

THE OPEN UNIVERSITY OF SRI LANKA
FACULTY OF MANAGEMENT STUDIES
BACHELOR OF MANAGEMENT STUDIES HONOURS
LEVEL 4: SEMESTER II
AFU4573 FINANCIAL MANAGEMENT
FINAL EXAMINATION – 2024/2025
DURATION – THREE (03) HOURS
DATE: 10.01.2026



TIME: 1.30 pm – 4.30 pm

INSTRUCTIONS:

- Answer any five (05) questions.
- All the workings should be shown clearly.
- Start each answer from a new page.
- Number of questions 06 and number of pages 04.
- Use of non-programmable calculators is allowed.

1. (a) Explain the objective of the finance function in a business organization. **(04 Marks)**
 (b) Discuss four (04) major decisions involved in finance as a business function. **(10 Marks)**
 (c) “The profit maximization is not operationally feasible criterion in financial decision making”.
 Justify this statement by discussing three (03) issues associated with the profit maximization criterion. **(06 Marks)**
(Total: 20 Marks)
2. (a) Explain the concept of time value of money and provide three (03) reasons as to why people prefer to receive money now rather than later. **(06 Marks)**
 (b) A bank has offered you a deposit scheme, which will triple your money in 9 years. What rate of return would you earn from this scheme? **(04 Marks)**
 (c) Suppose that you have obtained a 8-year, Rs. 500,000 loan. The loan carries an interest rate of 8 percent compounded annually during the loan period.
 You are required to calculate;
 (i) The annual loan installment and capital repayment during the first year.
 (ii) The total interest that will be paid over the life of the loan. **(10 Marks)**
(Total: 20 Marks)
3. (a) Explain two (02) characteristics of redeemable preference shares of a company. **(04 Marks)**
 (b) Explain two (02) advantages and two (02) disadvantages of equity as a source of finance when compared to debenture. **(08 Marks)**
 (c) Susantha PLC is a company listed on the Colombo Stock Exchange. With the increase of its financial performance during the last year, the board of directors has increased the dividend payout ratio (that is, the percentage of profit pay as dividend) from 30% to 40% for the year ended 31st March 2025. The following financial information has also been provided for the last two years.

Year ended 31 st March;	2024 (Rs'000)	2025 (Rs'000)
Profit after tax	14,800	15,200
No. of ordinary shares	5,000	5,000

The dividend is expected to be increased at a constant rate of 5% per annum. The company's cost of equity is 12% per annum.

You are required to;

- Calculate the value of an equity share of Susantha PLC using the dividend growth model.
- Discuss two (02) weaknesses of the dividend growth model when applying for equity share valuation.

(08 Marks)

(Total: 20 Marks)

4. (a) Explain how risk-return trade-off influences investment decisions. **(04 Marks)**

- (b) Explain the difference between systematic risk and unsystematic risk, and how a portfolio facilitates for managing these risks. **(04 Marks)**

- (c) ABC Investment PLC is a medium-sized investment firm that specializes in managing portfolios for its clients. Recently, a portfolio manager of the company has been assigned the task of evaluating the risk and return of several stocks and constructing an optimal portfolio for a client. The client is interested in stocks of three companies- X, Y, and Z. The following forecasts have been made in relation to these three stocks.

Economic condition	Probability of occurrence	Stocks of Company X	Stocks of Company Y	Stocks of Company Z
Boom	0.2	15%	25%	12%
Normal	0.3	10%	11%	10%
Recession	0.5	7%	4%	6%

Based on the above information, you are required to;

- Calculate the expected returns and standard deviation of returns of the stocks X, Y and Z.
- Identify the two most suitable stocks for the client's investment portfolio and justify your selection with appropriate reasoning.

(12 Marks)

(Total: 20 Marks)

5. (a) Briefly explain the meaning of "Capital Budgeting Decisions" in an organization.

(03 Marks)

- (b) Explain three (03) advantages of the Net Present Value method when compared to Payback Period and Accounting Rate of Return methods. **(06 Marks)**

- (c) You have been assigned the appraisal of a proposal to purchase a new machine which would be utilized for producing a new product. The machine will cost Rs 5,500,000 and will have a

useful life of five years. The following cash flows are expected to generate during the useful life of the machinery.

(Rs'000)

	Year 1	Year 2	Year 3	Year 4	Year 5
Net cash flow from sales of the product	1,200	2,400	2,700	2,000	1,100
Residual value of the machine					500

The company uses a cost of capital of 10% to appraise the projects of this type.

You are required to;

- (i) Calculate payback period, accounting rate of return and net present value of the proposal to purchase machine.
- (ii) Discuss the financial viability of the proposal based on the calculations in part (i) above.

