

**W1-2-60-1-6**

JOMO KENYATTA UNIVERSITY OF AGRICULTURE AND TECHNOLOGY

# **UNIVERSITY EXAMINATIONS 2014/2015**

SECOND YEAR FIRST SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR OF COMMERCE/ BACHELOR OF BUSINESS OFFICE MANAGEMENT

**HBC 2104 : BUSINESS FINANCE**

**DATE: AUGUST 2015 TIME: 2 HOURS**

**INSTRUCTIONS:**

**ANSWER QUESTION ONE AND ANY OTHER TWO QUESTIONS**

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**QUESTION ONE**

1. Describe agency theory [2 marks]
2. State any three types of agency relationship in the contest of a public Ltd Co. [6 marks]
3. Based on ‘b’ above, explain the conflicts that may arise in such agency relationships indicating the various ways to resolve them. [12 marks]
4. M intend to invest in a project whose initial cost is shs. 120 000 000. The project is expected to leave an economic life of 8 years. Annual cash flows expected from the project are as follows:

Year Cash flows (000)

1 20 000

2 18 000

3 22 000

4 28 000

5 42 000

6 12 000

7 28 000

8 17 000

Required:

Determine the pay back period. [10 marks]

**QUESTION TWO**

Jambo Ltd has the following capital structure as at 31st Dec 2012 ordinary share

capital shs. 16 000 000.

10% preference share capital shs. 2000 000

14% debentures shs. 14 000 000

Additional Information

1. The market price of each ordinary share as at 31st Dec 2012 was kshs. 40
2. The firm paid a dividend of kshs. 4 for each ordinary share for the year ended 31st Dec 2012.
3. The annual growth rate of dividend is 7%
4. Normal value of debentures is kshs. 100 wile the market price is shs. 90 ex-interest.

Required:

The WACC (Weighted Average Cost of Capital) of the firm as at 31st Dec 2012.

Ignore taxation. [20 marks]

**QUESTION THREE**

1. List two advantages and disadvantages of the following capital budgetary techniques
2. Payback period
3. Discounted pay back period
4. Net present value
5. Profitability index
6. Internal rate of return
7. Modified internal rate of return [10 marks]
8. Two projects A and B have their cash flows tabulated as follows:

Year Project A Project B

0 (7000) (8000)

1 2000 6000

2 1000 3000

3 5000 1000

4 3000 500

Determine the:-

1. Modified internal rate of return for each project
2. Net present value for each project using cost of capital of 15%. [10 marks]

**QUESTION FOUR**

The two broad sources of finance available for project finance are shareholders

funds in the form of equity capital, retained earnings and preference capital in

addition to debt in the form of debenture capital, term loans, different credits,

fixed deposits:-

1. Identifying the basic differences between equity and debt funds.
2. Identify factors that are key in determining the debt equity ratio [5 marks]
3. Discuss advantages and disadvantages of equity capital, preference capital and debt financing in funding projects. [10 marks]

**QUESTION FIVE**

1. What is meant by expected net present value?
2. What are the limitations of the ENPV in business finance.
3. Bamburi cement is considering to invest in the purchase of a machine for the factory or not. The machine cot $1000 000 and is expected to have a life of 3 years. the estimates of net revenue from the machine is however uncertain and depends on the state of the construction industry. The management of the company has produced the following estimates.

0 1 2 3

Boom -1.0m 0.6m 0.8m 0.96m

Normal -1.0m 0.5m 0.7m 0.6m

Depressed -1.0m 0.4m 0.4m 0.2m

The company uses a 10% discount rate in the project appraisal in the belief that

this correctly reflects the risk of the project. From the analysis in the

construction industry, suggest the following probabilities

Boom 0.3

Normal 0.5

Depression 0.2

Is the project to be accepted or rejected? Comment on your answer.