



MACHAKOS UNIVERSITY

University Examinations for 2016/2017 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF BANKING, ACCOUNTING & FINANCE

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

BAC203 BUSINESS FINANCE I

DATE: 3/8/2017

TIME:

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? (20 marks)