

LAIKIPIA



UNIVERSITY

UNIVERSITY EXAMINATIONS

EXAMINATION FOR MASTER OF BUSINESS ADMINISTRATION

MBAD 631: FINANCIAL MANAGEMENT

STREAM: MBAD

TIME: 3 HRS

DAY: THURSDAY [12.30-15.30 P.M]

DATE: 18/12/2025

THIS QUESTION PAPER CONSISTS OF THREE (3) PAGES

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

A company is considering a project which requires an investment of Shs120,000 in machinery. The machinery will last four years after which it will have scrap value of Shs20,000. The investment in additional working capital will be Shs15,000.

The expected annual profits before depreciation are:

Year

1 Shs45,000

2 Shs45,000

3 Shs40,000

4 Shs25,000

The company requires a minimum accounting rate of return of 15% from projects of this type. ARR is measured as average annual profits as a percentage of the average investment.

Required:

- Advise if this project should be undertaken. **(5 Marks).**
- Explain the three major types of financial management decisions that business firms make and describe the factors affecting each decision. **(6 Marks).**
- Define operating leverage and explain its implications for a company's profitability and risk. **(4 Marks).**

QUESTION TWO

- Explain the payback period method in capital budgeting decisions and highlight its advantages and disadvantages (limitations). **(6 Marks).**
- A company has Shs.500 million of equity capital and Shs.100 million of debt capital, all at current market value. The cost of equity is 14% and the cost of the debt capital is 8%. The company is planning to raise Shs.100 million by issuing new shares. It will use the money to redeem all the debt capital.

Required

According to Modigliani and Miller, if the company issues new equity and redeems all its debt capital, what will be the cost of equity of the company after the debt has been redeemed? Assume that there is no corporate taxation. **(9 Marks).**

QUESTION THREE

- Explain the significance of the current ratio in financial analysis. **(3 Marks).**



- b) What is considered a healthy range for current ratio, and what do deviations from this range imply? **(2 Marks).**
- c) Clearly explain the advantages and disadvantages of the CAPM. **(6 Marks).**
- d) Describe why it is found that the CAPM provides a more reliable estimate of the cost of equity than the dividend valuation model or the dividend growth model. **(4 Marks).**

QUESTION FOUR

An all-equity company has a market value of Shs.60 million and a cost of equity of 8%. It borrows Shs.20 million of debt finance, costing 5%, and uses this to buy back and cancel Shs.20 million of equity. Tax relief on debt interest is ignored.

Required

According to Modigliani and Miller, if taxation is ignored, what would be the effect of the higher gearing on

- a) The WACC **(6 Marks).**
- b) The total market value of the company and, **(3 Marks).**
- c) The cost of equity in the company? **(4 Marks).**
- d) How can the values in a, b, and c assist an investor in the decision-making process? **(2 Marks).**

QUESTION FIVE

- a) Using an illustration, explain how operating leverage affects net operating income with changes in revenue. **(5 Marks).**
- b) Explain the key sources and importance of short-term funds to a finance manager. **(10 Marks).**

