Scott Christian UNIVERSITY

SCHOOL OF PROFESSIONAL STUDIES

BACHELOR OF HOSPITALITY AND TOURISM MANAGEMENT

UNIT CODE/NAME: BHT 417: FOUNDATIONS OF FINANCIAL MANAGEMENT

September- December 2019/2020 End Semester Exam - Time: 2 Hours

Instructions: Answer Question ONE (Compulsory) and any other TWO Questions.

QUESTION ONE

a) Many enterprises begin as sole proprietorships and then as they grow and become successful, the need arises for them to convert to companies and eventually go public.

Required:

List and explain the advantages a company derives from going public. **(10 Marks)**

b) Wamaitha Company has the following costs of various types of capitals for the Year 2019.

Cost of debt k_i	=	5.6%
Cost of preference k_p	=	10%
Cost of retained earnings k_r	=	13%
Cost of new equity k_n	=	14%

The Company's target capital structure proportions are given as follows: -

	Weight
Debt	40%
Preferred stock	10%
Equity	50%
	100%

The company has a sizable amount of retained earnings that it intends to use for future investments.

Required: determine the company's WACC. **(10 Marks)**

c) In evaluating investment decisions, cash flows are considered to be more relevant than profitability associated with the project. Explain why this is the case. **(3 Marks)**

d) Although profit maximization has long been considered as the main goal of a firm, shareholder wealth maximization is gaining acceptance amongst most companies as the key goal of a firm.

Required:

(i) Distinguish between the goals of profit maximization and shareholder wealth maximization. **(2 Marks)**

(ii) Explain three limitations of the goal of profit maximization. **(5 Marks)**

QUESTION TWO

a) Zeroes limited wishes to expand its output by purchasing a new machine worth 170,000 and installation costs are estimated at 40,000/=. In the 4th year, this machine will call for an overhaul to cost 80,000/=. Its expected inflows are:

	Shs.
Year 1	60,000
Year 2	72,650
Year 3	35,720
Year 4	48,510
Year 5	91,630
Year 6	83,715

This company can raise finance to purchase machine at 12% interest rate.

Required

Compute NPV and advise management accordingly. **(9 Marks)**

b) Explain the following terms as used in finance.

i) Systematic Risk **(2 Marks)**

ii) Unsystematic risk **(4 Marks)**

c) Outline four limitations of the use of ratios as a basis of financial analysis.

QUESTION THREE

a) Discuss five factors that affect capital structure **(10 Marks)**

b) Explain the types of agency costs that arise in agent-principal relationship that exist between shareholders and managers. **(5 Marks)**

QUESTION FOUR

Explain the following Dividend Theories

(i) The Bird-in-hand theory **(4 Marks)**

(ii) Signaling theory **(4 Marks)**

(iii) The Clientele effect theory **(4 Marks)**

(iv) The Pecking Order Theory **(3 Marks)**

QUESTION FIVE

a) Distinguish between

i) Capital structure and financial structure. **(3 Marks)**

ii) Business risk and Financial risk **(3 Marks)**

b) KK Ltd is an all equity firm whose Beta factor is 1.2, the interest rate on Treasury bills is currently at 8.5% and the market rate of return is 14.5%. Determine the cost of equity K_e, for the company. **(3 Marks)**

c) i. Explain five factors that may lead to cash flow shortages in an organization. **(3 Marks)**

ii. Explain how an organization can ease (mitigate) the cash flow shortages **(3 Marks)**