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**KIRIRI WOMENS' UNIVERSITY OF SCIENCE AND TECHNOLOGY**  
**UNIVERSITY EXAMINATION, 2022/2023 ACADEMIC YEAR**  
**FIRST YEAR, SECOND SEMESTER EXAMINATION**  
**FOR THE DEGREE OF BACHELOR OF SCIENCE**  
**(BUSINESS ADMINISTRATION)**

Date: 8<sup>th</sup> December, 2022  
Time: 11.30am – 1.30pm

**KFI 001 - INTRODUCTION TO FINANCIAL MANAGEMENT**

**INSTRUCTIONS TO CANDIDATES**

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

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**QUESTION ONE (30 MARKS)**

- a) Explain your understanding of financial management. (3 Marks)
- b) Outline routine functions of financial management. (5 Marks)
- c) State the various kinds of agency relationships as integrated within the financial dynamics of a listed company. (4 Marks)
- d) Joshua and Daniel invested Ksh1,000,000. The investment is expected to earn interest at a rate of 20% compounded annually. Determine the future value of the investment after 3 years. (5 Marks)
- e) Outline the importance of cost of capital to a financial manager (4 Marks)
- f) Mama Reginah decided to invest Sh. 100,000 in savings account paying 8% interest compounded semi annually. If she leaves the money in the account for 2 years how much will she have at the end of the two years? (2 Marks)
- g) Kitale Ltd is an all equity firm whose Beta factor is 1.2, the interest rate on T. bills is currently at 8.5% and the market rate of return is 14.5%. Determine the cost of equity K<sub>e</sub> for the company. (3 Marks)
- h) Assume the company wants to invest in two mutually exclusive projects of 1000,000 shillings each generating the following cash flows:

Year	A Shs	B Shs
1	500,000	100,000
2	400,000	200,000
3	300,000	300,000
4	400,000	400,000
5	-	500,000
6	-	600,000

Required: Using payback period approach, advise management which project to choose. (4 Marks)

### **QUESTION TWO ( 20 MARKS)**

- a) Explain why the weighted average cost of capital of a firm that uses relatively more debt capital is generally lower than that of a firm that uses relatively less debt capital. ( 4 Marks )
- b) The total of the net working capital and fixed assets of Fada Ltd as at 30 April 2022 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 2023 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 Sh. 100. The debentures will mature in 10 years. 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:
- Debt capital
  - Preference share capital (4 Marks)
- iii) The company's existing weighted average cost of capital. (5 Marks)
- iv) The company's marginal cost of capital if it raised the additional Sh. 50,000,000 as intended. (5 Marks)

### **QUESTION THREE (20 MARKS)**

The following are the statements of income and financial position for Regina Ltd for last year and the prior year revealing some trend in terms of firm performance in regard to sales, expenses, income tax, assets, liabilities and equity:

#### **Income Statements**

	<b>Last Year</b>	<b>Prior Year</b>
Sales, net of returns and allowances	Shs 600,000	Shs 500,000
Subtract : Cost of Goods Sold	<u>330,000</u>	<u>280,000</u>
Gross Profit	270,000	220,000
Expenses :		
Selling Expenses	50,000	40,000
General Expenses	165,000	150,000
Total Selling and General expenses	<u>215,000</u>	<u>190,000</u>
Net Operating Income	55,000	30,000
Interest Expense	<u>10,000</u>	<u>13,000</u>
Net Income Before Income Tax	45,000	17,000
Income Tax	<u>11,000</u>	<u>4,000</u>
Net Income	Shs 34,000	Shs 13,000

#### **Statements of Financial Position**

	<b>Last Year</b>	<b>Prior Year</b>
Assets		
Current Assets:		
Cash	Shs 10,000	Shs 12,000
Accounts receivable, net of bad debt allowance	45,000	40,000
Inventory	160,000	130,000
Prepaid expenses	<u>10,000</u>	<u>8,000</u>
Total Current Assets	225,000	190,000
Fixtures and equipment, net of depreciation allowance	<u>75,000</u>	<u>90,000</u>
Total Assets	<u>Shs 300,000</u>	<u>Shs 280,000</u>
Liabilities		
Current Liabilities :		
Current portion, loans payable	Shs 25,000	Shs 25,000
Accounts Payable	50,000	35,000
Taxes Payable	20,000	20,000
Accrued Expenses	<u>10,000</u>	<u>8,000</u>
Total Current Liabilities	105,000	88,000
Long Term Liabilities:		
Notes payable to Bank	<u>75,000</u>	<u>100,000</u>
Total liabilities	<u>180,000</u>	<u>188,000</u>
Stockholders`equity		
Common stock, 5,000 shares		
Shs 10 par value authorized,		
1,000 issued and outstanding	10,000	10,000
Retained Earnings	<u>110,000</u>	<u>82,000</u>
Total stockholders`equity	<u>120,000</u>	<u>92,000</u>
Total liabilities and equity	<u>Shs 300,000</u>	<u>Shs 280,000</u>

You are required to compute

- i) return-on-assets ratios (2 Marks)
- ii) profit margin percentages (2 Marks)
- iii) debt-to-equity ratios (2 Marks)
- iv) current ratios (2 Marks)
- v) inventory turnover ratios (2 Marks)
- vi) earnings per share (2 Marks)
- vii) For each year , indicate whether they show an improving (I) or worsening (w) condition for Regina Ltd ( 8 Marks )

#### **QUESTION FOUR ( 20 MARKS )**

- a) Describe the Capital Asset Pricing Model ( CAPM) (8 Marks)
- b) You are given the risk free rate and risk premium rate as 7% and 13% respectively. The beta factor as 1.5. You are required to estimate the required rate of return on the stock, using the CAPM. (3 Marks )
- c) What is the implication of the computed required rate of return in (b) above. ( 2 Marks)
- d) What are advantages of using NPV to assess the viability of a venture ( 6 Marks)

#### **QUESTION FIVE ( 20 MARKS)**

- a) Outline limitations of ratios as measures of performance (4 Marks)
- b) State factors affecting working capital needs (8 Marks)
- c) ABC Ltd requires 2000 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 is 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

- i) How many units should be ordered each time an order is placed to minimize inventory costs?
- ii) What is the reorder level?
- iii) How many orders will be placed per year?
- iv) Determine the total relevant costs. ( 8 Marks)