The Co-operative University College of Kenya

(A Constituent College of Jomo Kenyatta University of Agriculture & Technology)

END OF SEMESTER EXAMINATION APRIL-2016

EXAMINATION FOR THE BACHELOR OF CO-OPERATIVES AND COMMUNITY DEVELOPMENT (YR II SEM II)
UNIT CODE: HCOB 2305

UNIT TITLE: FINANCIAL MANAGEMENT I

DATE: 20TH APRIL, 2016 **TIME: 2.00 PM – 4.00 PM**

INSTRUCTIONS:

- Answer question **ONE (compulsory)** and any other **TWO** questions

QUESTION ONE

a) Venture capital has contributed greatly to the economic development of various countries in the world. Discuss the major constraints of venture capital in Kenya. **(6 marks)**

b) Explain FIVE benefits of using non-financial measures when measuring the performance of an organization. **(6 marks)**

c) The directors of Donny Co are reviewing the performance of two of its divisions. The following information is available for the year ending 31 March 2010.

	South division	North division
	KES 000	KES 000
Sales	50,000	3,200
Operating profit	700	840
Capital employed	3,500	4,000

South division is a loud retailer that sells low priced food from a number of stores that are rented on short-term contracts. North division sells luxury motor vehicles, which it manufactures in a fully automated production plant.

Required:

Calculate the following performance measures for the two divisions:

(i) Return on capital employed; **(3 marks)**

(ii) Return on sales; **(2 marks)**

(iii) Asset turnover (based upon capital employed); **(2 marks)**

d) Suggest ONE reason for the differences between the two divisions in each of the following ratios:

(i) Return on sales;

(ii) Asset turnover. **(5 marks)**

e) Sh500 is invested in a fund on 1st January 2011. Calculate the amount on deposit by 31st December 2014.

i) 7% per annum simple. **(3 marks)**

ii) 7% per annum compound. **(3 marks)**

QUESTION TWO

a)The following is the capital structure of ZTE Ltd as at 31st December 2012.

	Sh. Millions
Ordinary share capital sh10 face value	400

Retained earnings	200
10% Preference share capital sh20 face value	100
12% debenture sh100 par value	200
	900

Additional information

1. Corporate tax rate is 30%.
2. Preference shares were issued 10 years ago and are still selling at face value per security.
3. The debenture has a 10 years' 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 dividend per share is expected to grow at 5% p.a. in future. The current market price security is Sh.40.

Required:

i) Determine the WACC of the firm.
ii) Explain why market values and not book values are used to determine the weights.
iii) What are the weaknesses associated with WACC when used as the discounting rate, in project appraisal. **(12 marks)**

b) Discuss the functions of financial markets or institutions in the economy. **(8 marks)**

QUESTION THREE

a) A company requires a minimum cash balance of KES 6000 and the variance of daily cash flows is estimated to be KES 2,250,000. The interest rate on securities is 0.025% per day and the transaction cost for each sale or purchase of securities is KES 20.

Required:

Calculate:

i. The Spread **(4 marks)**
ii. The Upper limit **(2 marks)**
iii. The return point **(2 marks)**
iv. Interpret the results **(4 marks)**

b) Companies have a variety of different interest groups or "stakeholders" - all of whom are likely to have different interests in and objectives for a company. Identify each stakeholder and their objectives. **(8 marks)**

QUESTION FOUR

a) A project has the following NPVs at the following discount rates.

Discount rate	NPV
%	Sh.
5	5, 300
10	400
15	(1, 700)
20	(2, 900)

Using the information estimated the IRR. **(10 marks)**

b) Discuss the importance of ratios application in various firms' financial performance measurement. **(10 marks)**

QUESTION FIVE

a) Security returns depend on only three risk factors-inflation, industrial production and the aggregate degree of risk aversion. The risk free rate is 8%, the required rate of return on a portfolio with unit sensitivity to inflation and zero-sensitivity to other factors is 13.0%, the required rate of return on a portfolio with unit sensitivity to industrial production and zero sensitivity to inflation and other factors is 10% and the required return on a portfolio with unit sensitivity to the degree of risk aversion and zero sensitivity to other factors is 6%. Security has betas of 0.9 with the inflation portfolio, 1.2 with the industrial production and 0.7 with risk bearing portfolio (risk aversion)

Assume also that required rate of return on the market is 15% and stock has CAPM beta of 1.1

Required:

Compute security i's required rate of return using

i) CAPM
ii) APT **(6 marks)**

b) CTI Ltd. requires 2,000 units of a component in its assembly process in the coming year which costs KES 50 each. The items are available locally and the lead time in one week. Each order costs KES 50 to prepare and process while the holding cost is KES 15 per unit per year for storage plus 10% opportunity cost of capital.

Required:

i. How many units should be ordered each time n order is placed to minimize inventory costs? **(6 marks)**

ii. What is the reorder level? **(4 marks)**

iii. How many orders will be placed per year? **(2 marks)**

iv. Determine the total relevant costs. **(2 marks)**