

CHUKA



UNIVERSITY

## UNIVERSITY EXAMINATIONS

### SECOND YEAR EXAMINATION FOR THE AWARD OF DEGREE OF BACHELOR OF COOPERATIVE MANAGEMENT

**BCOP 233: CO-OPERATIVE FINANCE**

**STREAMS: BCOP Y2S2**

**TIME: 2 HOURS**

**DAY/DATE: WEDNESDAY 10/8/2016**

**8.30 A.M. – 10.30 A.M.**

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#### INSTRUCTIONS:

- **Answer question one and any other two only**
1. (a) Agency problems arises when agents pursue their own interest other than interest of the principals.
- (i) Define the term agency relationship in the context of cooperative management. (2marks)
  - (ii) Discuss the reasons for conflict that may arise between share holders of a SACCO and auditors and explain how the conflict can be resolved. (6marks)
- (b) (i) How much money should an investor in a society deposit at the beginning of each year at an interest rate of 10% p.a so as to accumulate to ksh 500,000 at the end of 15 years? (3marks)
- (ii) Give reasons for the time preference of money. (3marks)
- (c) Ruth holds 500 shares in SGL Ltd. The company is listed under growth enterprise market segment at the NSE. Assume that the cost of capital is 15%. The following dividend pattern relates to SGL Ltd for the last 5 years.

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Year	Dividend per share (DPS)
2004	5.00
2005	5.50
2006	6.05
2007	6.66
2008	7.33

### Required :

- (i) Determine the theoretical value of her investment in SGL ltd at the end of 2008 assuming constant growth rate in perpetuity. (5marks)
  - (ii) Discuss the fundamental theory of valuation. (2marks)
  - (iii) Define the term intrinsic value with reference to valuation of shares. (2marks)
  - (d) Outline the routine functions of a finance manager in a contemporary cooperative society. (4marks)
  - (e) A cooperative society is considering investing in a capital assets whose cost is ksh 20,000 with an expected life of 5 years. The asset promises profit before depreciation and tax of ksh 10,000 per annum. The society uses straight line method for depreciation of non-current assets and the applicable tax rate is 30%. Calculate the accounting rate of return for the project. (6marks)
2. (a) Using examples discuss the various types of investment decisions. (4marks)
- (b) Ufundi cooperative is considering investing in a project with the following information.

Year	Units of output produced
1	200
2	300
3	500
4	700
5	1000

### Additional information:

- Selling price per unit is ksh 100

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- The variable cost is 20% of the sales revenue
- Fixed cost of ksh 5000 is incurred every year
- Depreciation is on straight line method
- Initial cost of capital is 12%
- Scrap value will be ksh 5000
- Tax rate is 30%

### Required:

- (i) Determine the annual cash flows expected from the project. (7marks)
- (ii) Advise on the suitability of the project on the basis of profitability index. (5marks)
- (c) Explain the following sources of finance available to cooperatives.
- (i) Mortgage finance. (2marks)
- (ii) Venture capital (2marks)
3. (a) Discuss the significance of cost of capital in financial decisions for cooperatives. (4marks)
- (b) Co-operative bank Ltd has the following capital structure

	Ksh (000)
10% debentures (ksh 1000par)	3600
Ordinary share capital (ksh 25 par)	6500
Retained earnings	4000
10% preference shares (ksh 20 par)	3000
	<b>17100</b>

### Additional information:

- The company currently pays a dividend of ksh 5 per share which is expected to grow at the rate of 6%. The market price of the ordinary shares is ksh 40.
- Ordinary share incurs a floatation cost of 10% of the market price
- The debenture will mature in 100 years and the current market price is ksh 1200
- The preference shares are currently selling at ksh 25

### Required:

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(i) Calculate the component cost of capital and hence weighted average cost of capital (WACC) . (10marks)

(c) A company has a 10 year 10% ksh 50,000 bond redeemable at par. The current market price of the bond is ksh 40,000.

(i) Determine the intrinsic value of the bond. (2marks)

(ii) Calculate the yield to maturity of the bond. (2marks)

(iii) Advise management if it is worth while to purchase the bond or not. (2marks)

4. (a) Outline the uses of ratio analysis as a way of interpreting financial statements. (4marks)

(b) Briefly explain the reasons why a cooperative may choose to finance a new investment by an issue of debt Finance. (5marks)

(c) Mwalimu SACCO society has for the last three years engaged in the business of identifying most viable projects for its clients. To ensure more effective projects, the CEO of the firm has hired you as their financial management consultant and one of your challenging tasks is to advise on the best project to be selected. The following are details of three projects.

Year	1	2	3
Return (%)	8	8	8
probability	0.3	0.5	0.2

Year	1	2	3
Return (%)	6	11	31
probability	0.3	0.5	0.2

Year	1	2	3
Return (%)	22	14	-4
probability	0.3	0.5	0.2

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### Required:

(i) Determine the expected return, standard deviation and coefficient of variation for each project. (9marks)

(ii) Advise on the most appropriate project to be selected by Mwalimu Sacco society. (2marks)

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