

CHUKA



UNIVERSITY

UNIVERSITY EXAMINATIONS

EXAMINATION FOR THE AWARD OF DEGREE OF BACHELOR OF
COMMERCE

BCOM 231: BUSINESS FINANCE

STREAMS: B.COM (ODEL) (Y2S2)

TIME: 2 HOURS

DAY/DATE: TUESDAY 05/10/2021

2.30 P.M. – 4.30 P.M.

INSTRUCTIONS

- Answer question one and any other two

Question one

- a) Agency problem exists when agents pursue their own interests rather than the interest of their principals. In light of this statement;
- Discuss the reason for conflict between shareholders and managers. (8 marks)
 - Explain the solution for conflict between shareholders and managers. (6 marks)
- b) Explain the non-financial goals of a business organization. (6 marks)
- c) The following information relates to the profits before depreciation and tax of project Mambo

		Project
Initial cost of project		200,000
Useful life of project		5
	1	100,000
	2	90,000
	3	80,000
	4	75,000
	5	70,000

Depreciation is charged on straight line basis, tax rate is 30% and the required rate of return for investors is 12%. Calculate

- i. Cash flows (5 marks)
- ii. Net Present Value (4 marks)
- iii. Profitability index (1 marks)

Question two

- a) The following is the capital structure of Sunny Investment Limited as at 31st December 2020

	Shs '000'
Ordinary share capital (shs 25 par)	8000
Retained Earnings	8000
15% Preference Share Capital (shs 24 par)	1200
10% Debenture (shs 100 par)	<u>6000</u>
	<u>23200</u>

Additional information

- i. Corporate tax rate is 30%
- ii. Preference shares were issued 5 years ago and selling sh 25
- iii. The 10% debt has a 10 year maturity period. It is currently selling at sh. 120 in the market.
- iv. The firm currently pays dividends of sh. 5 per share the dividend per share is expected to grow at 8% in the future. The market price per share is shs. 30.

Required

- i. The cost of various components of capital (8 marks)
- ii. The weighted Average Cost of Capital. (6 marks)
- b) Discuss the features of a good investment appraisal technique. (6 marks)

Question three

- a) Humphrey intends to deposit sh. 10,500 at the end of each year for 4 years. How much will he collect after 4 years at an interest rate of 15% per annum. (4 marks)
- b) Explain the following sources of finance that can be used by an organization. (6 marks)
 - i. Debentures
 - ii. Retained profits
 - iii. Mortgage

- c) A company is considering to invest in a project that has profits before tax of sh. 50,000 for 3 years. The depreciation is sh. 5000 and tax rate is 30%. Calculate the accounting rate of return. (5 marks)
- d) The following dividend pattern relates to Ginger company limited. Calculate the value of the share in 2013, if the cost of capital is 25%. (5 marks)

Year	Dividends
2009	2.5
2010	3
2011	4
2012	4.5
2013	5

Question four

- a) A company currently pays a dividend of sh 8 per share and this dividend is expected to grow at 10% for 3 years, 15% for the next 2 years after which it will fall to a constant rate at 12% thereafter. The cost of capital is 15%.
Required: Determine the real value of the company's share (8 marks)
- b) A 12% sh 8000 bond is currently selling in the market for sh. 12,000. The bond will mature in 5 years. The cost of capital is 15%. Determine the yield to maturity of the bond. (3 marks)
- i. Determine the value of the bond and advise management on whether to buy or sell the bond. (4 marks)
- c) Discuss the factors that affect the cost finance. (5 marks)
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