CHUKA UNIVERSITY

UNIVERSITY EXAMINATIONS

EXAMINATION FOR THE AWARD OF DEGREE OF BACHELOR OF COOPERATIVE MANAGEMENT AND AGRIBUSINESS MANAGEMENT

BPLM 321: FINANCIAL MANAGEMENT

STREAMS: BCOP, AGBM **TIME: 2 HOURS**

DAY/DATE: TUESDAY 21/09/2021 **8.30 A.M. – 10.30 A.M.**

Instructions: Answer question one and any other two questions

Question one

a) Bimbo limited is considering investing in 7 projects whose information is provided below.

Projects	**Initial cost (000)**	**Annual Revenue (000)**	**Fixed cost (000)**	**Useful life**
A	20	25	8	6
B	22	30	10	3
C	17	20	7	5
D	19	18	6	12
E	10	10	3	8
F	14	15	5	10
G	13	12	4	7

Additional information

Variable costs are 40% of annual revenues

Cost of capital is 10% and the company has a limit of sh 80,000. Determine the optimal allocation of sh 80,000 among the projects if the projects are divisible. (10 marks)

b) Agency problem exists when agents pursues their own interests rather that the interest of their principles. Discuss the causes of conflicts that occurs when shareholders pursue their interest rather than the interest of creditors and the solutions to the conflicts.

(6 marks)

c) Discuss the functions of the finance manager in the contemporary organization. (6 marks)

d) ABC limited is considering whether it should purchase a new machine to increase its production and sales. The machine costs sh 1,500,000 and has an expected life of 6 years with a scrap value of sh 300,000. For each of the 6 years of usage the machine is expected to produce 15,000 units. Each unit can be sold for sh 200 per unit and will incur variable cost of sh 140 per unit. Fixed costs incurred will be sh 500,000. Depreciation is on straight line method, tax rate is 30% and cost of capital is 12%. Determine the NPV of the project and by what percentage change is required in the cost of machine and sales revenue for the project to be rejected. (8 marks)

Question two

a) Highlight the steps involved in financial planning. (6 marks)

b) The following is the balance sheet of Migingo limited as at 31st December 2013

	Sh (000)
Fixed assets	
Land	7000
Machinery	15000
Equipment	8000
Current assets	
Cash	4000
Bank	3000
Debtors	8000
Stock	5000
	50000
Financed by:	
Ordinary share capital	25000
Retained earnings	6000
15% Long term debt	7000
Creditors	8000
Accrued expenses	4000
	50000

Additional information

- The sales for the year ended 31st December 2013 amounted to sh 70,000,000. The sales will increase by 10% in 2014 and 15% in 2015
- The after-tax profit on sales is 20%
- The company's dividend payout ratio is 80%

Determine the amount of external financial requirements for the next two years. (7 marks)

c) A company has a net operating income of sh 70,000, it has 12% sh 300,000 debenture, the overall capitalization rate is 10%.

   i. Calculate the value of the firm and the equity capitalization rate using the net operating income approach. (4 marks)

   ii. Highlight the assumptions of net operating income approach. (3 marks)

Question three

a) XYZ currently has 10,000 outstanding shares currently selling at sh 150 each. The dividend for the financial year is 15 per share. The company expects a net income of sh 160,000 and a proposal of making a new investment of sh. 300,000.

i. Show that under MM Hypothesis that dividend payment has no effect on the value of the firm if the equity capitalization rate is 12%. (5 marks)

ii. State three criticisms of Modigliani and miller hypothesis. (3 marks)

b) The following information related to a certain company for two years.

	2019	2020
Sales	6,000,000	8,400,000
Variable cost	2,500,000	3,000,000
Fixed cost	500,000	900,000
Interest	500,000	1,500,000
Tax rate	50%	50%
Number of outstanding shares	5,000	5,000

Required:

i. Determine the degree of operating, financial and combined leverage (7 marks)

ii. Discuss the factors affecting the leverage decisions of a firm. (5 marks)

Question four

a) Explain the factors that influence the working capital needs of a firm. (4 marks)

b) ABC ltd requires 6,000 units of a component in its manufacturing process in the coming year which costs sh 130. The items are available and the lead time is 2 weeks. Each order costs sh 150 to prepare while the holding cost is sh 20. The Company considers giving a quantity discount of 12% if a minimum of 500 units are ordered advice whether the quantity discount should be given. (6 marks)

c) State the significance of the cost of capital. (4 marks)

d) Shirandula limited has set the minimum cash balance of sh 17,500. The variance of the daily cash flow is sh. 6,250,000 and the interest rate on marketable securities is 12% per annum. The transaction cost is sh 30. Required target cash balance, average cash balance and the spread. (6 marks)

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