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**KIRIRI WOMENS' UNIVERSITY OF SCIENCE AND TECHNOLOGY**  
**UNIVERSITY EXAMINATION, 2017/2018 ACADEMIC YEAR**  
**DIPLOMA IN HUMAN RESOURCE MANAGEMENT**  
**DBA 1008- FINANCIAL MANAGEMENT**

Date: 16<sup>th</sup> August 2018  
Time: 11.00Am- 1.00 Pm

**INSTRUCTIONS TO CANDIDATES**

**ANSWER QUESTION ONE (COMPULSORY) AND ANY OTHER TWO QUESTIONS**

**QUESTION ONE (30 MARKS)**

- a) i) With the aid of diagram differentiate between systematic risk and unsystematic risk  
Which risk is priced by the market and why (4 Marks)
- ii) Distinguish between Weighted average cost of capital (WACC) and Marginal Cost of Capital  
(MCC) (2 Marks)
- b) Muna Ltd wishes to make a choice between two mutually exclusive projects. Each of these  
projects requires Sh.400, 000,000 in initial cash outlay. The details of the two projects are as  
follows:

**Project A:** This project is made up of two sub-projects. The first sub-project will require an  
initial outlay of Sh.100, 000,000 and will generate Sh.25, 600,000 per annum in perpetuity.  
The second sub-project will require an initial outlay of Sh.300, 000,000 and will generate  
Sh.85, 200,000 per annum for the 8 years of its useful life. This sub-project does not have a  
residual value at the end of the 8 years. Both sub-projects are to commence immediately.

**Project B:** This project will generate Sh.87, 000,000 per annum in perpetuity.

The company has a cost of capital of 16%.

**Required:**

- i) Determine the net present value (NPV) of each project. (8Marks)
  - ii) Compute the internal rate of return (IRR) for each project. (8Marks)
  - iii) Advise Magma Ltd. on which project to invest in, and justify your choice. (2 Marks)
- c) Describe instances in which the interests of the management of a company might conflict with those of the shareholders. Discuss your answer in close reference to the provisions of agency theory. (6Marks)

**QUESTION TWO (20 MARKS)**

- a) Explain the Uses of cost of capital (6Marks)
- b) The total of the net working capital and fixed assets of Faida Ltd as at 30 April 2016 was Sh.100,000,000. The company wishes to raise additional funds to finance a project within the next one year in the following manner.

Sh.30, 000,000 from debt

Sh.20, 000,000 from selling new ordinary shares.

The following items make up the equity of the company:

	Sh.
3,000,000 fully paid up ordinary shares	30,000,000
Accumulated retained earnings	20,000,000
1,000,000 10% preference shares	20,000,000
200,000 6% long term debentures	30,000,000

The current market value of the company's ordinary shares is Sh.30. The expected dividend on ordinary shares by 30 April 2016 is forecast at Sh.1.20 per share. The average growth rate in both earnings and dividends has been 10% over the last 10 years and this growth rate is expected to be maintained in the foreseeable future.

The debentures of the company have a face value of Sh.150. However, they currently sell for

The preference shares were issued four years ago and still sell at their face value.

Assume a tax rate of 30%

**Required:**

- i) The expected rate of return on ordinary shares. (2 Marks)
- ii) The effective cost to the company of:
  - a) Debt capital (2 Marks)
  - b) Preference share capital (2 Marks)
  - c) The company's existing weighted average cost of capital. (4 Marks)
  - d) The company's marginal cost of capital if it raised the additional Sh.50, 000,000 as intended. (4 Marks)

**QUESTION THREE (20 MARKS)**

- a) Discuss the main goals of a business entity and which is main goal? (8 Marks)
- b) Lumumba needs to have Sh.1, 500,000 at the end of 5 years in order to fulfill his goal of purchasing a sports car. He is willing to invest the amount as a lump sum today but wonders what type of investment return he will need to earn. Figure out the annual compound rate of return needed in each of the following cases.
  - i) Lumumba can invest Sh.1, 020,000 today. (6 Marks)
  - ii) Lumumba can invest Sh.815, 000 today (6 Marks)

**QUESTION FOUR (20 MARKS)**

- a) Mr. Katel has an investment capital of Sh.1, 000,000. He wishes to invest in two securities, A and B in the following proportion; Sh.200, 000 in security A and Sh.800, 000 in security B.

The returns on these two securities depend on the state of the economy as shown below:

State of Economy	Probability	Returns on Security A	Returns on Security B
Boom	0.4	18%	24%
Normal	0.5	14%	22%
Recession	0.1	12%	21%

**Required:**

- i) Compute the expected portfolio return (2 Marks)
- ii) Determine the correlation coefficient between security A and security B (6 Marks)
- iii) Calculate the portfolio risk (4 Marks)
- iv) Calculate the reduction in risk due to portfolio diversification (4 Marks)
- b) Explain how shareholders wealth maximization objective helps to solve problems with profit maximization. (4 Marks)

**QUESTION FIVE (20 MARKS)**

- a) Lynx Services Ltd., a debt collection agency, has estimated that the standard deviation of its daily net cash flow is Sh.22, 750. The company pays Sh.120 in transaction cost every time it transfers funds into and out of the money market. The rate of interest in the money market is 9.465%. The company uses the Miller-Orr Model to set its target cash balance. The minimum cash balance has been set at Sh.87, 500.

**Required:**

- i) The company's target cash balance. (4 Marks)
- ii) The lower and upper cash limit. (3 Marks)
- iii) Lynx Services Ltd.'s decision rules. (5 Marks)
- b) Explain the functions of a financial manager in a contemporary corporate set-up. (8Marks)