# GARISSA UNIVERSITY

**UNIVERSITY EXAMINATION 2017/2018 ACADEMIC YEAR FOUR SECOND SEMESTER EXAMINATION**

**SCHOOL OF BUSINESS AND ECONOMIC**

**FOR THE DEGREE OF BACHELOR OF F BUSINESS MANANEGEMT**

**COURSE CODE: BBM 410**

**COURSE TITLE: FINANCIAL MANAGEMENT**

**EXAMINATION DURATION: 3 HOURS**

**DATE: 07/04/18** **TIME: 02.00-05.00 PM**

## INSTRUCTION TO CANDIDATES

- **The examination has FIVE (5) questions**
- **Question ONE (1) is COMPULSORY**
- **Choose any other THREE (3) questions from the remaining FOUR (4) questions**
- **Use sketch diagrams to illustrate your answer whenever necessary**
- **Do not carry mobile phones or any other written materials in examination room**
- **Do not write on this paper**

**This paper consists of FOUR (4) printed pages** ***please turn over***

**QUESTION ONE (COMPULSORY)**

(a) Briefly explain any five dividend theories. [**9 marks]**

(b) Why should firms earn profit? Explain any three limitations of profit maximization objective

**[6 marks]**

(c) The capital structure of Fanaka Ltd as 31st December 2014 was as follows

| | Shs. |
|---|---|
| Ordinary share capital (400,000 shares) | 20,000,000 |
| 10% Preference shares (30,000 shares, issue price, shs100) | 3,000,000 |
| 14% Bond capital | 14,000,000 |

**Additional information**

i) The market price of each ordinary share as at 31st December 2014 was shs. 50 while that of bond was shs. 100.

ii) The firm paid a dividend of shs. 5 for each ordinary share for the year ended 31st December 2014.

iii) The annual growth rate in dividends is 7%

iv) The corporation tax rate is 30%

**Required:**

i) Compute the weighted average cost of capital of the firm as at 31st December 2014

**[5 marks]**

ii) The firm intends to issue a 15% shs. 6 million bond at shs. 100 each during the year ending 31st December 2015. The existing bond will not be affected by this issue. The dividend per share for the year ending 31st December 2015 is expected to be shs. 7 while the average market price per share over the same period is estimated to be sha. 70. The annual growth rate in dividends is expected to be 8%. Compute the WACC as at 31st December 2015 **[5 marks]**

**QUESTION TWO**

a) Describe any three ways of paying dividends **[3 marks]**

b) Ngamia LTD has a limit of shs. 2,000,000 available for investment in the current period. The company's cost of capital of 15%. It is expected that capital will be freely available in the future. The following information is available.

| PROJECT | OUTLAY | NPV @15% |
|---|---|---|
| A | 400,000 | 160,000 |
| B | 800,000 | 560,000 |
| C | 700,000 | 750,000 |
| D | 1,000,000 | 630,000 |
| E | 300,000 | 70,000 |
| F | 900,000 | (100,000) |

Project B and D are mutually exclusive

**Required**:

Determine the projects to be initiated clearly indicating the fractions of the projects and the resulting NPVs for the chosen projects. **[12 marks]**

**QUESTION THREE**

a) Briefly explain the various attitudes that investors have towards risk **[3 marks]**

b) Madogo Ltd is considering a project whose costis Shs. 900,000. The project is expected to yield the following uncertain cashflows:

| **Year** | **Cashflow** |
|---|---|
| 1 | 360,000 |
| 2 | 420,000 |
| 3 | 300,000 |
| 4 | 180,000 |

The project accountant has estimated the certainty equivalent coefficients as follows:

$\alpha_0 \quad = \quad 1.00$

$\alpha_1 \quad = \quad 0.90$

$\alpha_2 \quad = \quad 0.70$

$\alpha_3 \quad = \quad 0.50$

$\alpha_4 \quad = \quad 0.30$

The risk-free discount rate is given as 10%

**Required**

Compute the NPV of the project **[12 marks]**

## QUESTION FOUR

a) Two firms A and B are identical in all important respects except financial structure. Firm A has Sh 8 million of 7.5% debt, while Firm B uses only equity. Both firms have EBIT of Sh 1,800,000 and the firms are in the same business risk class. Both firms have the same equity capitalization rate of 10%.

**Required**:

Determine the value of each firm and explain the action of the investors. **[6 marks]**

b)Discuss any three term structure theories of interest rate. **[9 marks]**

## QUESTION FIVE

Discuss the agency relationship that exists between:

i) Shareholders and managers **[8 marks]**

ii) Shareholders and government **[7 marks]**

In each case identity the conflicts that may arise and suggest the solutions to those conflicts.