CHUKA UNIVERSITY

UNIVERSITY EXAMINATIONS

EXAMINATION FOR THE AWARD OF DEGREE OF MASTER OF BUSINESS IN BUSINESS ADMINISTRATION

MBAD 831: FINANCIAL MANAGEMENT

STREAMS: MBAD (ODEL) **TIME: 3 HOURS**

DAY/DATE: WEDNESDAY 07/08/2024 **2.30 P.M. – 5.30 P.M.**

INSTRUCTIONS: Answer question ONE and any other THREE questions

Question One

a) Agency problem exists when agents pursues their own interests rather than the interest of their principles. Discuss the causes of conflicts between shareholders and auditors and the solutions to the conflicts. (8 marks)

b) Outline four limitations of the Capital Asset Pricing Model (CAPM) as an investment appraisal technique. (4 marks)

c) Q Limited intends to invest in a machine X. The machine costs Ksh. 200,000 and the economic life of the machine is 10 years and has no scrap value. The corporation tax rate is 50% and the required rate of return is 10%. Depreciation is on straight line basis. The expected profit before depreciation and taxes is as follows.

Year	1	2	3	4	5
Profit (Shs)	40,000	50,000	30,000	60,000	70,000

Required:

i) Determine the net cash flows. (5 marks)

ii) Compute the net present value of the machine and advice the management on whether to undertake the investment or not. (5 marks)

d) Explain the following dividend theories.

   i) M-M dividend theory (4 marks)

   ii) The bird-in-hand theory (3 marks)

   iii) The clientele effect theory (3 marks)

e) State and explain benefits of good corporate governance to an organization. (8 marks)

Question two

a) Discuss the importance of cost of capital. (8 marks)

b) The following is the capital structure of XYZ Ltd as at 31/12/2022

	Shs "Millions"
Ordinary share capital (sh.10 per value)	400
Retained earnings	200
10% preference share capital sh.20 per value	100
12% debentures (sh.100 per value)	200
	900

Additional information

1. Corporate tax rate is 30%
2. Preference shares were issued 10 years ago and are still selling at per value i.e. MPS = per value.
3. The debentures has a 10 year maturity period. It is currently selling at sh.90 in the market.
4. Currently the firm has been paying dividend per share of sh.5. The DPS is expected to grow at 5% p.a in future. The current MPS is sh.40.

Required:

Calculate the weighted average cost of capital (WACC) (12 marks)

Question three

a) Tarbo Ltd is in the process of moderniting its operations. The factory manager has proposed the replacement of the milling machine with a new fully computerized machine. The milling machine was purchased two years ago at a cost of sh. 4 million. The economic life of the machine was five years. However, a management review has established that the machine has a further useful life of 5 years with a zero salvage value. The machine could be disposed immediately at sh 1.6 million.

The new machine has a purchase price of sh 8 million with an additional installation cost of sh 1.8 million and a salvage value of sh. 2 million. The new machine will lead to increased efficiency and annual savings in costs of sh. 2.1 million. However, electricity costs will increase by sh. 200,000 per annum. The operation of the new machine will also require an increase of sh 810,000 warth of raw materials. The company uses the straight line method of depreciation. The company's cost of capital is 10% and the corporate tax is 30%.

Require:

Advise the management of Tarbo Ltd. on whether to replace the machine. (16 marks)

b) Explain the management functions of finance. (4 marks)

Question four

Q Ltd has an expected return of 22 percent and a standard deviation of 40 per cent. P Ltd has an expected return of 24 per cent and standard deviation of 38 per cent. Q has a beta of 0.86 and P 1.24.

Required:

a) Is investing in P better than investing in Q? (4 marks)
b) If you invest 30% in P and 70% in Q, what will be the expected rate of return of the portfolio? (4 marks)
c) If is the market portfolio expected rate of return and how much is the risk free rate? (8 marks)
d) What is the beta of the portfolio if Q's weigh is 70% and P is 30%? (4 marks)

Question five

a) Explain three techniques of financial forecasting. (6 marks)
b) State four short-term sources of finance for a firm. (4 marks)
c) The following data was extracted from the financial statement of Jaribuni Ltd for the year ended 31 December 2020.

"Sh millions"

Cash and cash equivalents	200
Fixed assets	567
Sales (credit)	2,000
Net income	100
Current liabilities	211
Notes payable to bank	40
Current ratio	3:1
Debtors collection period	40 ss days
Return on equity	12%

Assume 365 days in a year

Required

i) Accounts receivable

ii) Return on total assets

iii) Currents assets

iv) Equity

v) Quick ratio (10 marks)

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