(11 Marks)

(Total: 20 Marks)

6. (a) Explain four (04) factors that a company should consider when determining its dividend policy. **(06 Marks)**
- (b) Discuss the relationship between capital structure and firm value by referring to the Trade-off Theory. **(06 Marks)**
- (c) Discuss how changes in market interest rates, tax policies, and investor expectations influence a firm's cost of capital. Provide examples to support your explanation. **(08 Marks)**

(Total: 20 Marks)

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PRESENT VALUE TABLE

Present value of \$1, that is $(1+r)^{-n}$ where r = interest rate; n = number of periods until payment or receipt.

Periods (n)	Interest rates (r)									
	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%
1	0.990	0.980	0.971	0.962	0.952	0.943	0.935	0.926	0.917	0.909
2	0.980	0.961	0.943	0.925	0.907	0.890	0.873	0.857	0.842	0.828
3	0.971	0.942	0.915	0.889	0.864	0.840	0.816	0.794	0.772	0.751
4	0.961	0.924	0.888	0.855	0.823	0.792	0.763	0.735	0.708	0.683
5	0.951	0.906	0.863	0.822	0.784	0.747	0.713	0.681	0.650	0.621
6	0.942	0.888	0.837	0.790	0.746	0.705	0.666	0.630	0.596	0.564
7	0.933	0.871	0.813	0.760	0.711	0.665	0.623	0.583	0.547	0.513
8	0.923	0.853	0.789	0.731	0.677	0.627	0.582	0.540	0.502	0.467
9	0.914	0.837	0.766	0.703	0.645	0.592	0.544	0.500	0.460	0.424
10	0.905	0.820	0.744	0.676	0.614	0.558	0.508	0.463	0.422	0.386
11	0.896	0.804	0.722	0.650	0.585	0.527	0.475	0.429	0.388	0.350
12	0.887	0.788	0.701	0.625	0.557	0.497	0.444	0.397	0.356	0.319
13	0.879	0.773	0.681	0.601	0.530	0.469	0.415	0.368	0.326	0.290
14	0.870	0.758	0.661	0.577	0.505	0.442	0.388	0.340	0.299	0.263
15	0.861	0.743	0.642	0.555	0.481	0.417	0.362	0.315	0.275	0.239
16	0.853	0.728	0.623	0.534	0.458	0.394	0.339	0.292	0.252	0.218
17	0.844	0.714	0.605	0.513	0.436	0.371	0.317	0.270	0.231	0.198
18	0.836	0.700	0.587	0.494	0.416	0.350	0.296	0.250	0.212	0.180
19	0.828	0.686	0.570	0.475	0.396	0.331	0.277	0.232	0.194	0.164
20	0.820	0.673	0.554	0.458	0.377	0.312	0.258	0.215	0.178	0.149

CUMULATIVE PRESENT VALUE TABLE

Periods (n)	Interest rates (r)									
	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%
1	0.990	0.980	0.971	0.962	0.952	0.943	0.935	0.926	0.917	0.909
2	1.970	1.942	1.913	1.886	1.859	1.833	1.808	1.783	1.759	1.736
3	2.941	2.884	2.829	2.775	2.723	2.673	2.624	2.577	2.531	2.487
4	3.902	3.808	3.717	3.630	3.546	3.465	3.387	3.312	3.240	3.170
5	4.853	4.713	4.580	4.452	4.329	4.212	4.100	3.993	3.890	3.791
6	5.795	5.601	5.417	5.242	5.076	4.917	4.767	4.623	4.486	4.355
7	6.728	6.472	6.230	6.002	5.786	5.582	5.389	5.206	5.033	4.868
8	7.652	7.325	7.020	6.733	6.463	6.210	5.971	5.747	5.535	5.335
9	8.566	8.162	7.786	7.435	7.108	6.802	6.515	6.247	5.995	5.759
10	9.471	8.983	8.530	8.111	7.722	7.360	7.024	6.710	6.418	6.145
11	10.368	9.787	9.253	8.760	8.306	7.887	7.499	7.139	6.805	6.495
12	11.255	10.575	9.954	9.385	8.863	8.384	7.943	7.536	7.161	6.814
13	12.134	11.348	10.635	9.986	9.394	8.853	8.358	7.904	7.487	7.103
14	13.004	12.106	11.296	10.563	9.899	9.295	8.745	8.244	7.786	7.367
15	13.865	12.849	11.938	11.118	10.380	9.712	9.108	8.559	8.061	7.606
16	14.718	13.578	12.561	11.652	10.838	10.106	9.447	8.851	8.313	7.824
17	15.562	14.292	13.166	12.166	11.274	10.477	9.763	9.122	8.544	8.022
18	16.398	14.992	13.754	12.659	11.690	10.828	10.059	9.372	8.756	8.201
19	17.226	15.679	14.324	13.134	12.085	11.158	10.336	9.604	8.950	8.365
20	18.046	16.351	14.878	13.590	12.462	11.470	10.594	9.818	9.129	8.514