets	948,800	Net worth	<u>663,000</u>
Net fixed assets	<u>285,750</u>		<u>1,</u>
	<u>1,233,750</u>		<u>1,</u>
233,750			

Income statement for the year ended 31 march 2016.

Sales	sh.1, 972,500
Less cost of sales	<u>sh.1, 36,8,000</u>
Gross profit	sh.604, 500
Selling and distribution expences	<u>sh.498, 750</u>
Earning before interest and tax	sh.105,750

Interest expense	34,500
	<hr/>
	sh.71,250
Estimated taxation (40%)	sh.28,500
Earnings after interest and tax	<hr/> <hr/>
	sh.42, 750

Required:

- (i) Inventory turnover ratio (2Marks)
- (ii) Total assets turnover (2Marks)
- (iii) Net profit margin (2Marks)
- (iv) state any two uses of financial ratios (2Marks)

QUESTION THREE (20 MARKS)

(a) Highlight four characteristics of a good investment evaluation/appraisal technique.
(4mks)

(b) ABC Ltd is contemplating investing in any of the projects A and B which require an initial outlay of of Kshs100,000. Their expected cash inflows are given below:

Year	1	2	3	4	5
Project A	kshs40000	25000	30000	25000	30000
Project B	kshs35000	35000	40000	20000	20000

Required:

Using the payback period advice XYZ on the best project to invest in using:

- (i) Payback Period (5 Marks)
- (ii) Net Present Value (5Marks)

(c) Explain the following concepts:

- (i) Arbitrage (2marks)
- (ii) Futures (2marks)
- (iii) Options (2marks)

QUESTION FOUR (20 MARKS)

(a) State four assumptions of Capital Assets Pricing Model (4marks)

(b) Differentiate between the following terms

- i. Systematic and unsystematic risk (2marks)
- ii. Aggressive and Defensive securities (2marks)

(d) 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 **(10 marks)**
- ii. Advise the investor on which security to invest in. **(2marks)**

QUESTION FIVE (20 MARKS)

- (a)(i) What is a money market? **(1 mark)**
 - (ii) Highlight three characteristics of money market instruments **(3marks)**
 - (iii) State and explain four money market instruments used in Kenya **(8 marks)**
- (b) Explain any four circumstance under which a company may favour the use of ordinary shares to source for funds. **(8marks)**

Present Value Table (PVIF)

Present value of 1 i.e. $PVIF = (1 + r)^{-n}$

Where r = discount rate

n = number of periods until payment

<i>Discount rate (r)</i>										
period (n)	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%
1	0.990	0.980	0.971	0.962	0.952	0.943	0.935	0.926	0.917	0.909
2	0.980	0.961	0.943	0.925	0.907	0.890	0.873	0.857	0.842	0.826
3	0.971	0.942	0.915	0.889	0.864	0.840	0.816	0.794	0.772	0.751
4	0.961	0.924	0.888	0.855	0.823	0.792	0.763	0.735	0.708	0.683
5	0.951	0.906	0.863	0.822	0.784	0.747	0.713	0.681	0.650	0.621
6	0.942	0.888	0.837	0.790	0.746	0.705	0.666	0.630	0.596	0.564
7	0.933	0.871	0.813	0.760	0.711	0.665	0.623	0.583	0.547	0.513
8	0.923	0.853	0.789	0.731	0.677	0.627	0.582	0.540	0.502	0.467
9	0.914	0.837	0.766	0.703	0.645	0.592	0.544	0.500	0.460	0.424
10	0.905	0.820	0.744	0.676	0.614	0.558	0.508	0.463	0.422	0.386
11	0.896	0.804	0.722	0.650	0.585	0.527	0.475	0.429	0.388	0.350
12	0.887	0.788	0.701	0.625	0.557	0.497	0.444	0.397	0.356	0.319
13	0.879	0.773	0.681	0.601	0.530	0.469	0.415	0.368	0.326	0.290
14	0.870	0.758	0.661	0.577	0.505	0.442	0.388	0.340	0.299	0.263
15	0.861	0.743	0.642	0.555	0.481	0.417	0.362	0.315	0.275	0.239
(n)	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%
1	0.901	0.893	0.885	0.877	0.870	0.862	0.855	0.847	0.840	0.833
2	0.812	0.797	0.783	0.769	0.756	0.743	0.731	0.718	0.706	0.694
3	0.731	0.712	0.693	0.675	0.658	0.641	0.624	0.609	0.593	0.579
4	0.659	0.636	0.613	0.592	0.572	0.552	0.534	0.516	0.499	0.482
5	0.593	0.567	0.543	0.519	0.497	0.476	0.456	0.437	0.419	0.402
6	0.535	0.507	0.480	0.456	0.432	0.410	0.390	0.370	0.352	0.335
7	0.482	0.452	0.425	0.400	0.376	0.354	0.333	0.314	0.296	0.279
8	0.434	0.404	0.376	0.351	0.327	0.305	0.285	0.266	0.249	0.233
9	0.391	0.361	0.333	0.308	0.284	0.263	0.243	0.225	0.209	0.194
10	0.352	0.322	0.295	0.270	0.247	0.227	0.208	0.191	0.176	0.162
11	0.317	0.287	0.261	0.237	0.215	0.195	0.178	0.162	0.148	0.135
12	0.286	0.257	0.231	0.208	0.187	0.168	0.152	0.137	0.124	0.112
13	0.258	0.229	0.204	0.182	0.163	0.145	0.130	0.116	0.104	0.093
14	0.232	0.205	0.181	0.160	0.141	0.125	0.111	0.099	0.088	0.078
15	0.209	0.183	0.160	0.140	0.123	0.108	0.095	0.084	0.074	0.065