CHUKA UNIVERSITY

UNIVERSITY EXAMINATIONS.

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

BPLM 321: FINANCIAL MANAGEMENT

STREAMS: BPLM, COOP MGT & AGBM Y3S1 **TIME: 2 HOURS**

DAY/DATE: WEDNESDAY 5/12/2018 **11.30 A.M - 1.30 P.M**

INSTRUCTIONS:

- **Answer question ONE (COMPULSORY) and any other TWO Question.**
- **Do not write anything on the question paper**

QUESTION ONE

(a) Conflict of interest arises when agents pursues their own interest rather than the interest of the principals. In view of this statement, discuss the causes of conflicts between shareholders and auditors and solutions to the conflicts. [4 Marks]

(b) Explain the functions that affect the value of the firm. [6 Marks]

(c) Company ABC is considering investing in two mutually exclusive projects.

Economic State	**Probability**	**Project A**	**Project B**
Good	0.4	8000	7000
Normal	0.3	6000	5000
Bad	0.3	4000	6000

Determine the coefficient of variation and advice on which project to invest in. [6 Marks]

(d) A company whose cost of capital is 10% is considering investing in a project with the following information

Years	**Cash flow '000'**	**Abandonment Value '000'**
1	2200	1500
2	1800	2000

3	1700	1800
4	1400	1000

The cost of the project is 4,500,000.

Required:
Advise on the optimal time to abandon the project. [6 Marks]

(e) ABC Ltd is evaluating new equipment for its production. The equipment has two years and costs Kshs.240,000. In the first year the probabilities of getting high returns is 0.6 and 0.4 for moderate returns with associated cashflows of Kshs.153,000 and 120,000 respectively. If it generates high returns the second year cashfolow will be 122,000, 140,000 and 180,000 with associated probabilities of 0.2, 0.3 and 0.5 respectively. If they generate moderate returns the second year cashflows will be 200,000, 220,000 and 250,000 with associated probabilities of 0.6, 0.2 and 0.2 respectively.

Required:
A decision tree depicting this information and the expected net present value. [6 Marks]

(f) A firm is an all equal firm. The risk free rate is 10% and the risk premium is 24% and the beta coefficient is 1.4.

Required
The cost of equity. [2 Marks]

QUESTION TWO

(a) (i) ABC Limited has 10,000 outstanding shares currently selling at Kshs.120 each. The dividend for the financial year is Kshs.12 per share. The Company expects a net income of Kshs.150,000 and a proposal of making a new investment of Kshs.240,000. Show that under MM Hypothesis payment of dividends does not affect the value of the firm if the equity capitalization rate is 10%. [6 Marks]

(ii) State the assumptions of MM Hypothesis. [4 Marks]

(b) Highlight the steps involved in financial planning. [6 Marks]

(c) A company is considering investing in a project costing Kshs.50,000

Years	**Cashflow**	**Certainty Coefficient**
1	25,000	0.9
2	17,000	0.6
3	15,000	0.7

4	20,000	0.8
5	12,000	0.5

The risk free rate is 12% should the project be undertaken. [4 Marks]

QUESTION THREE

(a) Describe the factors that affect the leverage decisions of a firm. [4 Marks]

(b) A Company expects a net operating income of Kshs.100,000. It has 12% KShs.400,000 debt and the equity capitalization rate is 15%. Calculate the value of the firm and the overall capitalization rate according to the net income approach. [4 Marks]

(c) Explain the various dividend policies that a firm employs. [4 Marks]

(d) Assume the following information;

	2011	**2012**
Units (Quantity)	50,000	65,000
Selling price per unit	100	100
Variable cost per unit	32	38
Fixed cost	400,000	530,000
Number of outstanding ordinary shares	5,000	5000
Interest	1,000,000	500,000
Tax rate	50%	50%

Required:

Degree of operating, financial and combined leverage. [8 Marks]

QUESTION FOUR

(a) Discuss the various approaches for financial current assets. [3 Marks]

(b) The management of XYZ limited wants to establish the amount of external fiancé needed for two years.

	Kshs.000
Fixed Assets	
Plant and Machinery	8,000
Equipment	4,000
Current Assets	
Stock	4,000
Debtors	3,500
Cash	1,500

	21,000
Financed by:	
Ordinary share capital	8,000
Retained earning	4,000
10% bond	3,000
Trade creditors	4,000
Accrued expenses	2,000

Additional information:

1. Sales amounted to 25,000,000 on 31st December, 2015. The firms projected that sales will increase by 12% on 2016 and 15% in 2017.
2. The after tax return on sales has been 15%.
3. The dividend payout ratio is 60%.

Required:

Determine the amount of external finance needed for two years. [7 Marks]

(c) A company requires 12,500 units of a component in its manufacturing process which costs Kshs.200 each. The items are available locally and the lead time is 3 weeks. Each order costs Kshs.250 and the holding cost is Kshs.100 to prepare and process. The company considers giving a quantity discount of 15% if a minimum of 1000 units are ordered. Advice whether the quantity discount should be given. [7 Marks]

(d) Discuss any three methods of incorporating risk in capital budgeting. [3 Marks]

....