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KIRIRI WOMENS' UNIVERSITY OF SCIENCE AND TECHNOLOGY
UNIVERSITY EXAMINATION, 2019/2020 ACADEMIC YEAR
SECOND YEAR, FIRST SEMESTER EXAMINATION
FOR THE DEGREE OF BACHELOR OF SCIENCE
(BUSINESS ADMINISTRATION)

Date: 6th December, 2019

Time: 2.30pm – 4.30pm

KFI 200 - BUSINESS FINANCE

INSTRUCTIONS TO CANDIDATES

ANSWER QUESTION ONE (COMPULSORY) AND ANY OTHER TWO QUESTIONS

QUESTION ONE (30 MARKS)

- a) Identify the fundamental features that distinguish debt finance from ordinary shares. (5 Marks)
- b) Explain the three uses and two limitations of financial ratios. (5 Marks)
- c) Explain why different sources of capital have different costs. (4 Marks)
- d) Define agency relationship from the context of a public limited company and briefly explain how this arises. (4 Marks)
- e) Distinguish between:
- i) Capital structure and financial structure. (2 Marks)
 - ii) Business risk and Financial risk. (2 Marks)
 - iii) Explain the effect of introduction of debt capital on weighted average cost of capital (WACC). (2 Marks)
- e) Describe four main objectives, which conflict and at the same time overlap. (8 Marks)

QUESTION TWO (20 MARKS)

- a) Within a business finance context, discuss the problems that might exist in the relationships (sometimes referred to as agency relationships) between:
- i) Shareholders and managers. (5 Marks)
 - ii) Shareholders and government. (5 Marks)
- b) Reasons why ordinary share capital is attractive despite being risky. (10 Marks)

QUESTION THREE (20 MARKS)

- a) Mombasa Hardware Tools Company Limited sells plumbing fixtures on terms of 2/10 net 30. Its financial statements for the last three years are as follows:

	2014	2015	2016
	Sh.'000'	Sh.'000'	Sh.'000'
Cash	30,000	20,000	5,000
Accounts receivable	200,000	260,000	290,000
Inventory	400,000	480,000	600,000
Net fixed assets	<u>800,000</u>	<u>800,000</u>	<u>800,000</u>
	1,430,000	1,560,000	1,695,000
Accounts payable	230,000	300,000	380,000
Accruals	200,000	210,000	225,000
Bank loan, short term	100,000	100,000	140,000
Long term debt	300,000	300,000	300,000
Common stock	100,000	100,000	100,000
Retained earnings	<u>500,000</u>	<u>550,000</u>	<u>550,000</u>
	1,430,000	1,560,000	1,695,000
Additional information:			
Sales	4,000,000	4,300,000	3,800,000
Cost of goods sold	3,200,000	3,600,000	3,300,000
Net profit	300,000	200,000	100,000

Required:

For each of the three years, calculate the following ratios:

- i) Acid test ratio (2 Marks)
 - ii) Average collection period, (2 Marks)
 - iii) Inventory turnover, (2 Marks)
 - iv) Total debt/equity, (2 Marks)
 - v) Net profit margin (2 Marks)
 - vi) Return on assets. (2 Marks)
- b) Outline the managerial functions of a financial manager in a contemporary corporate set-up. (8 Marks)

QUESTION FOUR (20 MARKS)

Pesa Limited is considering the purchase of a new machine. Two alternative machines, A and B, which will cost Sh.6,000,000 and Sh.7,000,000 respectively are available in the market. The cash flow after taxation of each machine are as follows:

Year	Cash flow	
	A	B
	Sh.	Sh.
1	600,000	1,800,000
2	1,800,000	2,400,000
3	2,000,000	3,000,000
4	3,000,000	1,800,000
5	2,400,000	1,600,000

Required

- a) Compute the net present value of each machine. (8 Marks)
- b) Assuming that each machine represents a project:
Compute the return Pesa Limited expects to earn from each of the two projects. (10 Marks)
- c) Comment on the use of the results obtained in (a) and (b)(i) above in selecting between the two projects. (2 Marks)

QUESTION FIVE (20 MARKS)

- a) Although profit maximization has long been considered as the main goal of a firm, shareholder wealth maximization is gaining acceptance amongst most companies as the key goal of a firm.

Required:-

- i) Distinguish between the goals of profit maximization and shareholder wealth maximization. (6 Marks)
- ii) Explain the two limitations of the goal of profit maximization. (4 Marks)
- b) What are the advantages of leasing an asset compared to borrowing to buy an asset? (10 Marks)