PAN AFRICA CHRISTIAN UNIVERSITY

END OF TERM EXAMINATION

BUS4213/BCM302: FINANCIAL MANAGEMENT

TUESDAY NOVEMBER 25TH, 2014

1400HRS – 1700HRS

INSTRUCTIONS

- This exam paper has **Six** Questions
- Answer **Any Four** 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 any five (5) questions. All questions carry equal marks. Show your workings properly.

QUESTION ONE

(a) Explain difference between direct and indirect agency costs and give an example of each. **(4 Marks)**

(b) Describe **four** mechanisms available for aligning the interests of managers andstockholders.**(4Marks)**

(c) Explain the financial goal of the firm**(6 Marks)**

(d) Briefly discuss **three** basic legal forms of organizing firms and how they raise initial capital.**(6 Marks)**

QUESTION TWO

(a) Briefly explain the importance of cost of capital to Management of Unga Limited in Kenya. **(4 marks)**

(b) Fibre Limited has in its books the following amounts and specific costs of each type of capital.

Source of Fund	**Book Value** Kshs.	**Market Value** Kshs.	**Specific Costs (%)**
Debt	400,000	380,000	5
Preference	100,000	110,000	8
Equity	600,000	900,000	15
Retained Earnings	200,000	300,000	13
Total	**1,300,000**	**1,690,000**	

Determine the weighted average cost of capital using:

(a) Book value weights. **(7 marks)**

(b) Market value weights.**(8 marks)**

(c) Explain the different in the answer. **(3marks)**

(d) Can you think of a situation where the weighted average costof capital would be the same using either of the weights.**(2 marks)**

QUESTION THREE

(a) Explain four factors that determine the capital structure of a firm**. (4 marks)**

(b) Good Tidings Limited expresses a net operating income of Kshs. 200,000. It has Kshs.800,000 to 7% debentures. The overall capitalization rate is 10%.

(a) Calculate the value of the firm and the equity capitalization rate (or) cost of equityaccording to the net operating income approach. **(8 Marks)**

(b) If the debenture debt is increased to Kshs. 1,200,000. What will be the effect onthe value of the firm, the equity capitalization rate? **(8 Marks)**

QUESTION FOUR

(a) Explain briefly six factors that determine the dividend policy of Family Bank Limited. **(6 marks)**

(b) Yellow Company Limited earns a rate of 12% on its total investment of Kshs. 600,000 in assets. It has 600,000 outstanding common shares at Kshs. 10 per share. Discount rate of the firm is 10% and it has a policy of retaining 40% of the earnings.

(i) Determine the price of its share using Gordon's Model. (**(7 marks)**

(ii) What shall happen to the price of the share if the company has payout of 60% (or) 20%**(7 marks)**

QUESTION FIVE

(a) Golden Shake Limited has to select one of the following two projects:

	ProjectA	Project B
	Kshs.	Kshs.
Cost	Rs.22,000	20,000
Cash inflows:		
Year 1	12,000	2,000
Year 2	4,000	2,000
Year 3	2,000	4,000
Year 4	10,000	20,000

Using the Internal Rate of Return (IRR) method suggest which is preferable.**(16 marks)**

(b) Explain two reasons for the superiority of the NPV method in evaluating capitalinvestment projects?**(4 marks)**

QUESTION SIX

(a) There are two firms 'A' and 'B' which are exactly identical except that A does not use any debt in its financing, while B has Kshs. 250,000 , 6% Debentures in its financing. Both the firms have earnings before interest and tax of Kshs. 75,000 and the equity capitalization rate is 10%. Assuming the corporation tax is 50%; calculate the value of the firm. **(10 marks)**

(b) Quick Distributors Limiteddecides to use two financial plans and they need Kshs. 50,000 for total investment.

Particulars	**Plan A (Kshs.)**	**Plan B(Kshs.)**
Debenture (interest at 10%)	40,000	10,000
Equity share (Kshs. 10 each)	10,000	40,000
Total investment needed	50,000	50,000
Number of equity shares	4,000	1,000

The earnings before interest and tax are assumed at Kshs. 5,000, and Kshs.12,500 respectively. The taxrate is 50%. Calculate the EPS.**(10 marks)**