PAN AFRICA CHRISTIAN UNIVERSITY

MASTERS IN BUSINESS ADMINISTRATION

END OF SEMESTER EXAMINATION

DEPARTMENT: BUSINESS

COURSE CODE: MBA 506

COURSE TITLE: FINANCIAL MANAGEMENT

TIME:

INSTRUCTIONS

- This examination script consists of **SIX (6)** questions.
- Read all questions carefully before attempting.
- Question **One** is compulsory and Answer any **Four (4)** questions.
- Write your **student number** on the answer booklet provided.

SECTION A: COMPULSORY

QUESTION ONE

a) Although profit maximization has long been considered as the main goal of a firm, shareholder wealth maximization is gaining acceptance amongst most companies as the key goal of a firm.

Required:

(i) Distinguish between the goals of profit maximization and shareholder wealth maximization. (2 Marks)

(ii) Discuss **two** limitations of the goal of profit maximization. (4 Marks)

b) Nyakati Ltd intends to invest in a four year mini project whose initial outlay is Shs.32, 000,000. The project is expected to generate the following cash outlay at the end of each year.

Year	**1**	**2**	**3**	**4**
Cash flows (shs, 000)	12,000	15,000	9,000	6,000

Ignore taxation

The cost of capital is 12%

Required

Advise the management on whether to undertake the project using the Internal Rate of Return (IRR) method (4 Marks)

SECTION B: CHOOSE ANY FOUR QUESTIONS

QUESTION TWO

(a) Define a Commercial Paper with an example (2 Marks)

(b) Explain how the Capital Authority can ensure:

(i) Faster growth and development of the Nairobi Security Exchange or Stock Exchange in your country. (4 marks)

(ii) Development of other stock exchanges in Kenya . (4 Marks)

QUESTION THREE

(a) Motor Works Limited intends to raise additional capital through an issue of ordinary shares. The company promises to pay dividend currently at the rate of Shs. 8 per share and the dividend is expected to grow at a constant rate of 7% per annum forever. If the required rate of return is assumed to be 10% . Determine the market price of the share. (5 Marks)

(b) Joel borrowed a three year loan of shs 1,500,000 at an interest rate of 9% per annum from his employer to buy a saloon car. His employer expects a three equal payment at the end of three years. Determine the amount of this annuity (5 Marks)

QUESTION FOUR

a) Define agency relationship from the context of a public limited company (2 Marks)

b) Briefly explain how the agency relation arises. (4 Marks)

c) Discus the various measures that would minimize agency problems between the owners and the management. (4 Marks)

QUESTION FIVE

Job Kwame plans to invest in two securities: security A and security B

The returns on each security is dependent on the state of the economy as shown below.

State of the economy	Probability	Return on security A	Return on security B
Boom	0.40	27%	36%
Average	0.50	21%	33%
Recession	0.1	18%	31.5%

Required

a) The standard deviation for security A and security B (6 Marks)

b) The covariance between security A and security B (4 Marks)

QUESTION SIX

a) Zatex Ltd. had the following capital structure as at 31 March 2015:

	Shs.
Ordinary share capital (200,000 shares)	4,000,000
10% Preference share capital	1,000,000
14% Debenture capital	3,000,000
	8,000,000

Additional information:

1. The market price of each ordinary share as at 31 March 2015 was Shs. 20.
2. The company paid a dividend of Shs. 2 for each ordinary share for the year ended 31 March 2015.
3. The annual growth rate in dividends is 7%.
4. The corporation tax rate is 30%.

Required:

Compute the weighted average cost of capital of the company as at 31 March 2015. (10 Marks)

Marking scheme

Year	Cash flow	PVIF	PV
1	12,000,000	0.8929	10, 714,800
2.	15,000,000	0.7972	11,958,000