(*University of Choice*)

MASINDE MULIRO UNIVERSITY OF SCIENCE AND TECHNOLOGY (MMUST)

MAIN, BUNGOMA, WEBUYE CAMPUS

UNIVERSITY EXAMINATIONS

2020/2021 ACADEMIC YEAR

FIRST YEAR SEMESTER ONE EXAMINATIONS

FOR THE DIPLOMA

IN

BUSINESS MANAGEMENT

COURSE CODE: DAF 106

COURSE TITLE: FINANCIAL MANAGEMENT

DATE: TUESDAY 11TH JANUARY 2022 TIME 9-11AM

INSTRUCTIONS TO CANDIDATES

Answer Question **ONE** and Any other **TWO** Questions

TIME: **2 Hours**

MMUST observes ZERO tolerance to examination cheating

QUESTION ONE (30 MARKS)

a) Since debt capital is cheaper than equity, companies should resort to 100% use of debt to finance their investments. Discuss the limitations of the above financing policy (5 marks)
b) List and explain five factors that should be taken into account by a businessman in making the choice between financing by short-term and long-term sources. (10 marks)
c) Define agency relationship from the context of a public limited company and briefly explain how this arises. (6 marks)
d) Highlight the various measures that would minimize agency problems between the owners and the management. (6 marks)
e) Discuss the word capital rationing as used in financial management **3 marks**

QUESTION TWO

a) Describe in brief the greatest difficulties faced in capital budgeting in the real world. **10 marks**

b) Although profit maximization has long been considered as the main goal of a firm, shareholder's wealth maximization is gaining acceptance amongst most companies as the key goal of a firm

Required

i) Distinguish between the goals of profit maximization and shareholder's wealth maximization **2marks**

ii) Explain the limitations of the goal of profit maximization **3marks**

c)List and explain five factors that should be taken into account by a businessman in making the choice between financing by short term and long term sources **5 marks**

QUESTION THREE

Mavuno was recently appointed to the post of finance manager of Fertilizer ltd a quoted company. The company has raised sh.8m through a rights issue

Mavuno has the task of evaluating two mutually exclusive projects with unequal economic lives. Project X has 7 years and project Y has 4 years of economic life. Both projects are expected to have a zero salvage value. The expected cash flows are as follows:

PROJECT	**X**	**Y**
YEAR	**CASH FLOWS (Sh)**	**CASH FLOWS (Sh)**
1	2000,000	4000,000
2	2200,000	3000,000

3	2080,000	4800,000
4	2240,000	800,000
5	2760,000	-
6	3200,000	-
7	3600,000	-

The amount raised would be used to finance either of the projects. The company expects to pay a dividend per share of sh.6.50 in one year's time. The current market price per share is sh, 50.

Fertilizer ltd expects the future earnings to grow by 7% per annum due to the undertaking of either of the projects; Fertilizer ltd has no debt capital in its capital structure.

Required

a) The cost of equity of the firm. **5marks**

b) The present value of each project. **5marks**

c)The internal rate of return of the projects (Rediscount the cash flows at 24%) **10 marks**

QUESTION FOUR

a) Explain fully the effect of the use of debt capital on the weighted average cost of capital of a company **10 marks**

b) Discuss the importance of capital budgeting as used in Financial Management **10 Marks**