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**KIRIRI WOMENS' UNIVERSITY OF SCIENCE AND TECHNOLOGY
UNIVERSITY EXAMINATION, 2020/2021 ACADEMIC YEAR
SECOND YEAR, FIRST SEMESTER EXAMINATION
FOR THE DEGREE OF BACHELOR OF SCIENCE
(BUSINESS ADMINISTRATION)**

Date: 15th December, 2020

Time: 11.30am – 1.30pm

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 internal and external sources of finance. (5 Marks)
- b) Explain the three uses and two limitations of financial ratios. (5 Marks)
- c) Explain the reasons 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) Profit maximization and wealth maximization. (4 Marks)
- e) Describe three main objectives, which conflict and at the same time overlap. (6 Marks)

QUESTION TWO (20 MARKS)

- a) Within a business finance context, managers are agents of the shareholders and they are expected to perform as per the interest of the their principal which sometimes they don't. Failure of them not doing so it will automatically cause a conflict. Discuss the actions which managers may undertake which will cause a conflict and the solution to this actions. (10 Marks)
- b) Though ordinary share capital is attractive to most of investors it is the one most risky investment. Explain. (10 Marks)

QUESTION THREE (20 MARKS)

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:

- a) 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) The finance manager has different functions to play in an organisation. He has the right to delegate some of the functions to the junior staff. Describe the functions which he can actually delegate. (8 Marks)

QUESTION FOUR (20 MARKS)

- a) XYZ Ltd is expected to pay a DPS of Sh.6 in one year's time. The dividend payout ratio is 60% and the Return on Equity is 15%.
- i) Determine whether the share is overvalued if the MPS is Sh.40. (5 Marks)
 - ii) What is the significance of valuation securities? (5 Marks)
- b) ABC Ltd has issued a 5-year zero coupon rate bond with maturity value of Sh.100,000. The bond is issued at a discount of 32%.
- i) Determine the rate of return of the bond. (5 Marks)
 - ii) What are the advantages of zero coupon bond? (5 Marks)

QUESTION FIVE (20 MARKS)

- a) Define agency relationship from the context of a public limited company and briefly explain how this arises. (6 Marks)
- b) Explain the reasons why firms in the same industry with equal earnings and share capital would pay different amount of dividends? (6 Marks)
- c) Kimani is contemplating purchasing a 3 year bond worth 40,000/= carrying a nominal coupon rate of interest of 10%. The required rate of return is 6%.What should he be willing to pay now to purchase the bond if it matures at par? (8 Marks)