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**GARISSA UNIVERSITY**

**UNIVERSITY EXAMINATION 2020/2021 ACADEMIC YEAR TWO**

**SECOND SEMESTER EXAMINATION**

**SCHOOL OF BUSINESS AND ECONOMICS**

**FOR THE DEGREE OF BACHELOR OF BUSINESS MANAGEMENT**

**COURSE CODE: BBM 231**

**COURSE TITLE: BUSINESS FINANCE**

**EXAMINATION DURATION: 2 HOURS**

**DATE: 07/04/2021 TIME: 12.00-2.00 AM**

**INSTRUCTION TO CANDIDATES**

* **The examination has FIVE (5) questions**
* **Question ONE (1) is COMPULSORY**
* **Choose any other TWO (2) questions from the remaining FOUR (4) 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 TWO (2) printed pages *please turn over***

**QUESTION ONE (COMPULSORY)**

1. Distinguish between primary and secondary securities market. (4 marks)
2. Discuss any four factors that a company should consider when choosing between equity and debt as sources of finance (6marks)
3. Naivas Ltd. had the following capital structure as at 31 December 2008

|  |  |
| --- | --- |
|  | **“sh. “000”** |
| Ordinary share capital (sh. 20 par value) | 10,000 |
| Retained earnings | 12,000 |
| 12% preference share capital (sh. 10 par value) | 4,800 |
| 10% debentures (sh. 1,000 par value) | 7,200 |
|  | 34000 |

**Additional information:**

1. The current market price per ordinary share, preference share and debenture is sh.. 50, sh. 24 and sh. 1,200 respectively.
2. For the year ended 31 December 2008, the company paid an ordinary dividend of sh. 6.00 per share. Analysts estimate that the company’s earnings and dividends will grow at an annual rate of 15 per cent indefinitely.
3. The corporation tax rate is 30 per cent.

**Required;-**

The company’s market weighted average cost of capital (10 marks)

1. Malikia Guyo borrowed Sh.1, 000,000 from Huduma Bank at an annual compound interest of 14% on the reducing balance. The loan was repayable in annual instalments over a period of four years. The installments were payable at end of the year.

**Required:**

A loan amortization schedule (10 marks)

**QUESTION TWO**

1. Explain the term agency theory as applied in financial management. (2 marks
2. Uchumi Ltd. maintains a minimum cash balance of Sh. 1,500,000.The standard deviation of the daily cash is Sh.800, 000. The annual interest rate is 12%. The transaction cost of buying and selling of marketable securities is Sh.200 per transaction. Assume that one year has 365 days.

**Required:**

Using the Miller-Orr cash management model, determine:

* 1. The return point. ( 2 Marks)
  2. Average cash balance. (2 Marks)
  3. The upper cash limit (2 Marks)

(c) Sunrise Limited presented the following financial statements for the year ended 31 December 2008:

**Income for the year ended 31 December 2008.**

|  |  |  |  |
| --- | --- | --- | --- |
|  |  | **Sh.** | **Sh.** |
| Sales |  |  | 9.040,000 |
| Cost of sales: | Opening stock | 2,500,000 |  |
|  | Purchases | 6,820,000 |  |
|  |  | 9,320,000 |  |
|  | Closing stock | (2,860,000) | (6,460,000) |
| Gross profit |  |  | 2,580,000 |
| expenses |  |  | (2,640,000) |
| Net loss |  |  | (60,000) |

**Balance sheet as at 31st December 2008**

|  |  |  |
| --- | --- | --- |
|  | **Sh.** | Sh. |
| **Non-current assets** |  |  |
| Premises | 5,600,000 |  |
| Fixtures and fittings (ne book value) | 500,000 |  |
| Motor vehicle (net book value) | 1,040,000 | 7,140,000 |
| **Current assets:** |  |  |
| Stock | 2,860,000 |  |
| Debtors | 3,260,000 |  |
|  | 6,120,000 |  |
| **Current liabilities:** |  |  |
| Trade creditors | 2,900,000 |  |
| Bank overdraft | 2,800,000 |  |
|  | 5,700,000 |  |
| Net current assets |  | 420,000 |
| Ne assets |  | 7,560,000 |
| **Financed by:** |  |  |
| Ordinary share capital |  | 2,000,000 |
| Retained profit |  | 3,160,000 |
| Long term loans |  | 2,400,000 |
| Capital employed |  | 2,400,000 |
|  |  | 7,560,000 |

**Assume a 360 – day year.**

**Required:**

* 1. Operating cash style ( 2 Marks)
  2. Quick ratio ( 2 Marks)
  3. Current ratio ( 2 Marks)
  4. Debt to equity ratio ( 2 Marks)
  5. Operating margin ratio ( 2 Marks)
  6. Debt turnover ratio ( 2 Marks)

**QUESTION THREE**

1. The earnings yield of excel Ltd. is 20% and the current market price per ordinary share is Sh100. Each Share has a par value of Sh.50. The dividend for the current year is expressed as 10% of the par value

**Required:**

1. The earnings per share ( 2 marks)
2. The dividend cover ( 2 marks)
3. The price earnings ratio ( 2 marks)
4. Explain three causes of conflict of interest between shareholders and debt holders (6 marks)
5. Describe four ways that could be used to mitigate agency conflict between managers and shareholders (8 marks)

**QUESTION FOUR**

1. Explain three factors that might influence the capital structure decision. (6 marks)
2. Discuss four functions of the capital markets regulator in your country. (8 marks)
3. The following information relates to two potential investments namely; A and B.

|  |  |  |  |
| --- | --- | --- | --- |
| **Investment A** |  | **Investment B** |  |
| **Probability** | **Return** | **Probability** | **Return** |
| 0.3  0.4  0.3 | 20%  8%  -4% | 0.2  0.6  0.2 | 20%  8%  -4% |

**Required:**

The standard deviation of each of the two investments (6 marks)

**QUESTION FIVE**

1. Citing relevant examples in each case, distinguish between
2. Agency costs" and "financial distress costs". (4 marks
3. Primary markets and secondary markets (4 marks)
4. Capital markets and money markets (4 marks)
5. Brokers and jobbers (4 marks)
6. Calculate the future value of sh 1,000,000 deposited in a saving account at 5% interest rate for 5 years. If interest is payable:
7. Half yearly (2 marks)
8. Quarterly (2 marks)