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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: 10th April, 2019
Time: 8.30am – 10.30am

KFI 200 - BUSINESS FINANCE

INSTRUCTIONS TO CANDIDATES

ANSWER QUESTION ONE (COMPULSORY) AND ANY OTHER TWO QUESTIONS

QUESTION ONE (30 MARKS)

- a) Although profit maximization has long been considered as the main goal of a firm, shareholder wealth maximization is going 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 profit maximization (4 Marks)
- b) Discuss the main problems sole traders' encounter in a bid to raise finance on Kenya's financial markets. (6 Marks)
- c) Describe the features of a sound appraisal technique? (3 Marks)
- d) What practical problems are faced by finance managers in capital budgeting decisions? (6 Marks)
- e) Explain why ordinary share capital have a high cost relative to debt capital. (5 Marks)

QUESTION TWO (20MARKS)

- a) Outline the functions of a financial manager in a contemporary corporate set-up. (10 Marks)
- b) Within a business finance context, discuss the problems that might exist in the relationships (sometimes referred to as agency relationships) between:
 - i) Shareholders and auditors. (5 Marks)
 - ii) Shareholders and creditors. (5 Marks)

QUESTION THREE (20 MARKS)

- a) What are the advantages of leasing as a source of finance? (6 Marks)
- b) Outline the constraints of venture capital financing in Kenya. (10 Marks)
- c) Why is operating lease called off-balance sheet financing? (4 Marks)

QUESTION FOUR (20 MARKS)

Paul 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.

Paul has a task of evaluating two mutually exclusive projects with unequal economic lives. Project x has 7 years and project y has 4 years of economic life. Both projects are expected to have zero salvage value. Their expected cash flows are as follows:

Project	x	y
Year	cash flows (sh)	cash flows (sh)
1	2,000,000	4,000,000
	2,200,000	3,000,000
	2,080,000	4,800,000
	2,240,000	800,000
	2,760,000	-
	3,200,000	-
	3,600,000	-

The cost of equity of the firm is 20%

Required:

- a) The net present value of each project (7 Marks)
- b) The internal rate of return (IRR) of the projects (rediscount cash flows at 24% for project x and 25% for project y) (11 Marks)
- c) Briefly comment on your results in (a) and (b) above (2 Marks)

QUESTION FIVE (20MARKS)

The following is the capital structure of XYZ Ltd as at 31/12/2016.

	Shs.M
Ordinary share capital Sh.10 par value	400
Retained earnings	200
10% preference share capital Sh.20 par value	100
	<u>200</u>
12% debenture Sh.100 par value	<u>900</u>

Additional information

1. Corporate tax rate is 30%
2. Preference shares were issued 10 years ago and are still selling at par value MPS = Par value
3. The debenture has a 10 year maturity period. It is currently selling at Sh.90 in the market.
4. Currently the firm has been paying dividend per share of Sh.5. The DPS is expected to grow at 5% p.a. in future. The current MPS is Sh.40.

Required

- a) Determine the WACC of the firm. (10 Marks)
- b) Explain why market values and not book values are used to determine the weights. (5 Marks)
- c) What are the weaknesses associated with WACC when used as the discounting rate, in project appraisal. (5 Marks)