PAN AFRICA CHRISTIAN UNIVERSITY

SCHOOL OF LEADERSHIP, BUSINESS & TECHNOLOGY

END OF SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR OF COMMERCE

BACHELOR OF BUSINESS LEADERSHIP

JANUARY-APRIL 2019 SEMESTER

CAMPUS: ROYSAMBU

DEPARTMENT: BUSINESS STUDIES

COURSE CODE: BUS4213|BCM302

COURSE TITLE: FINANCIAL MANAGEMENT

EXAM DATE: TUESDAY 16th APRIL 2019

DURATION: 3 HOURS

TIME: 9:00AM-12:00PM

INSTRUCTIONS

- Read the instructions and questions carefully before you write the answers.
- Write your **STUDENT NUMBER** in the Answer Booklet given
- *Write clearly and legibly.*
- This examination script consists of **Six (6)** questions.
- Answer Question **ONE** and any other **FOUR** questions
- Show all your workings
- *ALL PAC University's examination rules and regulations apply*

QUESTION ONE: COMPULSORY

a) Explain the following terms:
   i) Optimal capital structure (4 Marks)
   ii) Net Cash operating cycle (4 Marks)
   iii) Depreciation tax shield (4 Marks)

b) Distinguish between:
   i. Mutually exclusive projects and independent projects (4 Marks)
   ii. Soft capital rationing and hard capital rationing (4 Marks)
   iii. Cost of capital and capital structure (4 Marks)

c) Explain three arguments for the wealth maximization objective (6 Marks)

d) Explain five factors that affect the dividend policy (10 Marks)

QUESTION TWO

BLEND & Co. is considering the purchase of new Interlocking machine. Each machine will cost Sh50,000 and sh5,000 to install. The investment will result in a decrease in inventories of Sh35,000 and accounts payables of Sh30,000. The revenues forecast will increase by sh90,000 while the operating costs will rise by sh50,000 for each of the five years. Each machine will then be scrapped for sh10,000 at the end of the fifth year. The company's capitalization rate is 10% and it's tax bracket is 30%.

Determine the:

a) Net cash flows of the investment (7 marks)
b) The Net Present Value of the project (4 marks)
c) Comment on whether the machine should be bought in ,b, above (2marks)
d) The profitability index (2 marks)

QUESTION THREE

a) Highlight the main distinguishing features of each of the following capital structure theories:
   i. Traditional Approach (2 Marks)
   ii. Net Income approach (2 Marks)

b) CHEN Ltd revenue forecast is 7M while the operating cost forecast is 3M. The company is currently all equity financed with a capitalization rate of 10%. It is considering borrowing 2M at 6%. The institution's tax bracket is 30%. Determine the:

   a) The institution's value under:
      i) Net Income Approach (3 marks)
      ii) MM with taxes (3 marks)

   b) The cost of equity if it borrows and pays taxes (3 marks)

   c) The overall cost of capital if it borrows (2 marks)

QUESTION FOUR

Explain the following dividend theories:

a) Residual theory (3 Marks)

b) Bird in the hand (3 Marks)

c) Clientele effect (3 Marks)

d) Information asymmetry (3 Marks)

e) Signaling effect (3 Marks)

QUESTION FIVE

The following information was extracted from the books of MERRY Ltd as at 30th Sept 2016

	Sh'000
Annual sales	20,000
Average purchases	9900
Average stock	3,000
Average debtors	8568
Average creditors	1000
Cash	7500

Additional information:

1. The company's gross profit margin is 30%
2. All sales are on credit terms
3. Assume a 360 day year.

Required:

a) Estimate the required working capital (3 Marks)

b) Determine the duration of net cash operating cycle (12 Marks)

QUESTION SIX

a) Describe the agency theory (3 Marks)

b) Explain two ways in which agency problem can be minimized (4 Marks)

f) Discuss any two features of an appropriate capital structure (4 Marks)

g) Explain two types of non-cash dividends (4 Marks)