



MAASAI MARA UNIVERSITY

REGULAR UNIVERSITY EXAMINATION 2019/2020 ACADEMIC YEAR FOURTH YEAR FIRST SEMESTER

**SCHOOL OF BUSINESS AND ECONOMICS
BACHELOR OF COMMERCE**

COURSE CODE: BCM 4113

COURSE TITLE: FINANCIAL MANAGEMENT

DATE: 10/12/2019

TIME: 11.00AM - 1.00 PM

INSTRUCTIONS TO CANDIDATES:

Answers question ONE and any other three questions.

QUESTION ONE:

- a) In reference to the provisions of agency theory in financial management discuss clearly and precisely instances in which the interests of the management of a corporate body may conflict with those of the shareholders. **(8 marks)**
- b) Suggest mechanisms that can be adopted to resolve the conflicts in 1(a) above. **(7 marks)**
- c) Write short notes on the following theories relating to capital structure of firms; **(6 marks)**
- i. Net income approach.
 - ii. Net operating income approach
 - iii. The Modigliani-Miller Approach
- d) Before the introduction of interest rate caps in 2016 by the Kenyan legislature, lending rates charged by commercial banks were very erratic. Explain common factors attributable to such phenomenon. **(4 marks)**

QUESTION TWO

Handshake is contemplating to invest in a project on 1st January 2020 whose initial cost is Sh. 30,000,000 and additional capital of Sh. 1,500,000 on 1st January 2022. The project promises the following uncertain cash flows with corresponding assigned certainty equivalent coefficients.

Year	2020	2021	2022	2023
Uncertain cash flow	11,300,000	13,400,000	11,500,000	5,000,000
Certainty equivalent coefficient	0.9	0.8	0.5	0.3

- a) If the risk-free discount rate is 11% compute the NPV of the project and advice the firm whether the project can be undertaken. **(7 marks)**

- b) Show whether your advice would change if certainty equivalent was not taken into account in the decision-making process. **(4 marks)**
- c) Outline the weaknesses and strengths of certainty equivalent as used in project appraisals. **(4 marks)**

QUESTION THREE

TangaTanga Ltd is considering two possible capital projects for next year. Each project has a 1-year life, and project returns depend on next year's state of the economy. The estimated rates of return are shown in the table below:

State of the economy	Prob. of occurrence	Rate of return in %	
		X	Y
Recession	0.2	13	11
Average	0.5	15	15
Boom	0.3	17	20

Required:

- a. Compute each project's expected rate of return **(4 marks)**
- b. Compute the variance and standard deviation of each project. **(6 marks)**
- c. Compute the co-efficient of variation for each project **(2 marks)**
- d. Which project may be preferred and why? **(3 marks)**

QUESTION FOUR

- a) Mwananchi is considering to invest in a project that require initial capital of 40 million. Projected cash inflows over its useful life of two years are as follows:

Year1.

State of projection	Projected cash flow	Probability
Pessimistic projection	16 million	0.3
Moderate projection	20 million	0.2
Optimistic	24 million	0.5

Year 2; In the order of pessimistic, moderate and optimistic;

State of projection	16 million		20 million		24 million	
	Cash flow	Prob.	Cash flow	Prob.	Cash flow	Prob.
Pessimistic	5 million	0.2	30 million	0.2	40 million	0.1
Moderate	8 million	0.5	40 million	0.6	60 million	0.8
Optimistic	12 million	0.3	50 million	0.2	80 million	0.1

Required: Determine:

- Expected monetary value of the project using decision tree approach. **(6 marks)**
- Assuming the cost of capital is 10% advice the investor whether the project is viable using decision tree approach. **(9 marks)**

QUESTION FIVE

- Explain precisely whether you agree or disagree with assertions of the relevancy or irrelevancy dividend policy theorists. **(4 marks)**
- Discuss any five factors that influence formulation of dividend policies by corporate bodies. **(5 marks)**
- Umash Ltd is considering to invest in a certain project which promises the following cash flows over its useful life of 3 years. The market value for the asset has also been given after the end of each year.

Year	1	2	3
Cash flow	2,050,000	1,876,000	1,740,000
Market value	3,010,000	1,950,000	20,000

Required:

If the project requires 4,810,000 and the discount rate is 10% advice Umash limited whether the project should be undertaken for the entire useful life.

(6 marks)

- END -