



MASENO UNIVERSITY
UNIVERSITY EXAMINATIONS 2016/2017

**FIRST YEAR SECOND SEMESTER EXAMINATIONS FOR DIPLOMA
IN BUSINESS ADMINISTRATION**

CITY CAMPUS

ADB 0107: BUSINESS FINANCE

Date 24th November, 2016

Time: 9.00 - 12.00pm

INSTRUCTIONS:

- Answer Question ONE and any other THREE Questions.
- Show ALL your workings
- Carefully read and observe ALL the instructions on the Examination Booklet.



Question 1 (Compulsory)

- (a) Citing relevant examples, distinguish between internal and external sources of finance. (4 Marks)
- (b) Clearly explain the differences between finance planning and profit planning. (6 Marks)
- (c) Mataifa Ltd is a manufacturing company specializing in the production of biscuits. They wish to expand their production and the directors have proposed the purchase of a new machine worth Kshs.170,000.

Installation costs are expected to be to the tune of Kshs.40,000/=. In the fourth year, this machine would require an overhaul at a cost of Kshs.80,000/=. The cash inflows expected from using the new machine are as follows;

| | KShs. |
|--------|--------|
| Year 1 | 60,000 |
| Year 2 | 72,650 |
| Year 3 | 35,720 |
| Year 4 | 48,510 |
| Year 5 | 91,630 |
| Year 6 | 83,715 |

Mataifa Ltd can raise finance to purchase machine at 12% interest rate.

Required:

Using the Net Present Value technique of appraising projects, advise the directors of Mataifa Ltd . (15 Marks)

Question 2

- (a) In the context of management of debtors, clearly outline the distinction between 'factoring' and 'invoice discounting'. (5 Marks)
- (b) Identify and list the importance of the following terms as used in Capital Investment Appraisal;
- (i) Pay Back Period (5 Marks)
- (ii) Internal Rate of Return (5 Marks)

Question 3

The following is Huduma Ltd's current capital structure:

| | Kshs |
|------------------------|-----------|
| Ordinary share capital | 6,500,000 |
| Retained earnings | 4,000,000 |
| Long-term loan | 3,600,000 |

The Director's of Huduma Ltd have proposed to invest in a project requiring Ksh.45,000,000. They have proposed the following method of raising the funds;

- Issue ordinary shares at the current market price
- Issue 10% debentures at the current market price of Sh.1,000 per debenture
- Use all the existing retained earnings
- Issue 100,000 10% preference shares at the current market price of Sh.100 per share which is the same as the par value

You are provided with the following additional information about Huduma Ltd;

1. Currently, the company pays a dividend of Sh.5 per share which is expected to grow at the rate of 6% due to increased returns from the intended project. Huduma Ltd.'s price/earnings ratio and earnings per share are 5 and Sh.8 respectively.
2. The ordinary shares would be issued at a floatation cost of 10% based in the market price.
3. The debenture par value is Sh.1,000 per debenture.
4. The corporate tax rate is 30%.

Required:

Calculate Huduma Ltd's weighted average cost of capital (WACC). (15 marks)

Question 4

- (a) Define agency relationship and explain how it arises (4 Marks)
- (b) Highlight the measures that would minimize agency problems between shareholders and Business Managers (6 Marks)
- (c) Clearly outline and explain any five factors that affect a company's Dividend Policy (5Marks)

Question 5

- (a) Distinguish the following terms as used in Business Finance;
 - (i) Cash dividends and stock dividends (2 Marks)
 - (ii) Rights Issue and Stock split (2 Marks)
 - (iii) Cost of debt and capital gearing (2 Marks)
- (b) With the aid of a well labeled diagram, explain the cash cycle process of a manufacturing company. (9 Marks)

Question 6

- (a) XYZ Ltd intends to invest in a project whose initial cost is Kshs.10,000,000. The six-year annual cash flows expected once the project is operational are as follows;

| Year | Cashflows (Kshs) |
|------|------------------|
| 1 | 2,500,000 |
| 2 | 4,800,000 |
| 3 | 2,200,000 |
| 4 | 800,000 |
| 5 | 3,500,000 |
| 6 | 2,000,000 |

Required;

Using the Payback Period evaluation method, advise the company on whether to invest in the project. (7 Marks)

- (b) Business owners have various sources of raising capital to finance the operations of their companies. Among the sources of finance are debentures and equity capital.

- (i) Explain the meaning of debentures and equity capital (4 Marks)
- (ii) Give two reasons why equity capital is preferred over debentures as a source of business finance (4 Marks)