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**GARISSA UNIVERSITY**

**UNIVERSITY EXAMINATION 2020/2021 ACADEMIC YEAR FOUR**

**SECOND SEMESTER EXAMINATION**

**SCHOOL OF BUSINESS AND ECONOMICS**

**FOR THE DEGREE OF BACHELOR OF BUSINESS MANAGEMENT**

**COURSE CODE: BBM 414**

**COURSE TITLE: FINANCIAL MANAGEMENT**

**EXAMINATION DURATION: 2 HOURS**

**DATE: 04/04/2021 TIME: 3.00-5.00 PM**

**INSTRUCTION TO CANDIDATES**

* **The examination has FIVE (5) questions**
* **Question ONE (1) is COMPULSORY**
* **Choose any other TWO (2) 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 THREE (3) printed pages *please turn over***

**QUESTION ONE (COMPULSORY)**

1. Describe any three stakeholders that a firm should be socially responsible to, outlining how that can be achieved in each case. **(6 marks)**
2. Explain any three limitations of profit maximization objective. **(6 marks)**
3. The capital structure of Madogo Ltd as 31st December 2019 was as follows

Shs.

Ordinary share capital (800,000 shares) 40,000,000

10% Preference shares (60,000 shares, issue price, shs100) 6,000,000

12% Bond capital 28,000,000

**Additional information**

1. The market price of each ordinary share as at 31st December 2019 was shs. 50 while that of bond was shs. 100.
2. The firm paid a dividend of shs. 6 for each ordinary share for the year ended 31st December 2019.
3. The annual growth rate in dividends is 8%
4. The corporation tax rate is 30%

**Required:**

1. Compute the weighted average cost of capital of the firm as at 31st December 2019 **(10 marks)**
2. The firm intends to issue a 13% shs. 12 million bond at shs. 100 each during the year ending 31st December 2020. The existing bond will not be affected by this issue. The dividend per share for the year ending 31st December 2020 is expected to be shs. 8 while the average market price per share over the same period is estimated to be shs. 80. The annual growth rate in dividends is expected to be 9%. Compute the WACC as at 31st December 2020 **(8 marks)**

**QUESTION TWO**

1. Discuss any three term structure theories of interest rate **(6 marks)**
2. Fanaka LTD has a cost of capital of 15% and has a limit of shs. 1,500,000 available for investment in the current period. It is expected that capital will be freely available in the future. The company is considering a number of divisible projects for investment. You are informed that project B and D are mutually exclusive. The following information is available.

|  |  |  |
| --- | --- | --- |
| PROJECT | OUTLAY | NPV @15% |
| A | 350,000 | 90,000 |
| B | 480,000 | 320,000 |
| C | 420,000 | 435,000 |
| D | 600,000 | 420,000 |
| E | 350,000 | 70,000 |
| F | 550,000 | (80,000) |

**Required:**

1. Determine the excess present value index for each project. **(6 marks)**
2. Group the projects clearly showing the extent to which each project is implemented. **(6 marks)**
3. Advice management on the optimal investment plan. **(2 marks)**

**QUESTION THREE**

1. Sensitivity analysis is a key tool in financial decision making. Discuss the main steps to be followed when conducting a sensitivity analysis. **(10 marks)**
2. Two projects are under consideration for possible investment. The projected cash flows for the projects under different states of nature are provided as follows. The associated probabilities are also indicated

 **States of nature Project A's Project B's Probability**

 **Cash flow Cash flow**

 Optimistic prediction 1,800,000 1,200,000 0.2

 Moderate prediction 1,200,000 1,200,000 0.6

 Pessimistic prediction 600,000 1,200,000 0.2

**Required:**

1. Compute the expected cash flow for each project. **(4 marks)**
2. Based on the various attitudes of investors towards risk, indicate which project will be chosen by each category of investors. Explain. **(6 marks)**

**QUESTION FOUR**

1. Discuss any three capital structure theories **(6 marks)**
2. Faida Ltd is considering a project whose cost is Shs. 3,600,000. The project is expected to yield the following uncertain cash flows:

**Year Cash flow**

1 1,440,000

2 1,680,000

3 1,200,000

4 720,000

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

 α0 = 1.00

α1 = 0.90

α2 = 0.70

α3 = 0.50

α4 = 0.30

The risk-free discount rate is given as 10%

**Required**

1. Compute the NPV of the project **(12 marks)**
2. Advise the management.  **(2 marks)**

**QUESTION FIVE**

1. The shareholders of a company may take some actions which may conflict with the interest of the government as the principal. Describe any six such actions. **(6 marks)**
2. Explain any three key decision areas for a finance manager. **(6 marks)**
3. Justification for payment of dividend is based on a number of theories. Discuss any four such dividend theories **(8 marks)**