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CITY CAMPUS

MAIN EXAMINATION

AUGUST - DECEMBER 2014 TRIMESTER

FACULTY OF COMMERCE

MBA PROGRAMME

EVENING PROGRAMME

CFI 520: FINANCIAL MANAGEMENT

Date: DECEMBER 2014	Duration: 3 Hours
INSTRUCTIONS: Attempt ALL the FOUR Questions	

Q1. "It is argued that management will only make optimal decisions if they are monitored and appropriate incentives are given". In light of these statement discuss the following:

a) i) Performance – related pay. **(3 marks)**

ii) Rewarding managers with shares. **(3 marks)**

iii) Executive share option plans. **(3 marks)**

b) i) Benefits of linking reward schemes and performance. **(8 marks)**

ii) Problems associated with reward schemes. **(8 marks)**

Q2. Suppose that Hard Times Co. is considering four projects W, X, Y and Z. Relevant details are as follows:

Project	Investment required $	Present value of cash inflows $
W	(10000)	11240
X	(20000)	20991
Y	(30000)	32230
Z	(40000)	43801

Required:

a) i) Calculate the NPV of each project. **(2 marks)**

ii) Calculate the profitability index of each project. **(2 marks)**

iii) Rank the projects based on NPV. **(2 marks)**

iv) Rank the projects based on profitability index (PI). **(2 marks)**

b) Suppose that only $60000 was available for capital investment, calculate using:

i) NPV ranking/priority of the projects. **(6 marks)**

ii) Profitability index ranking/priority of the project. **(6 marks)**

Note: Comment on your results above for b(i) and (ii).

c) Discuss the problems of profitability index as a method of evaluating projects. **(5 marks)**

Q3. a) Mrs. Mulwa is considering investing in a security that has the following distribution of possible returns:

Probability	0.10	0.20	0.30	0.30	0.10
Possible return	-10	.00	0.10	0.20	0.30

Required:

i) What is the expected value of return and standard deviation associated with the investment? **(8 marks)**

ii) Is there much downside risk? How can you tell? **(4 marks)**

b) Mrs. Mulwa is analyzing another investment in Tanzania. The expected return on investment is 20 percent. The probability distribution of possible return is a normal bell shaped distribution with a standard deviation of 15 percent.

Required:

i) What are the chances that the investment will result in a negative return? **(4 marks)**

ii) What is the probability that the return will be greater than:
- I) 10 percent? **(2 marks)**
- II) 20 percent? **(2 marks)**
- III) 30 percent? **(2 marks)**

iii) Comment on your results in (i) and (ii) above. **(3 marks)**

Q4. The Beta-Alpha Company expects with some degree of certainty to generate the following net income and to have the following capital expenditure during the next 5 years (in thousands)

Year	1	2	3	4	5
Net income (Kshs)	2000	1500	2500	2300	1800
Capital expenditure	1000	1500	2000	1500	2000

The company currently has 1 million share of common stock outstanding and pays dividend of Ksh. 1 per share.

Required:

a) Determine dividend per share and external financing required in each year if dividend policy is treated as a residual decision. **(5 marks)**

b) Determine the amounts of external financial in each year that will be necessary if the present dividend per share is maintained. **(7½ marks)**

c) Determine dividends per share and the amounts of external financing that will be necessary if a dividend – payout ratio of 50 percent is maintained. **(12½ marks)**

END