

THARAKA



UNIVERSITY

**COLLEGE
UNIVERSITY EXAMINATIONS**

**EXAMINATION FOR THE AWARD OF DEGREE
OF BACHELOR OF COMMERCE**

BCOM 231: BUSINESS FINANCE

STREAMS: BCOM

TIME: 2 HOURS

DAY/DATE: TUESDAY 14/04/2020

11.30 A.M. – 1.30 P.M.

INSTRUCTIONS:

- **Answer Question One and any other Two Questions**
- **Do not write on the question paper**

QUESTION ONE

- (a) Agency problem arises when agents pursue their own interests other than that of the principal.
- (i) Explain the meaning of the term agency relationship in the context of corporate management. [3 marks]
- (ii) Discuss the reasons for conflicts between shareholders and creditors and explain how they can be resolved. [7 marks]
- (b) (i) Distinguish between discounting and compounding as used in finance. [3 marks]

(ii) How much will Kamau receive after 5 years if he deposits sh. 5000 at the beginning of year at 15% interest rate. [4 marks]

(c) Consider a project with initial outlay of sh. 1,000,000 promising the following cashflows.

Years	Cashflows
1	450,000
2	400,000
3.	300,000
4	350,000
5	250,000

Additional information

1. The cost of capital is 10%
2. Depreciation is on straight line method
3. Tax rate is 10% and scrap value is sh. 100,000

Required:

- | | |
|-------------------------------------|-----------|
| (i) Net Present Value (NPV) | [6 marks] |
| (ii) Profitability index (PI) | [3 marks] |
| (iii) Internal rate of return (IRR) | [4 marks] |

QUESTION TWO

(a) Discuss the significance of cost of capital. [6 marks]

(b) Overnight express ltd has the following capital structure.

	Sh.
10% debentures (sh. 1000 par)	3600
Ordinary share capital (sh. 25 par)	6500
Retained earnings	4000
10% preference shares (sh. 20 par)	3000
15% medium term loan	4000

Additional information:

- The company currently pays a dividend of sh. 5 per share which is expected to grow at the rate of 6%. The market price of the ordinary share is sh. 40
- There is a floatation cost of 10% on market price of ordinary shares.
- The debenture will mature in 10 years and the current market price is s. 1200
- The preference shares are currently selling at sh. 25
- The market value of the loan is sh. 5,000,000

Required:

The component cost of capital and the weighted average cost of capital (WACC)

[14

marks]

QUESTION THREE

(a) Discuss the various types of investment decisions. [4 marks]

(b) The following dividend pattern relates to SOYA ltd for the last 5 years.

Years	Dividend per share (DPs)
2014	5
2015	5.5
2016	6.05
2017	6.66
2018	7.33

Required:

Calculate the constant growth rate and determine the value of shares in the year 2018.

[8

marks]

(c) Outline the managerial functions of a finance manager in the contemporary business environment. [4 marks]

(d) Explain the following sources of finance

- (i) Mortgage finance
- (ii) Venture capital

QUESTION FOUR

(a) (i) Discuss the significance of finance ratio analysis as a method of interpreting financial statements. [6

marks]

(ii) XYZ ltd has a total current asset investment of sh. 1,200,000 and the total current liabilities of sh. 500,000. During the year, the company made sales of sh. 2,000,000. The total cost of sales was estimated at 60% of the sales. The company's stock is sh. 200,000.

Required:

(i) Current ratio [2 marks]

- (ii) Quick ratio [2 marks]
- (iii) Stock turnover ratio [3 marks]

(b) Discuss the reasons for time preference of money. [4 marks]

(c) Discuss the disadvantages of using payback period in evaluating investment projects. [3 marks]
