

**W1-2-60-1-6**

JOMO KENYATTA UNIVERSITY OF AGRICULTURE AND TECHNOLOGY

# **UNIVERSITY EXAMINATIONS 2014/2015**

SECOND YEAR FIRST SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR OF COMMERCE

**HBC 2202 / HPS 2404 : INTRODUCTION TO FINANCIAL MANAGEMENT/ FINANCIAL MANAGEMENT**

**DATE: AUGUST 2015 TIME: 2 HOURS**

**INSTRUCTIONS:**

**ANSWER QUESTION ONE AND ANY OTHER TWO QUESTIONS**

**=========================================================**

**QUESTION ONE [COMPULSORY ]**

1. P. Kurgat was recently appointed to the post of investment manager of Safaricom Ltd. The company raised shs. 8 000 000 through a rights issue. Kurgat has a task in evaluating two mutually excusive investment projects with unequal economic life. Project X has 7 years life and project Y has only 4 years life. Both projects are expected to have no salvage life at the end of their economic life. Their expected cash flows are projected as follows:

|  |  |  |
| --- | --- | --- |
| Year | Project X | Project Y |
|  | (sh) | (sh) |
| 1 | 2 000 000 | 4 000 000 |
| 2 | 2 200 000 | 3 000 000 |
| 3 | 2 080 000 | 4 800 000 |
| 4 | 2 240 000 | 800 000 |
| 5 | 2 760 000 | - |
| 6 | 3 200 000 | - |
| 7 | 3 600 000 | - |

The amount of money raised would be used to finance either of the two projects.

The company expects to pay dividends of shs. 6.50 per share in a years time

The current market price per share is shs. 50

Safaricom ltd expects the future earnings to grow by 7 % per annum after undertaking either of the projects

The company has no debt capital in its capital structure.

Required.

1. Calculate the cost of equity for the company [4 marks]
2. Determine the internal rate of return for eh two projects (ignore inflation factor) [12 marks]
3. Comment briefly on you results from O(ii) above advising the management on the best project to undertake [6 marks]
4. Discuss the difference between financial/planning, budgeting and control as used by financial managers. [8 marks]

**QUESTION TWO**

1. Discuss five major limitations of relying on ratio analysis in making investment decisions. [10 marks]
2. Mawazo Ltd makes a cash payment of shs. 10 000 per week. The interest rate on marketable securities is 12% and everytime the firm converts marketable securities to cash and the vice versa it incurs 20% cost.

Required:

1. Compute the optimal cash balance for the company [2 marks]
2. Determine the number of conversions to be made per year. [2 marks]
3. Determine the cost of maintaining the optimal cash balance [2 marks]
4. Determine and comment on the average optimal cash balance for the firm., [4 marks]

[TOTAL 20 MARKS]

**QUESTION THREE**

1. Determine any five roles of financial managers in any organization [10 marks]
2. Discuss five major characteristics of a reliable budgeting system [10 marks]

**QUESTION FOUR**

1. Consider a company with the following capital structure and the given component cost.

Source Amount After tax component

Ordinary shares 81 250 18%

Preference shares 12 250 15%

Debentures 21 250 10%

Required

1. Calculate the weighted average cost of capital for the company using the given components (show your workings) [12 marks]
2. Discuss any four effects of increasing debt as a source of capital to the company [8 marks]

**QUESTION FIVE**

1. Discuss the major factors to consider when choosing a reliable source of financing for a profit making company of you own. [8 marks]
2. Explain the term “gearing” in relation to the capital structure of a limited company. [4 marks]
3. Differentiate between the following terms as used in financial management
4. Weighted average cost of capital and marginal cost of capital [2 marks]
5. Capital structure and financial structure [2 marks]
6. Discuss the meaning of the term “Risk –return trade off in finance. [4 marks]

[Total = 20 marks]