



# MACHAKOS UNIVERSITY

University Examinations for 2020/2021 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ACCOUNTING BANKING AND FINANCE

SECOND YEAR SPECIAL/ SUPPLEMENTARY EXAMINATION FOR

BACHELOR OF COMMERCE

BAC 203 BUSINESS FINANCE I

DATE: 26/3/2021

TIME: 11.00-1.00 PM

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## INSTRUCTIONS:

*Answer question one and any other two questions.*

### QUESTION ONE (30 MARKS)

- a) Explain the benefits of retained earnings that accrue to the firm (6 marks)
- b) Discuss three advantages of issuing debt instead of equity (6 marks)
- c) State and explain the purpose of long-term finance to a business firm (6 marks)
- d) Ksh.200, 000/= is the amount that Jane requires after 20 years for her retirement. How much should she invest now at 5% per annum compounded annually? (6 marks)
- e) Discuss the two aspects of the cost of capital (6 marks)

### QUESTION TWO (20 MARKS)

- a) Critically examine the advantages and disadvantages of equity shares (12 marks)
- b) Accompany plans to issue 1000 new equity shares of Ksh. 100/= each at par. The floatation costs are expected to be 4% of the share price. The company pays a dividend of Ksh.12/= per share initially and growth in dividend is expected to be 5%. Calculate the cost of new issue of equity shares. (8 marks)

### QUESTION THREE (20 MARKS)

- a) Three years ago, Will invested Ksh. 2000/= in an individual retirement account (IRA). Two years ago, he invested Ksh. 1800/= and last year, he invested Ksh. 1500/=. How much is currently in the account, if this IRA earns interest at 8% p.a. ? (12 marks)

- b) The Duncan Company's stock is currently selling for Ksh.15/=. People generally expect its price to rise to Ksh. 18/= by the end of next year and that it will pay a dividend of Ksh.0.50/= per share during the year. What is the expected return on an investment in Duncan's stock? (8 marks)

**QUESTION FOUR (20 MARKS)**

- a) Realizing the benefits of diversification Risley invested in the following securities :

	United	Chubb	Chase
Expected return	12%	14%	9%
Standard deviation of return	2%	5%	3%
Beta	1.65	1.20	0.89
Amount invested in each security	Ksh. 50,000	125,000	75,000

**Required;**

Calculate the expected rate of return on the portfolio and the beta of the portfolio

(12 marks)

- b) Discuss the terms Risk and Return as use in business finance (8 marks)

**QUESTION FIVE (20 MARKS)**

What is the balance in an account at the end of 10 years if Ksh.2500/= is deposited today and the account earns 4% interest compounded annually and quarterly?