



SCHOOL OF TOURISM AND HOSPITALITY
MASTERS IN HOSPITALITY BUSINESS MANAGEMENT
END OF MODULE EXAMINATION
MHBM 8202: CORPORATE FINANCE FOR HOSPITALITY

DATE: Thursday, 19th October 2023

TIME: 14:30 – 17:30 Hrs

INSTRUCTIONS:

1. This examination consists of **FIVE** questions
2. Answer **Question ONE (Compulsory)** and **any** other **TWO** questions.
3. Do not write on the question paper

QUESTION ONE

[40 Marks]

- a) The management team at Faraja Ltd are setting the organization's strategy and goals. You are the finance manager in Faraja Ltd and have been invited by the board to distinguish between profit maximization and shareholder wealth maximization goals.

Required:

- i) Distinguish between the goals of profit maximization and shareholder wealth maximization **(6 marks)**
- ii) Explain two limitations of the goal of profit maximization **(2 marks)**

- b) Boris is deliberating on investing in a new machine costing Shs 100,000 with an expected life of 5 years. The machine has no residual value at the end of the 5 years. It is expected that 10,000 units will be sold each year at a selling price of shs12 per unit. The variable cost of production is expected to be Shs 6.60 per unit and the incremental fixed cost is expected to be Shs 20,000 per annum. Boris uses a discount rate of 15% for investment appraisal and has a target payback of 2 years.

Required:

- i) Evaluate the viability of the investment using the following techniques:
 - Payback period
 - NPV
 - IRR **(10 marks)**
- ii) Discuss two advantages and two disadvantages of payback method in project appraisal. **(4 marks)**

- c) Working capital management is an essential skill for every business and is crucial for the survival of start-ups. Explain the two main objectives of working capital management and their conflict. **(4 marks)**

- d) Samuel attended a workshop to learn about investment in financial securities. He was excited to share the knowledge with his colleagues. However, he realized that two concepts were confusing him when discussing about risk: Systematic and Unsystematic risk.

Required:

- Using examples, assist Samuel in distinguishing between the two types of risks. **(4 marks)**

- e) Mwendwa has an investment capital of Sh.1,000,000. He wishes to invest in two securities, A and B in the following proportion: Sh.400,000 in security A and Sh.600,000 in security B. The returns on these two securities depend on the state of the economy as shown below:

State of the economy	Probability	Returns on Security A	Returns on Security B
Boom	0.3	16%	22%
Normal	0.5	13%	20%
Recession	0.2	10%	18%

Required:

- i) Compute the expected return of each security **(2 marks)**
 ii) Compute the standard deviation of each security **(4 marks)**
 iii) Rank the projects based on the coefficient of variation **(2 marks)**
 iv) Compute the return of the portfolio **(2 marks)**

QUESTION TWO [30 Marks]

- a) Define agency relationships and briefly explain how the shareholder versus management relationship arises. **(4 marks)**
 b) State and explain any four actions by management and shareholders that can be harmful to the interest of debt holders (sources of conflict). **(8 marks)**
 c) Highlight the various measures that would minimize the agency problems in part (b) above. **(8 marks)**
 d) Define corporate governance and discuss four key principles that it provides. **(10 marks)**

QUESTION THREE [30 Marks]

- a) "Payment of dividends is relevant to firm valuation." Discuss this statement using three dividend theories. **(10 marks)**
 b) Discuss three benefits and two limitations of using debt as a source of finance for a firm. **(10 marks)**
 c) Briefly explain five reasons why companies list their shares on the stock exchange. **(10 MARKS)**

QUESTION FOUR [30 Marks]

- a) Define the term cash operating cycle (working capital cycle) **(2 marks)**
 b) Describe the four main components of the cash operating cycle. **(8 marks)**
 c) Briefly discuss five factors that determine the length of the cash operating cycle. **(10 marks)**
 d) Studies indicate that small business failure has a direct relationship with overtrading.
 i) Define the term over trading and provide four symptoms that a business is overtrading. **(6 marks)**
 ii) Explain two solutions to over trading **(4 marks)**

QUESTION FIVE**[30 Marks]**

The following financial statements are provided for Delux Ltd, a motel located in the outskirts of Nairobi County.

Delux Ltd. Balance Sheets as at 31 December

	2020	2021	2022
	Sh.'000'	Sh.'000'	Sh.'000'
Cash	15,250	14,400	8,000
Accounts Receivables	94,050	87,800	134,400
Inventory	<u>98,600</u>	<u>158,800</u>	<u>254,000</u>
Total current assets	194,170	261,000	396,400
Land and buildings	25,230	27,600	25,000
Machinery	33,800	36,400	30,600
Other fixed assets	<u>14,920</u>	<u>18,200</u>	<u>16,400</u>
Total assets	<u>268,120</u>	<u>343,200</u>	<u>468,400</u>
Accounts and notes payable	34,220	73,760	135,848
Accruals	<u>15,700</u>	<u>34,000</u>	<u>67,000</u>
Total current liabilities	49,920	107,760	202,848
Long term debt	60,850	60,858	81,720
Ordinary share capital	115,000	115,000	115,000
Retained earnings	<u>42,350</u>	<u>59,582</u>	<u>68,832</u>
Equity plus Total Liabilities	<u>268,120</u>	<u>343,200</u>	<u>468,400</u>

Delux Ltd. Income Statements for the year ending 31 December

	2020	2021	2022
	Sh.'000'	Sh.'000'	Sh.'000'
Sales (all on credit)	827,000	858,000	890,000
Cost of sales	<u>661,600</u>	<u>710,000</u>	<u>712,000</u>
Gross profit	165,400	148,000	178,000
Administrative and selling expenses	(63,600)	(47,264)	(51,200)
Other operating expenses	<u>(25,400)</u>	<u>(31,800)</u>	<u>(38,200)</u>
Earnings before interest and tax (EBIT)	76,400	68,936	88,600
Interest expense	<u>(12,800)</u>	<u>(26,800)</u>	<u>(63,600)</u>
Net income before taxes	63,600	42,136	25,000
Taxes	<u>(25,400)</u>	<u>(16,854)</u>	<u>(10,000)</u>
Net income	<u>38,200</u>	<u>25,282</u>	<u>15,000</u>

Industry Financial Ratios (2017)	
Quick ratio	1
Current ratio	2.7
Inventory turnover	7 times
Average collection period	32 days
Average payables period	42 days
Fixed asset turnover	13.0 times
Net income to net worth	12.8%
Net profit margin to sales	3.5%

Required

- a) Compute the financial ratios for Delux Ltd for the past three years corresponding to industry ratios given above and comment on performance in terms of liquidity, profitability, and efficiency. **(20 marks)**

- b) Discuss five users of financial statements of a firm and their interest in the reports. **(10 marks)**

TOTAL = 100 MARKS; WEIGHT = 50%