



ZIMBABWE EZEKIEL GUTI UNIVERSITY

FACULTY OF BUSINESS, ECONOMICS AND ACCOUNTING

DEPARTMENT OF ACCOUNTING AND FINANCE

EXAMINATION PAPER

COURSE CODE : CAC 209
COURSE TITLE : FINANCIAL MANAGEMENT
DURATION : 3 Hours
LEVEL : 2.2
DATE :

Printed

INSTRUCTIONS TO CANDIDATES:

1. No cell phones are allowed in the examination venue.
2. Use of silent, non-programmable calculators is allowed.
3. Answer all questions.
4. Begin each question on a new page.
5. The number of marks for each question or part question is shown in brackets.

Question One

Best Ltd is evaluating the following three investment projects:

	0	1	2	3	4
Project A	-10 000	4 000	4 000	3 000	3 000
Project B	-10 000	2 000	2 000	6 000	6 000
Project C	-20 000	7 000	8 000	8 000	6 000

The company is subject to capital rationing and the company's capital budget is limited to R20 million for the year. The company is unable to defer any of the projects. The cost of capital is 12%.

Required:

- a) Calculate the Profitability Index of each project? **[14 marks]**
- b) Which projects should be selected assuming that the company is subject to stringent capital rationing? **[5 marks]**
- c) Describe the relationship between the Capital Market Line and the Security Market Line. **[6 marks]**

Question Two

- a) Suggest the potential conflict in objectives which could arise between the following groups of stakeholders in a company.
 - i. Employees and shareholders
 - ii. Shareholders and finance providers
 - iii. Shareholders and managers **[6 marks]**
- b) Discuss ways in which the shareholders of a company can encourage its managers to act in a way which is consistent with the objective of maximisation of shareholder wealth. **[4 marks]**
- c) Explain the capital asset pricing model **[6 marks]**

- d) You are looking at an investment that will pay \$1200 in 5 years if you invest \$1000 today. What is the implied rate of interest? **[4 marks]**
- e) What is the PV of \$115,000 receivable in nine years' time if $r = 6\%$? **[2 marks]**
- f) What amount should be invested now to receive \$10,000 in four years' time if $r = 8\%$ pa. **[3 marks]**

Question Three

Emily is considering two investments and can only invest in either the shares of Company X or in the shares of Company Y. The following information regarding returns and probability distributions of returns is relevant:

Share X		Share Y	
Probability	Return X	Probability	Return Y
0.20	10%	0.20	0%
0.60	15%	0.30	10%
0.20	20%	0.30	20%
		0.20	30%

Required:

- a) Calculate the expected return of X and Y? **[6 marks]**
- b) Calculate the standard deviations of X and Y's returns **[6 marks]**
- c) Calculate the co-efficient of variation? **[4 marks]**
- d) Recommend the best share and explain why you recommend it? **[4 marks]**
- e) Instead of Share Y offering a probability of 20% of achieving a 30% return, assume instead that the possible return is 40%. Explain the effect to the investment decision? **[5 marks]**

Question Four

- a) Discuss the major sources of external financing for business firms? [13 marks]
- b) A company has maximum capital to invest of \$800 000. Five capital projects have been identified which are of similar of risk. The initial step analysis shows the following:

Project	Required initial outlay	NPV	Profitability index
No 1	\$298,000	\$128,000	1.4295
No 2	\$240,000	\$100,000	1.4166
No 3	\$400,000	\$160,000	1.40
No 4	\$160,000	\$ 60,000	1.375
No 5	\$798,000	\$239,000	1.300

Projects cannot be postponed and multiples of the same project are not allowed.

Required:

What is the optimal combination of projects to maximise NPV assuming?

- i. projects are divisible? [6 marks]
- ii. projects are not divisible? [6 marks]

End of Examination Question Paper