



MAASAI MARA UNIVERSITY

REGULAR UNIVERSITY EXAMINATIONS

2022/2023 ACADEMIC YEAR

FOURTH YEAR FIRST SEMESTER

SCHOOL OF BUSINESS & ECONOMICS

BACHELOR OF COMMERCE

COURSE CODE: BCM 4113

COURSE TITLE: FINANCIAL MANAGEMENT

DATE: 7TH DECEMBER, 2022

TIME: 1430-1630

INSTRUCTIONS TO CANDIDATES

Answer question **ONE** and any other **THREE** questions

QUESTION ONE

a) Conflict between equity owners and the management is a common phenomenon in the management of corporate bodies. Explain any possible causes of such conflict and possible remedies. **(12 marks)**

b) Explain the main argument by Modiglian and Miller (M-M) in relation to dividend payments **(3 marks)**

c) Explain any **four** considerations taken into account when designing a dividend policy. **(5 marks)**

d) Explain any **five** factors that influence capital structure of a firm.

(5 marks)

QUESTION OTWO

a) Explain any **four** assumptions of Net Operating Income approach in the context of capital structure of a firm. **(4marks)**

b) KK Ltd posted a Net Operating Income of Sh 2,000,000 in 2019. The company had 7% 8,000,000 debentures. The overall cost of capital was 10%.

Required:

i. Calculate the value of the firm and the cost of Equity according to Net Operating Income approach. **(5 marks)**

ii. If debt was increased to Sh.12,000,000 what would have been the effect on the value of the firm and the cost of Equity? **(6 marks)**

QUESTION THREE

Malimali ltd is considering two mutually exclusive investments M and N. Each investment requires initial finance of 5,100,000. The company has approached you to analyze the investments by using certainty equivalent approach and advice accordingly. The following are the uncertain cash inflows and associated certainty equivalent coefficients.

Year	Investment X		Investment Y	
	Uncertain Cash inflow	Certainty equivalent	Uncertain Cash inflow	Certainty equivalent
1	3,100,000	0.8	3,700,000	0.9
2	2,500,000	0.7	2,200,000	0.8
3	2,000,000	0.6	1,800,000	0.7
4	1,400,000	0.5	1,200,000	0.6

Project M & N will require additional equipment whose current market price is 1,100,000 and 920,000 respectively. The equipment for M is required at the start of year three and N

at the start of year four. The prices of the equipment to be bought for the overhaul is likely to differ from the current market rate, and the company anticipates that the price won't decline below 60% of the current market price.

Required:

- a) If the risk-free rate is 10% evaluate which investment will be preferred. **(10 marks)**
- b) Explain the strengths and weaknesses of certainty equivalent as an approach to capital budgeting. **(5 marks)**

QUESTION FOUR

XYZ Ltd earns a rate of 14% on its total investments of Sh 8,000,000 in assets. The company has 7,000,000 outstanding ordinary shares at Sh 10 per share. Discount rate of the firm is 10% and it has a policy of retaining 40% of the earnings.

Required:

- a) Determine the price of its share using Gordon's Model **(4 marks)**
- b) What shall happen to the price of the share if the company changes its policy to a Payout ratio 50%? **(5 marks)**
- c) Write short notes on the following dividend theories:
 - i. Tax Differential Theory **(2 marks)**
 - ii. Signaling theory **(2 marks)**
 - iii. Clientele Effect theory **(2 marks)**

QUESTION FIVE

Pamoja Ltd is faced with two possible capital projects to invest in. Each project has a 1-year life, and each investment returns depend on subsequent year's state of the economy. The estimated rates of return for each are shown below:

State of the Economy	Probability of occurrence	Rate of Return	
		A	B
Recession	0.20	11%	10%
Average	0.50	15%	14%
Boom	0.30	17%	20%

Required:

- i. Compute each project's expected rate of return. **(4 marks)**
- ii. Compute the standard deviation of each project. **(6 marks)**
- iii. Compute the co-efficient of variation for each project **(2 marks)**
- iv. On the basis of the above computations which is a better investment. **(3 marks)**

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