PAN AFRICA CHRISTIAN UNIVERSITY

END OF SEMESTER EXAMINATION FOR THE DEGREEE OF BACHELOR OF COMMERCE
BACHELOR OF BUSINESS LEADERSHIP
MAY-JULY 2017

CAMPUS: VALLEY ROAD

DEPARTMENT: BUSINESS

COURSE CODE: BCM202|BUS3213

COURSE TITLE: BUSINESS FINANCE

EXAMINATION DATE: THURSDAY 27th JULY 2017

TIME: 5.30PM-8.30PM

INSTRUCTIONS

- Read all questions carefully before attempting.
- Answer any **Five** Questions. Question **one** is **compulsory**
- Write your **student number** on the answer booklet provided.

QUESTION ONE

a) Define agency theory (2 Marks)

b) Discus any three measures that would minimize agency problems between the owners and the management. (6 Marks)

c) Describe four characteristics of capital budgeting decisions (8 Marks)

d) A politician intends to contest for elections at the end of the year 2017. To raise the funds he decides to invest in a fixed deposit account. He intends to deposit Shs. 3,000,000 at the end of each year commencing 2014 to 2017 inclusive. The rate of interest to his deposit is 8 per cent per annum. Determine his accumulated annuity. (5 Marks)

e) Calculate the future value of shs.700,000 compounded at 8% per annum for 5 years if compounding is done

   (i) Annually (3 Marks)
   (ii) Half yearly (3 Marks)
   (iii) Quarterly (3 Marks)
   (iv) Monthly (4 Marks)

f) John promised to give his son Shs.1, 000, 000 in cash on his 25th birthday. Today is the son's 16th birthday. John intends to make an annual equal payment into a fund so as to have the amount of money when his son reaches 25years. Determine the equal payments that john has to make to the fund. , if the fund pays 8% interest annually. (6 Marks)

QUESTION TWO

A company is interested in investing any one of the following assets whose return is given below.

State of the economy	**Probability**	**Possible returns (%) for Asset A**	**Possible returns(%) for Asset B**
1	0.05	10%	-13%
2	0.10	02%	8%
3	0.20	04%	12%
4	0.30	09%	10%
5	0.20	14%	18%
6	0.10	20%	16%
7	0.05	28%	23%

Required

a) Determine the expected return for each asset (4 Marks)

b) Compute the risk for each asset using standard deviation (8 Marks)

c) Using coefficient variation, determine which asset the company should invest in.

(3 Marks)

QUESTION THREE

Bright ltd. is considering the investment into a new product line so as to supplement it current products. It anticipates that the new product line will involve an initial cash investment of Shs, 1,400,000. After tax cash inflows are expected to be as follows: Shs. 300,000 in year one. Shs. 500,000 in year two, Shs. 600,000 in year three, Shs. 700,000 in year four and a final Shs 800,000 in year five. The company expects the project to end in five years and during that period the expected rate of return is 15%.

Required

Advise Bright Ltd. on whether to invest in the new product line using the following investment evaluation criteria

a) Ordinary payback method (3 Marks)
b) Discounted Payback period method. (6 Marks)
c) Net present Value (NPV) (6 Marks)

QUESTION FOUR

a) Discuss three attitudes investors have towards risk and return (6 Marks)
b) Discuss two advantages and three disadvantages of net present value (NPV) method of capital budgeting. (4 Marks)
c) Although profit maximization has long been considered as the main goal of a firm, shareholder wealth maximization is gaining acceptance amongst most companies as the key goal of a firm. Distinguish between the goals of profit maximization and shareholder wealth maximization. (5 Marks)

QUESTION FIVE

Mawindo Ltd. is analyzing two mutually exclusive projects whose details are shown below:-

Year	Project A	Project B
	Cash Flow (Shs.)	Cash Flow (Shs.)
1	3,000,000	6,000,000
2	1,000,000	5,000,000
3	4,000,000	4,000,000
4	5,000,000	3,000,000
5	6,000,000	1,000,000

Addition Information

1. The above cash flows have been acted on after-tax basis.
2. Each of the projects will cost Shs. 10,000,000 at commencement. The company intends to raise this finance through an issue of debentures at an interest rate of 10% per annum.

Required:

Advise the management of Mawindo Ltd. on which of the two projects to undertake using:

(i) Internal Rate of return (12 Marks)

(ii) Profitability Index (3 Marks)

QUESTION SIX

Rafiki Hardware Tools Company Limited sells plumbing fixtures. Its financial statements for the last three years are as follows:

	2010	**2011**	**2012**
	Sh.'000'	**Sh.'000'**	**Sh.'000'**
Cash	30,000	20,000	5,000
Accounts receivable	200,000	260,000	290,000
Inventory	400,000	480,000	600,000
Net fixed assets	800,000	800,000	800,000
	1,430,000	**1,560,000**	**1,695,000**
Accounts payable	230,000	300,000	380,000
Accruals	200,000	210,000	225,000
Bank loan, short term	100,000	100,000	140,000
Long term debt	300,000	300,000	300,000
Common stock	100,000	100,000	100,000
Retained earnings	500,000	550,000	550,000
	1,430,000	**1,560,000**	**1,695,000**

Additional information:

Sales	4,000,000	4,300,000	3,800,000
Cost of goods sold	3,200,000	3,600,000	3,300,000
Net profit	300,000	200,000	100,000

Required:

a) For each of the three years, calculate the following ratios:
   - (i) Acid test ratio (2 Marks)
   - (ii) Current ratio (2 Marks)
   - (iii) Inventory turnover (2 Marks)
   - (iv) Net profit margin (2 Marks)
   - (v) Return on capital employed. (2 Marks)

b) From the ratios calculated above, comment on the
   - i. Liquidity position of the company (2 Marks)
   - ii. Profitability positions of the company (3 Marks)