

CHUKA



UNIVERSITY

UNIVERSITY EXAMINATIONS

**EXAMINATION FOR THE AWARD OF DEGREE OF
BACHELOR OF COMMERCE, BACHELOR OF PROCUREMENT AND LOGISTICS
MANAGEMENT AND BACHELOR OF ENTERPRENEURSHIP AND ENTERPRISE
MANAGEMENT**

BCOM 231: BUSINESS FINANCE

STREAMS: BCOM, BPLM, BEEM Y2S2

TIME: 2 HOURS

DAY/DATE: TUESDAY 14/04/2020

11.30 AM – 1.30 PM

INSTRUCTIONS:

Answer Question One and any other Two Questions

QUESTION ONE

- (a) Explain any four arguments against shareholders wealth maximization objective. [6 marks]
- (b) A company is considering purchasing a 12% sh 100,000 debenture currently selling at a market price of sh. 120,000. Cost of capital is 15%. Required
- (i) Should the company purchase the debenture? [4 marks]
- (ii) Discuss the fundamental theory of valuation [3 marks]
- (c) Describe the following sources of finance
- (i) Factoring of debtors [2 marks]
- (ii) Bills of exchange [2 marks]
- (iii) Debentures [2 marks]
- (d) One of the solutions to conflicts between shareholders and managers is incurring agency costs. Clearly discuss some of the agency costs to be incurred by a business. [6 marks]

- (e) Determine the amount that will be received after 12 years if Njeri deposits sh 50,000 at the end of each year at an interest rate of 15%. [3 marks]
- (f) State two reasons for time value of money. [2 marks]

QUESTION TWO

- (a) Evaluate the effectiveness of Net present value (NPV) as a tool of capital investment appraisal. [4 marks]
- (b) A company is considering investing in a project with the following information

Years	Units produced
1	300
2	220
3	180
4	250
5	200

Addition information:

- (i) Tax rate is 30% and depreciation is on straight line method
 (ii) Cost of capital is 10%, scrap value is 6000 and the initial cost is sh 22,000
 Required: NPV, PI and IRR [14 marks]

- (c) Highlight two limitations of accounting rate of return [2 marks]

QUESTION THREE

- (a) Kingsley investment limited has the following capital structure

	Sh (000)
Ordinary shares (sh 80 par)	8,000
Retained earnings	5,200
12% preference shares (sh 130 par)	6,500
10% debentures (sh 100 par)	3,500
6-year 15% long term loan	<u>4,000</u>
	<u>27,200</u>

Additional Information:

- Ordinary shareholders expect a dividend of sh 15 which is expected to grow at 5%. The shares are trading at a premium of 25% and incurs a floatation cost of sh 10 per share
- preference shares will mature in 13 years and currently sell at a discount of 10%
- debentures were issued 10 years ago and currently changing hands at a premium of 20%
- long term loan is currently selling at sh 6,000,000 Calculate the weightened average cost of capital [3 marks]

- (b) State three reasons why weighted average cost (WACC) is relevant in decision making as opposed to component cost of capital. [3 marks]
- (c) In an organization set up conflict can arise between different parties such as shareholders and auditors. The conflict can be a result of agent pursuing their own interests.
 (i) In the above, identify the agent and identify their role in the organization [2 marks]
- (ii) Discuss the sources for conflict between shareholders and auditors [3 marks]

QUESTION FOUR

- (a) Describe the significance of the use of ratios when analyzing financial statements. [5 marks]

- (b) XYZ company has the following data

Profit before interest and tax	sh 500,000
8% debenture	sh 2,000,000
10% preference shares	sh 1,000,000
Dividend paid	sh 80,000

Total outstanding ordinary shares 16,000

Market price is sh 20

Tax rate is 30%

The company paid interest and preference dividend entitled to debenture holders and preference shareholders

Required:

- (i) Dividend per share [1.5 marks]
- (ii) Earnings per share [1 mark]
- (iii) Dividend yield [1.5 marks]
- (iv) Dividend cover ratio [1.5 marks]
- (c) A company currently pays a dividend of sh 2 per share which is expected to grow at 20% for 4 years, 15% for 3 years after which it will fall to a constant rate of 7%. Risk free rate is 7.5% and the risk premium is 4.5%. Required: Determine the theoretical value of the company's share. [9 marks]