



# **MACHAKOS UNIVERSITY**

**University Examinations for 2016/2017 Academic Year**

**SCHOOL OF BUSINESS AND ECONOMICS**

**DEPARTMENT OF BUSINESS ENTREPRENEURSHIP AND MANAGEMENT  
SCIENCES**

**SECOND YEAR FIRST SEMESTER EXAMINATION FOR BACHELOR OF  
COMMERCE**

**BAC 203: BUSINESS FINANCE 1**

**DATE: 29/11/2016**

**TIME: 2:00 – 4:00 PM**

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## **INSTRUCTIONS.**

**Answer Question One and Any Other Two Questions**

### **QUESTION ONE (30 MARKS)**

- a) Discuss the main problems sole traders' encounter in a bid to raise finance on Kenya's financial markets. (5 marks)
- b) Differentiate between Debt Finance from Ordinary Share Capital (Equity Finance) (10 marks)
- c) Why do different sources of finance have different costs? (5 marks)
- d) A company offers to start a pension plan for its workers, and the plan is to place kshs. 15,000 for each worker at the end of each year in their accounts that earns 6% annually. Calculate the amount that will be in the account of a worker at his retirement age of 60 years, if he is now 40 years old at the time of the start of this pension plan. (5 marks)
- e) James intends to raise kshs. 990,000 in three years time. At the beginning of the first year, James deposited kshs. 350,000, and another kshs. 380,000 in the second year in Hekima bank that pays 10% interest on deposits. Calculate the amount that James need to deposit into the account in order to raise the required amount. (5 marks)

## QUESTION TWO (20 MARKS)

The executive director of Mapema Ltd has circulated the following information as part of board paper:

Mapema Ltd.

Financial Performance for the year ended 31 March:

	2016	2015
i) Return on investment	12%	10%
ii) Gross profit on sales	25%	20%
iii) Number of days credit given	30 days	45 days
iv) Administrative cost of sales	7%	10%

### Required

- a) Brief report on each of the above 4 ratios indicating the reservation, if any, you may have or judging them as improvement in performance. (8 marks)
- b) Taifa Ltd has sales of Sh.20,000,000 in 2015. Beginning and closing stock was Sh.800,000 and Sh.2,200,000 respectively. G.P. margin is usually 25% of sales.

### Required

- i) Stock turnover ratio (3 marks)
- ii) Number of days stock held (3 marks)
- iii) Brief explanation on how the ratio computed in (i) above can be improved and financial Consequences of such action. (6 marks)

## QUESTION THREE (20 MARKS)

- a) Explain the meaning of “time value of money” (4 marks)
- b) Mrs. Luke deposited kshs. 900,000 in a savings account that pays 12% interest compounded semi-annually. Calculate the amount that shall be in her account at the end of 10 years. (6 marks)
- c) The company and its shareholders as agents may take some actions that might prejudice the position or interest of the government as the principal. Explain five of these actions. (10 marks)

#### QUESTION FOUR (20 MARKS)

- a) The capital of a Kwenda Co. Ltd. is all Equity and consists of 800,000 shares of Shs.120. each. The anticipated growth rate is 10% and last years dividend was Shs.4 per share. What is the cost of Equity? (3 marks)
- b) Salama Co. Ltd has decided to adjust its capital structure proportions to 25% debt of 36,000 irredeemable debentures, 25% preferred stock in form of 200,000 preference shares and 50% equity while maintaining the same level of capital. The company anticipates the same growth rate as above and its preferred stock and 10% and 6% respectively. The corporate income tax rate is 30%.
- Calculate the cost of equity. (4 marks)
  - Calculate the dividend per share of preferred stock. (3 marks)
  - Calculate the cost of debt. (3 marks)
- c) What is Salama`s Co. Ltd. Weighted Average cost of Capital(WACC) ? (7 marks)

#### QUESTION FIVE (20 MARKS)

The following relates to two securities (security P and Q) being offered for subscription with their respective characteristics.

State of the Economy	Possibility of occurrence	Security P	Security Q
U	0.15	10%	25%
V	0.25	15%	10%
W	0.2	30%	15%
X	0.25	25%	40%
Y	0.15	20%	10%

- Calculate the expected return on each security. (6 marks)
- Calculate the standard deviation of the returns on security P and Q (10 marks)
- Which security do you recommend for the company to invest in and why? (4 marks)