



MAASAI MARA UNIVERSITY

**REGULAR UNIVERSITY EXAMINATION
2017/2018 ACADEMIC YEAR
THIRD YEAR SECOND SEMESTER**

**SCHOOL OF BUSINESS AND ECONOMICS
BACHELOR OF SCIENCE IN AGRICULTURAL
ECONOMICS**

COURSE CODE: AGBM 3105

COURSE TITLE: FINANCIAL MANAGEMENT IN AGRIBUSINESS

DATE: 23RD APRIL, 2018

TIME: 11.00 A.M-1.00 P.M.

INSTRUCTIONS TO CANDIDATES:

Answers question ONE and any other THREE.

This paper consists of 3 printed pages. Please turn over.

QUESTION ONE

- a) Define agency relationship in the context of a public limited company and briefly explain how this arises between the shareholders and the managers. **(5 marks)**
- b) Discuss the various causes of agency conflict between the shareholders and management on one hand and the bond holders/ financiers on the other. **(6 marks)**
- c) Highlight the various measures that would minimize agency conflict between the shareholders and the bond holders. **(6 marks)**
- d) The management of Sasini, a company involved in a range of agricultural activities intend to raise additional capital to finance it activities. It is considering to go for debt instead of equity. The management has approached you for advice concerning its intention. Discuss considerations that you are likely to advice the company to take into account when deciding to use debt finance. **(8 marks)**

QUESTION TWO

- a) Discuss the meaning of cost of finance. **(1 mark)**
- b) Outline factors that influence the cost of finance for corporate bodies. **(8 marks)**
- c) Discuss the meaning of the concept of working capital, highlighting its relevance in financial management. **(6 marks)**

QUESTION THREE

The following is the capital structure of company ABC as at 31/12/2015.

| | |
|--|----------------|
| | Sh."000" |
| Ordinary share capital Sh.10 par value | 400,000 |
| Retained earnings | 200,000 |
| 10% preference share capital Sh.20 par value | 100,000 |
| 12% debenture Sh.100 par value | <u>200,000</u> |
| | <u>900,000</u> |

Additional information

1. Corporate tax rate is 30%
2. Preference shares were issued 10 years ago and are still selling at par value MPS = Par value
3. The debenture has a 10 years' maturity period. It is currently selling at Sh.90 in the market.
4. Currently the firm has been paying dividend per share of Sh.5. The DPS is expected to grow at 5% p.a. in future. The current MPS is Sh.40.

Required

- a) Compute the cost of each capital component. **(8 marks)**
- b) Determine the WACC of the firm. **(5marks)**
- c) Outline the weaknesses associated with WACC when used as the discounting rate, in project appraisal. **(2 marks)**

QUESTION FOUR

Mara Limited is considering the purchase of a new plant for its production process. Two alternative plants, White and Black, which will cost Sh.6,000,000 and Sh.7,000,000 respectively are available in the market. The anticipated cash flows after taxation of each plant are as follows:

| Year | | | | | |
|-------|-----------|-----------|-----------|-----------|-----------|
| White | 600,000 | 1,800,000 | 2,000,000 | 3,000,000 | 2,400,000 |
| Black | 1,800,000 | 2,400,000 | 3,000,000 | 1,800,000 | 1,600,000 |

Required; Assuming the cost of capital is 10%, for each plant compute;

- a) Payback period **(2 marks)**
- b) Compute the net present value (NPV). **(4 marks)**
- c) Internal rate of return (IRR) **(4 marks)**
- d) Profitability Index. **(2 marks)**
- e) Based on your computation above which plant is better? **(3 marks)**

QUESTION FIVE

- a) Explain the reasons why firms in the same industry with equal earnings and share capital would pay different amount of dividends. **(6 marks)**
- b) The following information is on a company in the agricultural processing business:
- | | |
|--------------------------------------|--------------------|
| 10% PREFERENCE shares (Sh. 10 par). | 40,000,000 |
| Ordinary share capital (Sh. 10 par). | <u>40,000,000</u> |
| | 80,000,000 |
| Retained profits | <u>70,000,000</u> |
| | 150,000,000 |
| 15% debentures. | <u>120,000,000</u> |
| | <u>270,000,000</u> |
- i) Calculate the gearing ratio for the above company. **(2 marks)**
- ii) If the company's net profit (before interest and tax) is Sh.2,000,000,000 and assuming a dividend payout ratio of 60% of the earnings, compute the dividend per share (DPS). **(5 marks)**
- iii) If the market price per share now is Sh.80, compute the dividend yield. **(2 marks)**

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