



## GARISSA UNIVERSITY

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

SUPPLEMENTARY/SPECIAL 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: 19/03/18**

**TIME: 02.00-05.00 PM**

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### INSTRUCTION TO CANDIDATES

- The examination has **SIX (6)** questions
- Question **ONE (1)** is **COMPULSORY**
- Choose any other **THREE (3)** questions from the remaining **FIVE (5)** 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 **FIVE (5)** printed pages

*please turn over*



## QUESTION ONE (COMPULSORY)

- (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. [4 marks]
  - ii. Explain three limitations of the goal of profit maximization [6 marks]
- (b) Explain three key roles of a capital markets regulator in your country [6 marks]
- (c) Briefly explain the factors that influence the decision regarding economic order quantities of any stock. [4 marks]
- (d) Ndu Power's Ltd. had the following capital structure as at 31 March 2015:

	Shs.
Ordinary share capital (100,000 shares)	4,000,000
8% Preference share capital	1,000,000
10% Debenture capital	<u>3,000,000</u>
	<u>8,000,000</u>

### Additional information:

1. The market price of each ordinary share as at 31 March 2015 was Shs. 20.
2. The company paid a dividend of Shs. 2 for each ordinary share for the year ended 31 March 2015.
3. The annual growth rate in dividends is 7%.
4. The corporation tax rate is 30%.

### Required:

- i. Compute the weighted average cost of capital of the company as at 31 March 2015. [5 marks]



## QUESTION TWO

- (a) “Despite the large investment in the stock exchange and the various government incentives, only a few companies are listed at the stock exchange of the three East African countries.” This was the opening remark by the guest speaker in a seminar whose theme was “Developing our capital market.”

### Required:

- i. The advantages of being listed at the stock exchange. **[3 marks]**
- (b) Highlight four factors that may hinder companies from being listed at the stock exchange. **[4 marks]**
- (c) Maslah invested in a project which promises annual cash flow of shs 20,000 every year for 4yrs. Calculate the Present Value (P.V) of the annuity if the discounting rate is 10% assuming that the cash flow occurs:
- i. At the end of each year **[4 marks]**
- ii. At the beginning of each year **[4 marks]**

## QUESTION THREE

- (a) “It is always better for a company to use debt finance since lower cost of debt results in higher earnings per share”. Briefly comment on this statement. **[5 marks]**
- (b) Amina was recently appointed to the post of investment manager of Masada Ltd. a quoted company. The company has raised Sh. 8,000,000 through a rights issue. Amina has the 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	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 amount raised would be used to finance either of the projects. The company expects to pay a dividend per share of Sh.6.50 in one year's time. The current market price per share is Sh.50. Masada Ltd. expects the future earnings to grow by 7% per annum due to the undertaking of either of the projects. Masada Ltd. has no debt capital in its capital structure.

**Required:**

- i. The cost of equity of the firm **[2 marks]**
- ii. The net present value of each project **[4 marks]**
- iii. The Internal Rate of return (IRR) of the projects. (Rediscount cash flows at 24% for project X and 25% for Project Y). **[4 marks]**

**QUESTION FOUR**

- (a) Discuss the limitations of using ratio analysis in the evaluation of the performance of a company. **[5 marks]**



(b) Warsan ltd has the following data for the year ended 31<sup>st</sup> December, 2016

Profit after tax	Shs.30,000,000
Total dividend for the year	Shs.18,000,000
Market price per share (MPS)	shs.20
Number of ordinary shares	6,000,000

Using this data, determine the following financial ratios and explain their significance:

- i. Earnings per share (EPS) [2 marks]
- ii. Dividend per share (DPS) [2 marks]
- iii. Dividend payout ratio [2 marks]
- iv. Retention ratio [2 marks]
- v. Earnings yield [2 marks]

### QUESTION FIVE

- (a) In the past, it was considered prudent and a sign of success for business organizations to maintain large bank balances and to have as few liabilities as possible. Today this state of affairs may no longer be satisfactory. Explain [3 marks]
- (b) Distinguish between the following sets of terms:
  - i. Treasury bills and treasury bonds [4 marks]
  - ii. Complementary projects and mutually exclusive projects [4 marks]
  - iii. Financial risk and operating risk [4 marks]

### QUESTION SIX

- (a) What are the major considerations that determine the dividend policy of a company [5 marks]
- (b) Distinguish between primary and secondary securities market [4 marks]
- (c) Identify and briefly explain three conditions which have to be satisfied before the use of the weighted average cost of capital (WACC) can be justified [6 marks]

