

CHUKA



UNIVERSITY

UNIVERSITY EXAMINATIONS

EXAMINATION FOR THE AWARD OF DEGREE OF BACHELOR OF  
PROCUREMENT AND LOGISTICS MANAGEMENT, AGRIBUSINESS  
MANAGEMENT AND COOPERATIVE MANAGEMENT

BPLM 321: FINANCIAL MANAGEMENT

STREAMS: BPLM (Y3S1, Y4S1)

TIME: 2 HOURS

DAY/DATE: FRIDAY 26/03/2021

8.30 A.M. – 10.30 A.M.

**INSTRUCTIONS: Answer question ONE and any other TWO questions**

QUESTION ONE

- (a) In an organization set up, conflict can arise between different parties such as shareholders and creditors. The conflict can be as a result of agent pursuing their own interest
- (i) In the above, identify the principal and identify their role in the organization [2 marks]
- (ii) Discuss the sources of conflict between shareholders and creditors [3 marks]
- (b) A given company has employed you as their investment advisor on various projects they want to undertake, the cost of capital is 12%

Projects	Initial cost (000)	Annual Cashflows (000)	Useful life (yrs)
A	24	8	5 years
B	20	9	3
C	22	5	6
D	18	4	7
E	16	6	4
F	15	3	8
G	38	7	10

**Additional information:**

- (i) Projects D and E are mutually exclusive
- (ii) Determine the optimal allocation of sh 70,000 if the company does not allow external borrowing and the projects are in divisible [4 marks]

## BPLM 321

- (c) Explain the managerial finance functions [6 marks]
- (d) A company is evaluating a new equipment. The equipment has 2 years and costs sh 30,000. In the first year the equipment is expected to produce 10,000, 12,000 and 15,000 cashflows with the associated probabilities of 0.2, 0.6 and 0.2 respectively. If it generates 10,000 cashflows, then the second year Cashflows will be 10,000 and 12,000 with probabilities of 0.4 and 0.6 respectively. If they generate 12,000, then second year cashflow will be 16, 000, and 20,000, with associated probabilities of 0.2 and 0.8 respectively. If it generates 15,000, then second year cashflow will be 18,000 and 24,000 with associated probabilities of 0.7 and 0.3. The cost of capital is 13%.

### Required:

- Determine the expected monetary value (EMV) and the expected net present value (ENPV) and advise if the project is viable. [12 marks]
- (e) A firm is an all equity firm with a beta coefficient of 1.4; the risk free rate is 8% and the risk premium is 14%. Calculate the cost of equity [2 marks]

## QUESTION TWO

- (a) ABC limited is considering whether it should purchase an equipment to increase its production. The equipment costs sh 1,200,000 and has a useful life of 8 years with a scrap value of sh 200,000 for each of the 8 years of usage the equipment is expected to produce 10,000 units each costing sh 200. The variable cost per unit is sh.100 and the fixed cost is sh 300,000. The cost of capital is 14%, tax rate is 30% and depreciation is on straight line method.

### Required:

- (i) Calculate the NPV of the project [3 marks]
- (ii) Compute the perchange change in the cost of equipment, sales revenue and scrap value for the project to be rejected [6 marks]
- (b) State the significance of cost of capital [4 marks]
- (c) A company expects an earnings before interest and tax of sh 120,000. It has sh 500,000 10% bond. The equity capitalization rate is 7%.

### Required:

- (i) Calculate the value of the firm and the overall capitalization rate using the net income approach. [4 marks]
- (ii) Highlight the assumptions of net income approach [3 marks]

**QUESTION THREE**

(a) Discuss the various forms of dividends [6 marks]

(b) A company is in a risk class and the capitalization rate is 8%, it has 10,000 outstanding shares selling at sh. 125 each. The dividend for the current financial year is sh 10. The company expects to have a net income of 80,000 and a proposal of new investment worth sh 160,000

**Required:**

Show that dividend payment has no effect on the value of the firm using MM hypothesis [6 marks]

(c) The management of a certain company wants to establish the amount of financial needs for three years. The statement is for 31<sup>st</sup> Dec 2017

	Sh (000)
Fixed assets	150,000
Current assets	<u>100,000</u>
	<u>250,000</u>
Financed by:	
Ordinary share capital	80,000
Retained earnings	40,000
10% bond	50,000
Trade creditors	50,000
Accrued expenses	<u>30,000</u>
	<u>250,000</u>

**Additional information:**

- (i) Sales amounted to 400 million in 31<sup>st</sup> December 2017. The firm projected that sales will increase by 10% in 2018, 15% in 2019 and 20% in 2020
- (ii) The after tax return on sales has been 10%
- (iii) Dividend payout ratio is 75%

**Required:**

Determine the amount of external finance needed for three years [8 marks]

**QUESTION FOUR**

- (a) A company requires 12,500 units of a component in its manufacturing process which costs sh 200 each. The items are available locally and its lead time is 3 weeks. Each order costs sh 250 and the holding cost is sh 100. The company is considering giving a quantity discount of 15% if a minimum of 500 units is ordered. Advice whether the quantity discount should be given. [6 marks]
- (b) Explain the factors affecting the leverage decision of a firm [6 marks]
- (c) Assume the following information

Sales volume (units)	120,000
Selling price per unit	80
Variable cost per unit	35
Fixed cost	1,400,000
10% sh 5,000,000 bond	
Tax rate	30%

**Required:**

- Degree of financial, operating and combined leverage [6 marks]
- (d) Differentiate between matching approach and conservative approach [2 marks]
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