



**MASINDE MULIRO UNIVERSITY OF SCIENCE AND TECHNOLOGY**

**UNIVERSITY EXAMINATIONS**

**2021/2022 ACADEMIC YEAR**

**FIRST YEAR SECOND SEMESTER**

**MAIN EXAMINATION**

**FOR THE DEGREE OF MASTERS IN BUSINESS ADMINISTRATION**

**COURSE CODE: MBA 808**

**COURSE TITLE: FINANCIAL MANAGEMENT**

**DATE: Wednesday 27<sup>TH</sup> APRIL 2022**

**TIME: 2-5PM**

**INSTRUCTIONS TO CANDIDATES**

Answer Question One and Any other THREE (3) Questions

TIME: 3 Hours

MMUST observes ZERO tolerance to examination cheating

This Paper Consists of 4 Printed Pages. Please Turn Over.

**QUESTION ONE (COMPULSORY) (40 Marks)**

- a) Why should a company concentrate primarily on wealth maximisation instead of profit maximisation. **(5 marks)**
- b) How does the notion of risk and reward govern the behaviour of financial manager **(5marks)**
- c) A retiree needs your help in retirement planning. He is 30 years old and would like to retire at the age of 55 years. He estimates that post retirement he would need an annuity of shs. 12000 per annum for the next 30 years to meet his living expenses. The rate of return on his investment portfolio is expected to be 8 percent per annum.
- i. Determine the retirement corpus needed to provide him an annuity of shs.12000 per annum for 30 years so that at the end, his corpus is completely exhausted. Assume the annuity is needed at the beginning of each year. **(3 marks)**
- ii. How much should he invest each year to reach the target retirement corpus? Assuming that the investments are made at the end of each year. **(3marks)**
- d) Capital budgeting techniques are important in determination of project viability. Make brief notes on the discounted techniques with their decision criteria, strengths and weakness. **(8marks)**
- e) Explain three factors that influence dividend decisions and their relationship with firm value. **(6marks)**
- f) A washing machine which cost shs. 200,000 has been depreciated on straight line basis and now has a book value of shs 80,000. It has a remaining useful life of 5 years. This machine has disposal value of shs 90,000 now. In five years its disposable value will be zero. A new machine is available that will dramatically reduce operating costs. Annual revenue of shs 100,000 will not change regardless of the decision. The new machine will cost shs 110,000 and will have zero disposal value at the end of five year life. The new machine promises to slash variable operating costs from shs 80,000 per year to sh 50,000 per year. The cost of capital is 10%. What action should management take? **(10 marks)**

**QUESTION TWO (20 marks)**

- a) The following information refer to possible returns on investment for fox associates.

Probability	0.1	0.2	0.4	0.2	0.1
Possible return (%)	-10	5	20	35	50

- i. What are the expected return and standard deviation? **(4marks)**

Assume that the parameters pertain to a normal probability distribution. What is the probability the returns will be **(6marks)**

- ii. Zero or less  
iii. Less than 10 percent  
iv. More than 40 percent

- b) Distinguish between degree of operating leverage, degree of financial leverage and degree of total leverage in capital structure decisions. **(10 marks)**

**QUESTION THREE** **(20 marks)**

- a) A company is considering a new product line to supplement its range. It is expected that the new product line will involve cash investment of shs. 700,000 at time 0 and shs. 1.0 million in year 1. After tax cash inflows of shs. 250,000 are expected in year 2, shs. 300,000 in year 3, shs. 350,000 in year 4 and shs. 400,000 in year 5.

**Required:**

- i. If the required rate of return is 15 percent what is the net present value of the project? Is it acceptable? **(3 marks)**
  - ii. What is the internal rate of return? **(3marks)**
  - iii. What would be the case if the required rate of return were 10 percent **(2 marks)**
  - iv. What is the projects payback period if the cash flows are discounted? **(2 marks)**
- b) How does a financial manager deal with investment appraisal decisions under conditions of uncertainty and risk? **(10 marks)**

**QUESTION FOUR** **(20 marks)**

- a) What are the critical decisions involving inventory management that a manager has to address and how does he/she ensure that these decisions are value maximizing? Discuss. **(10 marks)**
- b) Assume that patoo bookstore uses up cash at a steady rate of shs. 20000 a year. The interest rate is 2 percent and each sale of securities costs shs.2.00
- i. What is the marginal carrying cost of the cash for each shilling increase in order size? **(3marks)**
  - ii. At what point does the marginal carrying cost equal the marginal reduction in order cost? **(3 marks)**
  - iii. How many times a year should the store sell securities? **(2marks)**
  - iv. What is the average cash balance? **(2marks)**

**QUESTION FIVE** **(20 marks)**

- a) “Dividends are shareholder wages. Therefore, if a government adopts an income policy which restricts increase in wages, it should also restrict increases in dividends” Does this make sense? Discuss. **(6marks)**

- b) Many Companies use stock repurchase to increase earnings per share. Suppose a company is in the following position:

Net profit	shs. 10 million
Number of shares before repurchase	1 million
Earnings per share	shs. 10
Price-earnings ratio	20
Share price	shs. 200

The company now repurchases 200,000 shares at shs.200 a share. Assume the price earnings ratio stays at 20, what is going to be the share price. **(2 marks)**

- c) Discuss four reasons behind a firm's preference for share repurchase over dividends payments as a distribution decision? **(4 marks)**
- d) Dividend decisions by managers of listed firms at the NSE according to Bulla (2021) are said to be explained by signaling, information asymmetry and agency theories. Describe how these theories explain dividend payments and thus value creation for shareholders. **(8marks)**