KENYATTA UNIVERSITY

UNIVERSITY EXAMINATIONS 2014/2015

DIGITAL SCHOOL OF VIRTUAL AND OPEN LEARNING

SECOND SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR OF COMMERCE

BAC 203: BUSINESS FINANCE I

DATE: Saturday, 2nd May 2015 **TIME:** 8.00 a.m. – 10.00 a.m.

INSTRUCTIONS:

Answer ALL questions.

QUESTION ONE

(a) Explain four functions of a finance manager in a business organisation. (4 marks)

(b) (i) Explain four agency relationships which exits in a business organisation. (4 marks)

(ii) Explain the conflicts that may arise in each relationship and how it can be reduced. (4 marks)

(c) Explain four merits of using ordinary shares as a source of finance for the business. (4 marks)

(d) Explain four factors you need to consider before a choice of debt finance. (4 marks)

QUESTION TWO

(a) Explain the factors that may affect the expected return for a firm. (4 marks)

(b) A limited intends to invest in two securities available and the Security Exchange Market. The following information based on the future states of economy in a country.

State of the Economy	Probability	Security A	Security B
Expansion	0.3	19%	21%
Peak	0.4	24%	26%
Contraction	0.2	15%	14%
Recession	0.1	11%	12%

Required:

(i) Expected return of each company securities

(ii) Standard deviation for each company security return

(iii) Correlation Coefficient between the two securities return

(iv) Portfolio Risk for an investor who intends to hold 45% in A and 55% in B.

(8 marks)

(e) Explain structure of Kenyan capital market. (4 marks)

QUESTION THREE

(a) Consider the stock of B Limited that will pay an annual dividend of Kshs 2 in the coming year. The dividend is expected to grow at a constant rate of 5% permanently. The market requires is 12% in the company.

(i) Determine the current price of a share of the stock. (4 marks)

(ii) What will the stock price be 10 years from today? (3 marks)

(b) Express Limited borrowed Kshs 3,000,000 from a local commercial bank payable at maturity plus accumulated interest. The instead for the amount is 15% p.a. and the maturity period is 5 years from now. The firm has decided to create a sinking fund to generate enough money to pay the loan at maturity.

You are required to prepare amortization schedule for the sinking fund to pay the amount. (5 marks)

(c) Management of Thika Limited is anticipating investing in a project. The project is expected to have a life of 7 years. The expected cash inflows are as follows:

Years	1	2	3	4	5	6	7
Cash flows	150,000	180,000	190,000	200,000	220,000	230,000	200,000

You are required to determine total present value for the firm if required rate of return for the firm is 12%. (7 marks)

QUESTION FOUR

(a) Explain four importance of cost of capital finance decision making. (4 marks)

(b) Highway Ltd a firm listed at a local security exchange has a capita structure as follows: 30% ordinary shares, 20% retained earnings, 30% of preference shares and the remaining is financed by debt. The ordinary shares of the company are currently trading at Kshs 180 per share and company has paid a dividend of Kshs 10 per share and a divided growth policy of 8% p.a. The 12% preference shares are trading at their nominal value and the debt is of 18% bank loans. The company is within the 40% tax bracket.

You are required to determine the Weighted Average Cost of Capital (WACC) (8 marks)

(c) Explain the uses if the following ratios:

(i) Liquidity rations

(ii) Activity ratios

(iii) Revenue rations (3 marks)