

2906/306

2924/306

2926/306

FINANCIAL MANAGEMENT

July 2017

Time: 3 hours



THE KENYA NATIONAL EXAMINATIONS COUNCIL

DIPLOMA IN BUSINESS MANAGEMENT
DIPLOMA IN INVESTMENT MANAGEMENT
DIPLOMA IN HUMAN RESOURCE MANAGEMENT

FINANCIAL MANAGEMENT

3 hours

INSTRUCTIONS TO CANDIDATES

This paper consists of SEVEN questions.

Answer any FIVE questions in the answer booklet provided.

Candidates should answer the questions in English/ Swahili

This paper consists of 5 printed pages.

Candidates should check the question paper to ascertain that all the pages are printed as indicated and that no questions are missing.

1. (a) Explain **five** ways in which the concept of time value of money may be applied in business. (10 marks)
- (b) ABC limited had the following capital structure as at 31 December 2015.

	<u>Ksh</u>
1,600,000 ordinary shares of Ksh. 30 each	48,000,000
14% preference shares of Ksh. 80 each	12,000,000
18% debentures of Ksh. 100 each	16,000,000
20% bank loan	<u>24,000,000</u>
	<u>100,000,000</u>

Additional information:

- The ordinary shares are currently selling at Ksh 60 each.
- Ordinary shareholders expect a dividend of Ksh 4 per share with a growth rate of 6% per annum forever.
- The market price of preference shares and debentures are Ksh 90 and Ksh 120, respectively.
- The corporation tax rate is 30%.

Calculate the:

- (i) cost of each source of capital;
 (ii) weighted average cost of capital.

(10 marks)

2. (a) Explain **four** characteristics of capital investment decisions. (8 marks)
- (b) PK Limited intends to invest in a project whose initial cash outlay is Ksh 600,000. The following information relates to the project.

- Uncertain cash inflows

Year	Ksh
1	240,000
2	280,000
3	200,000
4	120,000

- The certainty equivalent coefficients are estimated as follows:

α_0	1.0
α_1	0.8
α_2	0.75
α_3	0.3
α_4	0.4

- The risk free discount rate is given as 12%.

(i) Using certainty equivalent coefficients, determine the net present value of the project.

(ii) Advise the management on whether to invest in the project or not.

(12 marks)

3. (a) Explain **five** factors that may be considered by management of a company when selecting a suitable source of finance.

(10 marks)

(b) Apim Limited intends to invest in the following projects.

Project	Initial investment	Total Present Value of
	Ksh	Cash Inflows
		Ksh
A	1,200,000	800,000
B	1,500,000	2,000,000
C	1,600,000	1,670,000
D	800,000	850,000

(i) For each of the project, calculate the profitability index.

(ii) Rank the projects in order of profitability index.

(iii) Advise the management on the investment plan.

(10 marks)

4. (a) Explain **five** functions of a finance manager in an organisation. (10 marks)
- (b) The following financial statements relate to XL Limited for the year ended 31 December 2015.

Income Statement

	Ksh '000'
Sales	100,000
Less cost of sales	<u>40,000</u>
Gross profit	60,000
Less expenses (including interest)	<u>22,000</u>
Income before tax	38,000
Less tax	<u>11,400</u>
Net profit for the year	<u>26,600</u>

Statement of Financial Position As at 31 December 2015

Assets	Ksh
Plant and equipment	359,000
Inventory	18,000
Accounts receivable	10,000
Cash	<u>8,000</u>
	<u>395,000</u>
 Capital and liabilities	
Ordinary shares at Ksh 20 each	350,000
Retained profit	7,000
15% Debentures	20,000
Trade creditors	<u>18,000</u>
	<u>395,000</u>

Calculate each of the following ratios:

- (i) Current ratio;
- (ii) Net profit margin;
- (iii) Accounts receivable turnover;
- (iv) Inventory turnover;
- (v) Sales to total assets turnover.

(10 marks)

5. (a) Explain **five** ways in which financial ratios may be used in decision-making. (10 marks)
- (b) Explain **five** factors that influence the dividend policy of a company. (10 marks)
6. (a) There has been a rapid increase in financial institutions in Kenya. Explain **five** reasons that have contributed to such a trend. (10 marks)
- (b) The following information relates to component X used by HK Limited.

Annual demand	10,000 units
Unit price	Ksh 1,000
Lead time	7 days
Ordering costs	Ksh 2,500 per order
Holding costs	Ksh 150 per unit per year plus 5% opportunity cost of capital

Determine the:

- (i) economic order quantity (EOQ);
- (ii) re-order level;
- (iii) number of orders to be placed per year;
- (iv) total relevant cost. (10 marks)
7. (a) Explain **five** types of risks that may affect the operations of multinational corporations. (10 marks)
- (b) Mato Limited has approached Kwetu Bank for a loan. Explain **five** requirements that should be met by Mato Limited to qualify for the loan. (10 marks)

THIS IS THE LAST PRINTED PAGE.