



Riara School of Business

Nurturing business innovators

MAY-AUGUST 2017 TRIMESTER

EXAMINATION FOR DIPLOMA IN BUSINESS MANAGEMENT

DAY PROGRAMME

RBM 024: FUNDAMENTALS OF FINANCIAL MANAGEMENT

DATE: 4TH AUGUST 2017

TIME: 2 HOURS

INSTRUCTIONS

- i) Answer question one and any other two**
 - ii) Marks allocated to each question are shown at the end of the question**
 - iii) Arrange your work neatly and indicate the questions answered in the Examination booklet**
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QUESTION ONE (COMPULSORY – (30 MARKS))

- (a) Explain the following terms in relation to dividends policy: **(6 marks)**
- (i) the residual theory of dividends;
 - (ii) the clientele effect;
 - (iii) the signaling properties of dividends;
 - (iv) The 'bird in the hand' argument.

- (b) There are various types of ratios which can be used for performance measurement and they can give the basis of financial planning and forecasting. State **FOUR** main classification of ratios **(4 marks)**
- (c) ABC Limited is considering the purchase of a new machine. Two alternative machines, T and M, which will cost Sh.6, 000,000 and Sh.7, 600,000 respectively are available in the market. The cash flow after taxation of each machine are as follows:

Year	Cash flow	
	T Sh.	M Sh.
1	600,000	1,800,000
2	1,800,000	2,400,000
3	2,000,000	3,000,000
4	3,000,000	1,800,000
5	2,400,000	1,600,000

The cost of capital is 12%

Required Assuming that each machine represents a project:

- (i) Compute the net present value that ABC Ltd expects to earn from each of the two projects **(8 marks)**
- (ii) Compute the profitability index of each machine. **(2 marks)**
- (iii) Compute the discounted payback period for each of the two projects **(6 marks)**
- (iv) Comment on the use of the results obtained in (a) (i),(ii) and (iii) above in selecting between the two projects. **(4 marks)**

QUESTION TWO

- (a) Discuss the concept of Agency theory under the following headings. Your discussion should include the relationship between each and the conflict and solutions. **(16 marks)**
- Shareholders and Management
 - Shareholders and creditors

iii. Shareholders and government

iv. Shareholders and auditors

(b) Explain the evaluation criterion for Internal rate of return (IRR) (4 marks)

QUESTION THREE

(a) Explain **FOUR** basic assumptions underlying MM's theories of capital structure (7 marks)

(b) Explain four main functions of Finance Manager/decisions in financial management (8 marks)

(c) State **FIVE** main factors that determine the source of finance/ capital for a corporation (5 marks)

QUESTION FOUR

(a) Explain the term capital structure (2 marks)

(b) Explain the term risk free rate (2 marks)

(c) Explain **FOUR** classification of Financial Markets (6 marks)

(d) Kenya ABC Ltd has issued 100million, 15% preference shares at a nominal value of Kshs.20 per share. The shares are irredeemable and they are trading at Kshs.45 per share at NSE.

Required: Determine

(i) The value of preference shares and (2.5marks)

(ii) The cost of preference shares. (2.5marks)

(e) From the following information related to two firms A & B. Determine the WACC (5 marks)

	FIRM A			firm B
Debt capital	4,000,000			-
Equity capital	6,000,000			10,000,000
Cost of debt	6%			-
Cost of equity	10%			10%