



OFFICE OF THE DEPUTY PRINCIPAL
ACADEMICS, STUDENT AFFAIRS AND RESEARCH

UNIVERSITY EXAMINATIONS

2020/2021 ACADEMIC YEAR

THIRD YEAR SECOND SEMESTER MAIN/REGULAR EXAMINATION

FOR THE DEGREE IN BUSINESS MANAGEMENT

COURSE CODE: BBM 224

COURSE TITLE: BUSINESS FINANCE

DATE: 22ND JULY, 2021

TIME: 1 P.M TO 4 P.M

INSTRUCTION TO CANDIDATES

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BBM 224

REGULAR/ MAIN
COURSE CODE: BBM 224 COURSE TITLE: BUSINESS FINANCE

STREAM: BBM

DURATION: 3 Hours

INSTRUCTIONS TO CANDIDATES

- i. Answer Question **ONE** and any other **TWO** questions.*
- ii. Maps and diagrams should be used whenever they serve to illustrate the answer.*
- iii. Do not write on the question paper.*

QUESTION ONE

- (a) Show how shareholders may take some actions that may conflict the interests of the government (6 marks).
- (b) The earnings per share of B Ltd. is ` 4 and the rate of capitalization applicable is 10%. The company has before it an option of adopting 50% dividend payout ratio. Compute the market price of company's shares as per Walter's model if it can earn a return of 10% on its retained earnings. (4 marks)
- (c) Distinguish between credit terms and credit standards as used in working capital management (4 marks)
- (d) Outline the key features that discriminate ordinary shares from others types of shares (6 marks)
- (e) Kiwanda Limited is considering the purchase of a new machine. Two alternative machines, Pesi and Upesi 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	
	Pesi	Upesi
	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; Compute the net present value of each machine if the required rate of return is 13% (10 marks)

QUESTION TWO

- (a) Abinaya company Ltd. expresses a net operating income of Shs. 200,000. It has Shs. 800,000 to 7% debentures. The overall capitalization rate is 10%. Calculate
- The value of the firm and the equity capitalization rate (or) cost of equity according to the net operating income approach. (10 marks)
 - If the debenture debt is increases to Shs. 1,200,000. What will be the effect on the value of the firm, the equity capitalization rate? (4 marks)
- (b) Examine the determinants of capital structure of most companies in Kenya (8 marks)

QUESTION THREE

- (a) The following information relates to XYZ Limited who are contemplating on investment to undertake given investment K and L. The following table gives the returns and related probabilities;

<i>Probability</i>	<i>Investment K returns (%)</i>	<i>Investment L returns (%)</i>
0.3	18	22
0.4	16	15
0.3	12	18

Required; advise the management accordingly by computing the following;

- Standard deviation or risk of each investment (10 Marks)
 - Covariance between investment K and L (2 Marks)
- (b) Assess the determinants that the management XYZ limited need to consider as far as returns of investment (8 marks)

QUESTION FOUR

- There are key components of all time value of money problems. Elaborate (8 marks)
- Sharon decided to invest Sh.100,000 in savings account paying 8% interest. If she leaves the money in the account for 2 years how much will she have at the end of the two years if interest is compounded;
 - Semiannually (4 marks)
 - Quarterly (4 marks)
- Assume an ordinary annuity will give you \$ 1000 at the end of each year for 4 years. What is the maximum amount would you be willing to pay if the required rate of return is 10%? (4 marks)

QUESTION FIVE

- (a) Financial ratio evaluate relationship between components of financial statements to obtain a better understanding of company performance. In view of this, discuss the limitations of financial ratios (8 marks)
- (b) Ram Company supplies the following information regarding the year ended 31st December 2020;

	Shs.
Fixed Assets	1,000,000

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Current assets	360,000
Share capita (shs. 10 each)	800,000
Reserves	200,000
8% debentures	200,000
Creditors	160,000
Net profit before tax	280,000
Tax rate	50%
Dividends declared	120,000

Required; Compute the following financial ratios

- (i) Return on total resources (4 marks)
- (ii) Return on capital employed (4 marks)
- (iii) Return on shareholders fund (4 marks)