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**GARISSA UNIVERSITY**

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

**FIRST SEMESTER EXAMINATION**

**SCHOOL OF BUSINESS AND ECONOMICS**

**FOR THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION**

**COURSE CODE: MBA 811**

**COURSE TITLE: FINANCIAL MANAGEMENT**

**EXAMINATION DURATION: 2 HOURS**

**DATE: 05/04/2021 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. Explain the functions of a financial manager in a contemporary corporate set-up (5 marks)
2. Explain the importance of working capital management to a small and medium sized company. (6 marks)
3. Explain the concept “time value of money” and its importance in financial decision making process by finance managers (4 marks)
4. Assume you receive Shs. 1,000,000 today and invest the total amount at a compounded annual rate of 10% p.a. What will be the future value of your investment at the end of three years (4 marks)
5. Explain the concept of valuation of securities? Why is the valuation concept relevant for financial decision- making purposes? (5 Marks)
6. For any company, the amount of earnings retained within the business has a direct impact on the amount of dividends. Financial Managers believe that Retained Earnings have an advantage over the use of Debt as a source of Capital. Discuss the Advantages and Disadvantages of Retained Earnings over Debt as a source of Capital. (6 Marks)

**QUESTON TWO**

The following information was extracted from the books of Faida limited as at 31 December 2020:

**Shs.**

Ordinary share capital (par value sh. 25) 8,000,000

8% preference share capital (par value sh. 24) 6,000,000

10% preference share capital (par value sh. 20) 4,000,000

10% debentures 4,000,000

22,000,000

**Additional information;**

1. The share prices as at 31 December 2020 were as follows:

Market price per share (shs.)

Ordinary shares 30

8% preference shares 20

10% preference share 25

1. The market value of the 10% debentures on 31 December 2020 was 5,000,000
2. The corporate tax rate is 30%
3. The company has maintained payment of an ordinary dividend per share of sh. 3.80 over the past five years.

**Required;**

1. Cost of ordinary share capital (3 Marks)
2. Cost of 8% Pref. share capital (2 Marks)
3. Cost of 10% Pref. share capital (2 Marks)
4. Cost of 10% debentures (3 Marks)
5. Market weighted average cost of capital (5 Marks)

**QUESTION THREE**

1. Explain capital budgeting and five limitations of capital budgeting applications (7 marks)
2. ABC Ltd has identified a project that will cost Sh. 1,000,000 and will generate the following returns:

Years Cash inflows

1. 1 300,000

2 200,000

3 400,000

4 200,000



**Required:**

Calculate the NPV of the project if cost of capital is 8%. (4 marks)

1. Explain the factors that lead to capital rationing (4 marks)

**QUESTION FOUR**

* 1. Compare and contrast between Net Present Value (NPV) and Internal Rate of Return (IRR) (5 marks)
  2. A company has to select one of the following two projects

Project A Project B

‘000’ ‘000’

Cost Sh.22, 000 Sh.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

**Required:**

Using the Internal Rate of Return method (IRR), suggest the preferable project. (10 marks)

**QUESTION FIVE**

1. Explain the two dividend theories that you know. Give examples of each (4 marks)
2. The following information is available for Kavita Musicals.

Earnings per share: sh. 5.00

Rate of return required by shareholders: 16%

Assuming that the Gordon valuation model holds, what rate of return should be earned on investments to ensure that the market price is sh. 50 when the dividend payout is 40%? (5 Marks)

1. Discuss the factors that may affect working capital requirement for a manufacturing firm in Kenya

(6 marks)