PAN AFRICA CHRISTIAN UNIVERSITY

END OF TERM EXAMINATION

BUS3213: BUSINESS FINANCE

MONDAY JULY 28TH, 2014

1800HRS – 2100HRS

INSTRUCTIONS

- This exam paper has **Six** Questions
- Answer **Any Five** Questions
- Write your **student number** on the answer booklet provided.
- Read all questions carefully before attempting.

Question One

Equity finance, preference share capital or debt finance are three major sources of finance

i. Contrast the Ordinary Share Capital and Preference Share Capital. **(8 Marks)**

ii. Explain the features of debt finance; indicate clearly the strengths and weaknesses of employing debt finance in your company. **(8 Marks)**

iii. State the at least four basic functions of financial Markets. **(4 marks)**

Question Two

i. The stocks of XYZ Ltd are currently trading at Kes 30 per share. The stock is expected to pay a dividend of Kes 3 per share at the end of the year. The dividend is expected to grow at a constant rate of 5%. If the company is to issue external equity, it would incur a 10% floatation costs. Calculate:

   a. The cost of internal equity **(5 marks)**

   b. Cost of External Equity **(5 marks)**

ii. A compaany must maintain a good balance between the inventory holding and the liquidity aspect of the business. Eaplain this statement in relation to the working capital management **(10 Marks)**

Question Three

a. The typical dividend policy of most firms is to distribute part of the net earnings and to retain the other part for expansion. Explain this statement and identify at least five practical considerations that the company would make in developing the dividend policy **(12 Marks)**

b. What are the Advantages and Disadvantages of Stock split to the company's shareholders **(8Marks)**

Question Four

Projects A and B are of equal risks, and they are alternatives for expanding the Rosa Company's capacity. The firm's cost of capital is 12%. The cash flows for each project are shown in the following table. (20 Marks)

	Project A	**PROJECT B**
	$	**$**
Initil Investment (CFo)	**80,000**	**50,000**
Year	**Cash Inflows**	
1	15,000	15,000
2	20,000	15,000
3	25,000	15,000
4	30,000	15,000
5	35,000	15,000

Required:

i. Calculate the project's payback period **(5 Marks)**

ii. Calculate the net present value (NPV) for each project **(6 Marks)**

iii. Calculate the profitability Index **(5Marks)**

iv. Summarize the preferences dictated by each measure, and indicate which project you would recommend. Explain why. **(4 marks)**

Question Five

i. Describe the four primary factors that influence the capital structure decisions of a firm **(10 Marks)**

iii. County Company has the following mix of capital employed in the business.

20,000 ordinary shares market value of Shs. 50

10,000 Preference shares with a market value of Shs. 20 each

Short term bank loan of Shs. 100,000.

The monetary cost of this capital is 30% for the ordinary share capital, 20% for the preference share capitaland 10% for the short term bank loan. The rate of company tax is 40%.

Calculate the weighted average monetary cost of capital for this company **(10 Marks)**

Question Six

a. The uncertainty of outcomes in an investment and the expected return are two important elements in financial management. Discuss this statement in relation to the risk and return on a business.

(8 Marks)

b. Having been appointed to serve as the new compliance manager in your organization one of the greatest assignments is to advise the company on the types of risk that can affect its long term investments both locally and abroad. Identify at least six types of risk and advise the company on the possible risk mitigation measures that it would apply to remain afloat in the market.

(12 Marks)

END