PAN AFRICA CHRISTIAN UNIVERSITY

END OF TERM EXAMINATION

BUS4213/CFN302: FINANCIAL MANAGEMENT

SATURDAY NOVEMBER 29TH, 2014

1100HRS – 1400HRS

INSTRUCTIONS

- This exam paper has **Six** Questions
- Answer **Any Five** Questions
- Write your **student number** on the answer booklet provided.
- Read all questions carefully before attempting.
- Use a new page for every question attempted and indicate the question number on the space provided on each page of the answer sheet.

Answer five questions only

Question One

i. Discuss the various sources of finance to a company in Kenya today **(6 Marks)**

ii. Explain the features of debt finance; indicate clearly the strengths and weaknesses of employing debt finance in your company **(8 Marks)**

iii. Discuss the case for and against the retained earnings on the after tax profits of the company **(6 Marks)**

Question Two

i. The uncertainty of outcomes in an investment and the expected return are two important elements in financial management. Discuss this statement in relation to the risk and return on a business. **(8 Marks)**

ii. As the Finance and compliance manager in your organization one of the greatest assignments is to advise the company on the types of risk that can affect its long term investments both locally and abroad. Identify at least **SIX** types of risk and advise the company on the possible risk mitigation measures that it would apply to remain afloat in the market. **(12 Marks)**

Question Three

Planning an optimal capital structure is a highly complex yet important and it involves balancing the shareholders' expectations (risk & returns) and capital requirements of the firm

a. Discuss this statement highlighting the importance of an optimal capital structure **(6 Marks)**

b. Contrast Modigliani and Miller's (MM's) proposition in determination of the firm's market value with the Net Income Approach. **(6 Marks)**

c. Firm A is unlevered while firm B has Kes 2 000 000 long term debt. Assuming that the tax rate is 40% and the net operating income is Shillings 400 000 and the cost of equity is 10%, calculate the value of the firms if M-M assumptions are met. **(8 Marks)**

Question Four

a. Explain the importance of trade credit and accruals as sources of working capital**.** **(5 Marks)**

b. How does the operating cycle management enable the firm to improve its efficiency **(5 Marks)**

c. The stocks of XYZ Ltd are currently trading at Kes 30 per share. The stock is expected to pay a dividend of Kes 3 per share at the end of the year. The dividend is expected to grow at a constant rate of 5%. If the company is to issue external equity, it would incur a 10% floatation costs. Calculate:

   i. The cost of internal equity **(5 marks)**

   ii. Cost of External Equity **(5 marks)**

Question Five

a. Identify the Arguments in favor of and against the following capital budgeting approaches

   i. Net present value approach **(3 Marks)**

   ii. Internal Rate of Return approach **(3 Marks)**

b. The table here below contains information on the Cash flows of four mutually exclusive projects. The firm's cost of capital is 10%. The cash flows for each project are shown in the following table.

Year	A	B	C
	USD	USD	USD
0	-80000	-80000	-80000
1	30000	20000	5000
2	25000	20000	15000
3	20000	25000	20000
4	18000	25000	25000
5	10000	20000	35000

Using the data:

   i. Calculate the project's payback period **(5 Marks)**

   ii. Calculate the net present value (NPV) for each project **(6 Marks)**

   iii. Calculate the profitability Index **(5Marks)**

iv. Summarize the preferences dictated by each measure, and indicate which project you would recommend also explain why you have made that decision **(4 marks)**

Question Six

a. Agency Theory is a problem of motivating one party (the agent) to act on behalf of another (the principal). Discuss the economic and non-economic interests that exist in an the agency relationship **(10 Marks)**

b. Explain five types of control measures would that you would put in place to ensure that managers behave in a manner that fully takes into account the wishes of the owners? **(5 Marks)**

c. Discuss at least **FIVE** factors that must be considered in formulating the dividend policy of a firm **(5 Marks)**