

CHUKA



UNIVERSITY

UNIVERSITY EXAMINATIONS

**THIRD YEAR EXAMINATION FOR THE AWARD OF DEGREE OF
BACHELOR OF EDUCATION ARTS**

BCOM 337: FINANCIAL MANAGEMENT I

STREAMS: Y4S1

TIME: 2 HOURS

DAY/DATE: WEDNESDAY 31/3/2021

2.30 PM – 4.30 PM

INSTRUCTIONS:

- Answer Question One and any other Two Questions
- Do not write on the question paper

QUESTION ONE

(a) Agency conflict occurs when agents pursue their own interest rather than the interest of the Principal in an organization a conflict between shareholders and auditors arises.

(i) in the above, identify the agent and his role in the organization. [2 Marks]

(ii) Discuss the causes of conflicts between shareholders and auditors and the solutions to the conflicts. [6 Marks]

(b) What will be amount that will be deposited each year so as to accumulate to sh.450,000 in 8 years at an interest rate of 18%. [3 Marks]

(c) A company is considering whether it should purchase an equipment to increase its production. The equipment costs sh.1,500,000 and has a useful use of 6 years with a scrap value of shs.300,000. For each of the 6 years of usage the equipment is expected to produce 15,000 units each costing shs.200. The variable cost per unit is sh.140 and the fixed cost is sh.500,000. The cost of capital is 11%. Tax rate is 30% and depreciation is on straight line method.

Required;

(i) NPV of the project [4 Marks]

(ii) Compute the percentage change in the cost of equipment and scrap value for the project to be rejected. [4 Marks]

d. A company is considering investing in a project that promises profit before depreciation and tax of sh.40,000 each year for 4 years. The cost of the project is sh. 120,000 with sh.20,000 as the scrap value. Tax rate is 30%. Depreciation is on straight line method. Required

(i) Accounting rate of return. [4 Marks]

(ii) State three limitations of Accounting rate of return. [3 Marks]

(e) A Company is considering purchasing a 12% 8 years sh.100,000 debenture currently selling at sh.120,000. The cost of capital is 14% Required: Should the company purchase the debenture. [4 Marks]

QUESTION TWO

(a) Bimbo investment limited has the following capital structure

| | (Sh 000) |
|------------------------------------|---------------|
| Ordinary shares (sh 80 par) | 8,000 |
| Retained Earnings | 5,000 |
| 12% preference shares (sh 100 par) | 6,500 |
| 10% debentures (sh 130 par) | 4,500 |
| 6 Year 15% long term loan | 4000 |
| | <u>28,000</u> |

Additional Information

(i) Ordinary shareholders expect a dividend of sh.15 which is expected to grow at 8%. The shares are trading at a premium of 25% and incurs a flotation cost of sh.10.

(ii) Preference shares will mature in 13 years and currently sell at a discount of 10%

(iii) Debentures were issued 10 years ago and currently sell at a premium of 20%.

(iv) Long term loan is currently selling at sh 6,000,000.

Required: Weighted Average cost of capital [12 Marks]

(b) Explain the significance of cost of capital. [4 Marks]

(c) Distinguish between venture capital and mortgage finance. [4 Marks]

QUESTION THREE

(a) Describe the functions of financial markets to the Kenyan economy. [6 Marks]

b) Bimbo Limited is considering investing in an equipment that costs sh.360,000. The equipment will produce 1,500, 1,300, 1,200, 900, 800 and 1,000 quantity of units from year one to year six respectively. Each unit is sold at sh.150 and incurs a variable cost of sh.60 each unit and fixed cost incurred each year is sh.10,000 cost of capital is 11%, tax rate is 30%, depreciation is on straight line method and the scrap value is sh.60,000. Required

NPV, PI and IRR [14 Marks]

QUESTION FOUR

(a) A company is considering relaxing its credit standards, the firm current credit terms is net 30 but the average collection period is 45 days. Current annual sales amount to sh.8 million, the firm wants to extend the period to net 75 days. With that sales will increase by 25% and bad debts will increase from 2% to 2.5% of annual credit sales, collection cost will increase by sh.90,000. The return on investment in debtors is 10%. Selling price per unit is sh.120 and the variable cost per unit is sh.90. Assume a year has 360 days. Required should the firm change the credit policy. [7 Marks]

(b) Explain the determinants of working capital needs of a firm. [5 Marks]

(c) A company currently pays a dividend of sh.15 per share which is expected to grow at 10% for 2 years, 15% for 2 years and 20% for 2 years after which it will fall to a constant rate of 11%. Calculate the intrinsic value of the share if the risk free rate is 6% and the risk premium is 9%.

[8 Marks]

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