



MERU UNIVERSITY OF SCIENCE AND TECHNOLOGY

P.O. Box 972-60200 – Meru-Kenya

Tel: +254(0) 799 529 958, +254(0) 799 529 959, + 254 (0) 712 524 293,

Website: info@must.ac.ke Email: info@must.ac.ke

University Examinations 2024/2025

FIRST YEAR FIRST SEMESTER EXAMINATION FOR THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION AND MASTER OF SCIENCE IN FINANCE

BFS 5100/BFA 5102: FINANCIAL MANAGEMENT

DATE: JANUARY 2025

TIME: 3 HOURS

INSTRUCTIONS: Answer question *one* and any other *three* questions

QUESTION ONE (30 MARKS)

- a) Discuss the factors that influence the capital decisions of a firm (5mks)
- b) Explain reasons why debts are considered cheaper than equity (4mks)
- c) You have two investment options: (5mks)

Investment A: Kshs 5,000 now, growing at 8% per year for 5 years.

Investment B: Kshs 1,200 at the end of each year for 5 years at the same rate.

Which investment has a higher value at the end of 5 years? (4mks)

- d) A Company's accounts receivable increased from Kshs 100,000 to Kshs 150,000 over a year, while credit sales increased from Kshs 600,000 to Kshs 720,000. Calculate the change in the accounts receivable turnover ratio and assess whether the collection policy has become more or less effective. (4mks)
- e) **All life LTD** has the following financial data:
- EBIT: Kshs 800,000
 - Interest Expense: Kshs 200,000
 - Total Equity: Kshs
 - Total Debt: Kshs

Required:

- i. Calculate the ROE for the Company (2mks)
- ii. If the Company increases its debt to Kshs 2,000,000 (and equity decreases accordingly), with the same EBIT and interest rate, calculate the new ROE. Discuss the impact of increased leverage. (5mks)

QUESTION TWO (12 MARKS)

- a) Explain financial leverage and its impact on a firm's return on equity (ROE). (3mks)
- b) Money love LTD is entirely equity-financed. It decides to change its capital structure by introducing debt. If the company issues Kshs 2,000,000 in debt at an interest rate of 5%, and the expected EBIT is Kshs 600,000. Assuming there are 100,000 shares outstanding and no debt repayment. Ignore taxes

Required:

- i. The company's earnings per share (EPS) (4mks)
- ii. EPS if EBIT decreases to Kshs 400,000 due to market conditions. (5mks)

QUESTION THREE (12 MARKS)

A Company is considering its dividend policy. The firm has a net income of Kshs 1,500,000, currently pays a dividend of Kshs 600,000, and has a return on equity (ROE) of 10%. The management is evaluating a policy to increase dividends by 20% and wants to maintain a sustainable growth rate of 6%.

- i. Calculate the current dividend payout ratio and retention ratio. (4mks)
- ii. Determine the sustainable growth rate with the current policy. (4mks)
- iii. If dividends are increased by 20%, analyse if the new payout ratio aligns with the sustainable growth rate of 6% (4mks)

QUESTION FOUR (12 MARKS)

- a) Discuss the importance of cost of capital (5mks)
- b) A Company has the following capital structure:
 - Debt: Kshs 4,000,000 at an interest rate of 5%
 - Equity: Kshs 6,000,000 with a cost of equity of 12%
 - Corporate Tax Rate: 40%
- i. Calculate the WACC for the Company. (4mks)

- ii. If the company decides to increase its debt to Kshs 6,000,000 and reduce equity to Kshs 4,000,000, with the cost of debt remaining at 5% and the cost of equity increasing to 14%, recalculate the WACC (3mks)

QUESTION FIVE (12 MARKS)

- a) Explain Agency Theory and its implications in financial management. (6mks)
- b) Write explanatory notes on the following theories:
- i. Pecking order theory (3mks)
- ii. A bird in hand theory (3mks)