



ALUPE UNIVERSITY
COLLEGE
... Bastion of Knowledge...

P. O. Box 845-50400 Busia(K)
principal@auc.ac.ke
Tel: +254 741 217 185
+254 736 044 469
off Busia-Malaba road

OFFICE OF THE DEPUTY PRINCIPAL
ACADEMICS, RESEARCH AND STUDENTS' AFFAIRS

UNIVERSITY EXAMINATIONS

2020 /2021 ACADEMIC YEAR

FOURTH YEAR SECOND SEMESTER REGULAR
EXAMINATION

FOR THE DEGREE OF BACHELOR OF
BUSINESS MANAGEMENT

COURSE CODE: DBM 19

COURSE TITLE: FINANCIAL MANAGEMENT

DATE: 15TH JULY, 2021

TIME: 1:00 PM TO 4:00PM

INSTRUCTION TO CANDIDATES

- SEE INSIDE

THIS PAPER CONSISTS OF 3 PRINTED PAGES

PLEASE TURN OVER

REGULAR – MAIN EXAM

DBM 19: FINANCIAL MANAGEMENT

STREAM: Diploma in Business Management

DURATION: 3 Hours

INSTRUCTIONS TO CANDIDATES

- i. Answer *Question ONE* and any other *TWO* questions.
- ii. Show all your calculations.
- iii. Do not write on the question paper.

QUESTION ONE

- a) Discuss the goals of Financial Management and state which is the best goal (12 marks)
- b) You have been appointed as a new finance manager in Sukari Sacco Ltd. What are the major functions you will play in the institution (6 marks)
- c) Explain the meaning of the term “cost of capital” and explain why a company should calculate its cost of capital with care (4marks)
- d) Identify and briefly explain three conditions which have to be satisfied before the use of the weighted average cost of capital (WACC) can be justified (8 marks)

QUESTION TWO

The following is the capital structure of XYZ Ltd as at 31/12/2002.

| | Shs.M |
|--|------------|
| Ordinary share capital Sh.10 par value | 400 |
| Retained earnings | 200 |
| 10% preference share capital Sh.20 par value | 100 |
| | <u>200</u> |
| 12% debenture Sh.100 par value | <u>900</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 year 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) Determine the WACC of the firm (10 marks)
- b) Explain why market values and not book values are used to determine the weights. (4 marks)

- c) What are the weaknesses associated with WACC when used as the discounting rate, in project appraisal (6 marks)

QUESTION THREE

A company is considering two mutually exclusive projects requiring an initial cash outlay of Sh 10,000 each and with a useful life of 5 years. The company required rate of return is 10% and the appropriate corporate tax rate is 50%. The projects will be depreciated on a straight line basis. The before depreciation and taxes cash flows expected to be generated by the projects are as follows.

| YEAR | 1 | 2 | 3 | 4 | 5 |
|-----------|-----------|-------|-------|-------|-------|
| Project A | Shs 4,000 | 4,000 | 4,000 | 4,000 | 4,000 |
| Project B | Shs 6,000 | 3,000 | 2,000 | 5,000 | 5,000 |

Required:

Calculate for each project

- The payback period (5 marks)
- The average rate of return (5 marks)
- The net present value (5 marks)
- Profitability index (2 marks)
- The internal rate of return (3 marks)

QUESTION FOUR

ABC Ltd requires 2,000 units of a component in its manufacturing process in the coming year which costs Sh.50 each. The items are available locally and the leadtime in one week. Each order costs Sh.50 to prepare and process while the holding cost is Shs.15 per unit per year for storage plus 10% opportunity cost of capital.

Required

- How many units should be ordered each time an order is placed to minimize inventory costs? (8 marks)
- What is the reorder level? (5 marks)
- How many orders will be placed per year? (2 marks)
- Determine the total relevant costs (5 marks)

QUESTION FIVE

- What is meant by the term “matching approach” in financing fixed and current assets? (10 marks)
- Briefly explain how the Miller-Orr cash management model operates. (10 marks)
