KABARAK UNIVERSITY

THIRD SEMISTER 2017/2018 ACADEMIC YEAR

EXAMINATION FOR THE DEGREE OF BACHELOR OF ECONOMICS AND FINANCE

FNCE 110: PRINCIPLES OF FINANCE

STREAM: SEM 2

EXAMINATION SESSION: AUGUST

DATE: 14//08/2018

INSTRUCTIONS:

i. The paper carries five questions
ii. Answer question one and any other two of the remaining questions
iii. Marks are allocated at the beginning of each question
iv. Be precise and neat

QUESTION ONE :(30 MARKS)

a)Explain any five measures that would minimize agency problems between the owners and the management(10 marks)

b)"….The function of a financial management is to review and control decisions to commit and recommit funds to new or ongoing uses. Thus in addition to raising funds, financial management is directly concerned with production, marketing and other functions within an enterprise whenever decisions are made about the acquisition or destruction of assets". Briefly explain this statement.(10 marks)

c)You borrow Sh 1 million at 12% per year for 10 years, payable after every six months. Prepare an amortization table for this loan(10 marks)

QUESTION TWO:

a)List and explain any three types of projects identified in capital budgeting decisions by managers(6 marks)

b)Kiwanda Ltd is considering the purchase of a new machine. Two alternative machines, Pesi TZO and Upesi MO2, which will cost Sh 6 000 000 and sh 7 000 000 respectively are available in the market. The cash fllows of each machine are as follows

CASH FLOWS

Year	Pesi TZO	Upesi MO2
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

i. The payback period for each machine
ii. The net present value (NPV) of each machine

QUESTION THREE:

a)using a well labeled diagram, briefly explain the three basic risk preference behaviors among managers.(8 marks)

b)Stocks A, B and C have the following probability distributions of returns.

PROBABILITY	ESTIMATED RATE OF RETURNS		
	A	B	C
0.20	14%	13%	12%
0.20	19	7	10
0.10	16	5	12
0.25	3	5	4
0.25	20	11	15

Required, compute for each project's expected rate of return, variance, standard deviation and coefficient of variation.

QUESTION FOUR:

a)Business finance is about making decisions with consequences in the future . The time value of money is a technique for comparing investments made in today's dollars with payoffs in future dollars. Time value of money has applications to compound interest, mortgage and auto loans, leases and investments.

Required,

i. Distinguish the following terminologies: discounting and compounding(6 marks)
ii. Explain any three importance of time value of money(4 marks)

b)Exactly ten years from now, assume that Kennedy will start receiving a pension of ksh 3 000 a year. The payment will continue for sixteen years. How much is the pension worth now, if George's interest rate is 10%? (10 marks)

QUESTION FIVE:

a) Briefly explain any five factors affecting a firm's cost of capital(10 marks)
b) Explain how each of the following forms of compensation is most likely to align the interests of the managers and shareholders:
   i. A fixed salary (2 marks)
   ii. A salary linked to company's profits (2 marks)
   iii. A salary that is paid partly in the form of company's shares (3 marks)
   iv. An option to buy the company's shares at an attractive price (3 marks)