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Mount Kenya University

UNIVERSITY EXAMINATIONS 2015/2016

SCHOOL OF BUSINESS AND ECONOMICS
DEPARTMENT OF ACCOUNTING AND FINANCE

BACHELOR OF COMMERCE/BACHELOR OF BUSINESS MANAGEMENT /BACHELOR OF EDUCATION
SCHOOL BASED

UNIT CODE: BAF3102 | **UNIT TITLE: FINANCIAL MANAGEMENT II**

DATE: APRIL 2016 | **MAIN EXAM** | **TIME: 2 HOURS**

INSTRUCTIONS: ANSWER QUESTION ONE AND ANY OTHER TWO

1. a) Capital budgeting helps the management to make strategic investment decisions. What are some of the difficulties experienced? (5 Marks)

   b) The most important objective of a firm in finance is maximization of shareholders wealth. Various conflicts will always arise. In reference to the above statement discuss. (6 Marks)

   c) Undercapitalization means that the company earning capacity is more in relation to its capital employed. What effect does it have on the organization. (6 Marks)

   - whether accept project
   - whether the project will

   d) Define the following terms:
      i) Bonus issue
      ii) Right issue
      iii) Stock split. (2 Marks each)

   e) Define gearing and its disadvantages to the company. (4 Marks)

f) Features of sound capital structure 1. (5 Marks)

g) List two classification of financial sources.

2. Risk is inherent in almost every business decision. More so in capital budgeting decision as they involve costs and benefits extending over a long period of time. Discuss in details the techniques employed in risk analysis. (20 Marks)

3. a) Discussions on dividend policy and firm value assumes that the investment decision of a firm is independent of it dividend decision. However there are some models which assumes that investment and dividend decisions are related in lit of the above statement discuss the dividend theories. (12 Marks)

b) Discuss the Modigliani and Mil'e hypothesis of capital structure as a theory in criticisms. (8 Marks)

4. Assume that firms earnings before interest ~~of~~ tax is sh 15,000 the cost of equity capital is ke 15% and cost of debt is 10%. Its total capital is sh 100,000. Assuming that the firm can have the following alternatives degree of leverages. Calculate the cost of capital ~~income~~ approach. Leverage at 0%, 20%, 50%, 80% and 100% (debt to capital). ~~(5 Marks)~~ 20 mks

capital structure using the

determining the optimum capital

net income approach.

5. Z ltd is considering the launch a new product for which the investment is sh 6,000,000 in plant and machinery will be required. The production is expected to last 5 years after which it will be sold for sh 1,500,000.

Additional information:

i) Product will be sold at sh 600 per unit variable cost of sh 240 per unit.

ii) Fixed production cost 600,000 per annum .

iii) Depreciation is on straight line method.

iv) Cost of capital is 10% p.a

v) Units expected to be sold for 5 years.

Years	units expected to be sold
1	8,000
2	7,000
3	7,000
4	5,000
5	3,000

Tax is at 30%

a). Calculate the NPV and advice the management. (14 Marks)

b) Calculate the internal rate of return of the project and advice the management. (6 Marks)