GARISSA UNIVERSITY

UNIVERSITY EXAMINATION 2017/2018 ACADEMIC YEAR ONE SECOND SEMESTER EXAMINATION

SCHOOL OF BUSINESS AND ECONOMICS

FOR THE DIPLOMAIN BUSINESS MANAGEMENT

COURSE CODE: DBM19

COURSE TITLE: INTRODUCTION TO FINANCIAL MANAGEMENT

EXAMINATION DURATION: 3 HOURS

DATE: 09/04/18 **TIME: 2.00-5.00 PM**

INSTRUCTION TO CANDIDATES

- **The examination has SIX (6) questions**
- **Question ONE (1) is COMPULSORY**
- **Choose any other THREE (3) questions from the remaining FIVE (5) 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) State six drawbacks of internal rate of return **[6 marks]**

(b) Abdullah limited has the following details of two of the future production plans. Only one of these machines will be purchased and the venture would be taken to be virtually exclusive. The Standard model costs £50,000 and the Deluxe cost £88,000 payable immediately. Both machines will require the input of the following:

i. Installation costs of £20,000 for Standard and £40,000 for the Deluxe
ii. A £10,000 working capital through their working lives.

Both machines have no expected scrap value at end of their expected working lives of 4 years for the Standard machine and six years for the Deluxe. The operating pre-tax net cash flows associated with the two machines are:

Year	1	2	3	4	5	6
Standard	28,500	25,860	24,210	23,410	-	-
Deluxe	36,030	30,110	28,380	25,940	38,500	35,100

The deluxe machine has only been introduced in the market and has not been fully tested in the operating conditions, because of the high risk involved the appropriate discount rate for the deluxe machine is believed to be 14% per annum, 2% higher than the rate of the standard machine. The company is proposing the purchase of either machine with a term loan at a fixed rate of interest of 11% per annum, taxation at 30% is payable on operating cash-flows one year in arrears and capital allowance are available at 25% per annum on a reducing balance basis.

Required

i. For both the Standard and the Deluxe machines, calculate the payback period. [**17 marks]**
ii. Advice the company accordingly [**2 marks]**

QUESTION TWO

(a) Outline the functions of a financial manager in a contemporary corporate set-up **[6 marks]**

(b) Explain any three theories on dividend **[9 marks]**

QUESTION THREE

(a) Nuriye limited wishes to expand its output by purchasing a new machine worth 170,000 and installation costs are estimated at 40,000/=. In the 4th year, this machine will call for an overhaul to cost 80,000/=. Its expected inflows are:

	Shs.
Year 1	60,000
Year 2	72,650
Year 3	35,720
Year 4	48,510
Year 5	91,630
Year 6	83,715

(a) This company can raise finance to purchase machine at 12% interest rate. Compute NPV and advise management accordingly. **[8 marks]**

(b) State the disadvantages of using NPV in assessing the viability of a project **[7 marks]**

QUESTION FOUR

(a) Explain the importance of working management **[10 marks]**

(b) Explain the following terms

i. Cash cycle **[2 marks]**

ii. Cash turnover **[2 marks]**

iii. Opportunity cost **[1 mark]**

QUESTION FIVE

Triple A Ltd. makes cash payments of Shs.10,000 per week. The interest rate on marketable securities is 12% and every time the company sells marketable securities, it incurs a cost of Shs.20.

Required

(a)

i. Determine the optimal amount of marketable securities to be converted into cash every time the company makes the transfer **[3 marks]**

ii. Determine the total number of transfers from marketable securities to cash per year. **[3 marks]**

iii. Determine the total cost of maintaining the cash balance per year **[3 marks]**

iv. Determine the firm's average cash balance. **[3 marks]**

(b) State the determinant of working capital needs **[3 marks]**

QUESTION SIX

Project X cost	500,000
Scrap value	100,000

Stream of income before depreciation and taxes are as follows:

	Shs.
Year 1	100,000
Year 2	120,000
Year 3	140,000
Year 4	160,000
Year 5	200,000

Tax = 50% and depreciation straight line. Calculate the accounting rate of return **[15 marks]**