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**GARISSA UNIVERSITY**

**UNIVERSITY EXAMINATION 2017/2018 ACADEMIC YEAR TWO**

**THIRD TRIMESTER EXAMINATION**

**SCHOOL OF BUSINESS AND ECONOMICS**

**FOR THE DEGREE OF BACHELOR OF BUSINESS MANAGEMENT**

**COURSE CODE: BBM 231**

**COURSE TITLE: BUSINESS FINANCE**

**EXAMINATION DURATION: 3 HOURS**

**DATE: 09/08/18 TIME: 09.00-12.00 PM**

**INSTRUCTION TO CANDIDATES**

* **The examination has FIVE (5) questions**
* **Question ONE (1) is COMPULSORY**
* **Choose any other THREE (3) questions from the remaining FOUR (4) questions**
* **Use sketch diagrams to illustrate your answer whenever necessary**
* **Do not carry mobile phones or any other written materials in examination room**
* **Do not write on this paper**

**This paper consists of FOUR (4) printed pages *please turn over***

**QUESTION ONE (COMPULSORY)**

1. At the beginning of year 2008, James Chiro deposited Sh.1, 000,000 in an investment account which earned compound interest at 15% per annum.

**Required:**

1. The amount of money in the investment account by the end of year 2012 if he made the deposit at the end of each period. **[3 marks]**
2. The amount of money in the investment account by the end of year 2012 if he made the deposit at the begging of each period. **[3 marks]**
3. Shadrack Chando borrowed Sh.80, 000 from XYZ commercial bank at an interest rate of 1.25% compounded monthly. The loan is to be amortized using the reducing balance method and be repaid in 12 equal monthly installments payable at the end of each month.

**Required:**

1. A loan amortization schedule **[9 marks]**

1. The following is the capital structure of Ngana Ltd:

|  |  |
| --- | --- |
|  | **Sh.** |
| Ordinary share capital (par Sh.100)  Preference share capital (par Sh. 100)  Debentures (par Sh. 100) | 80,000,000  35,000,000  27,000,000 |

**Additional information:**

1. The shareholders of Ngana Ltd. expect earnings and dividends to grow at a constant rate of 5% in the future. The company has just paid a dividend of Sh4.00 per share.
2. The current market price of one ordinary share of Ngana Ltd. is Sh.80.
3. Treasury bonds yield 12%. The return on the market is 14%. The company's beta is 1.50.
4. New preference shares can be sold at Sh. 120 per share with a dividend of Sh. 12 per share; and floatation costs of Sh.6 per share.
5. The corporation tax rate is 30%.
6. The company pays out all its earnings as dividends.
7. The company will sell 12% debentures with a maturity of 10 years at Sh.90 per debenture. The par value of the debenture is Sh.100.

**Required:**

1. Using market values, calculate the weighted average cost of capital (WACC) of Ngana Ltd **[10 marks]**

**QUESTION TWO**

Bashir was recently appointed to the post of investment manager of Masada limited, a quoted company. The company has raised sh. 8,000,000 through a right issue.

Bashir has a task of evaluating two mutually exclusive projects with unequal economic lives. Project X has 7 years of economic life while project Y has 4 years of economic life. Both projects are expected to have zero salvage value. Their expected cash flows are as follows.

|  |  |  |
| --- | --- | --- |
| Projects | X | Y |
| Year | Cash flows (sh.) | Cash flows (sh.) |
| 1 | 2,000,000 | 4,000,000 |
| 2 | 2,200,000 | 3,000,000 |
| 3 | 2,080,000 | 4,800,000 |
| 4 | 2,240,000 | 800,000 |
| 5 | 2,760,000 | - |
| 6 | 3,200,000 | - |
| 7 | 3,600,000 | - |

The cost of equity is 20%.

**Required:**

1. Calculate the net present value of each project. **[5 marks]**
2. Calculate the internal rate of return of each project **[5 marks]**
3. Calculate the payback period of each project. (PBP) **[5 marks]**

**QUESTION 3**

1. Discuss 3 factors to consider when determining the level of working capital in a firm. **[6 marks]**
2. Wanga Ltd. maintains a minimum cash balance of Sh. 1,500,000.

The standard deviation of the daily cash is Sh.800, 000. The annual interest rate is 12%. The transaction cost of buying and selling of marketable securities is Sh.200 per transaction. Assume that one year has 365 days.

**Required:**

Using the Miller-Orr cash management model, determine:

1. The return point **[3 marks]**
2. Average cash balance. [**3 marks]**
3. The upper cash limit. **[3 marks]**

**QUESTION 4**

* 1. You are given the following financial statement information for Moto Ltd. for the year ended 31 December 2010:

|  |  |  |  |
| --- | --- | --- | --- |
| **Item** | **Beginning** | | **Ending** |
|  | **Sh.”000”** | **Sh. “000”** | **Sh. “000”** |
| Inventory  Accounts receivable  Accounts payable  Net Sales  Cost of goods sold | 17,340  42,240  35,510 | 120,000  92,000 | 15,960  37,250  27,370 |

**Required;**

1. The operating and cash conversion cycles assuming that the year has 360 days. **[8 marks]**
2. Explain rasons that May drive a company to raise equity finance than debt finance **[7 marks]**

**QUESTION FIVE**

1. Faiba investment ltd makes payment of sh. 10,000 per week, the interest rate on marketable securities is 12% p.a. and every time the company issues marketable secures it incurs a cost of sh.20 per every transaction.

**Required:**

1. Determine the optimal cash balance. **[3 marks]**
2. Determine the total number of transactions from marketable securities to cash per year **[3 marks]**
3. Determine the total cost of maintaining the optimal cash balance per year. [**3 marks]**
4. Calculate the firms average cash balance per year. **[2 marks]**
5. Briefly explain the assumptions of Baumol’s model. **[4 marks]**

**QUESTION SIX**

1. Explain the term agency theory as applied in financial management [**2 marks]**
2. Explain 3 causes of conflict of interest between shareholders and creditors **[6 marks]**
3. Describe 4 ways that could be used to mitigate agency conflict between managers and shareholders **[4 marks]**
4. Explain how the objective of wealth maximization differs from that of profit maximization for a company listed at Nairobi securities exchange. **[3 marks]**