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KIRIRI WOMENS' UNIVERSITY OF SCIENCE AND TECHNOLOGY
UNIVERSITY EXAMINATION, 2022/2023 ACADEMIC YEAR
FIRST YEAR, SECOND SEMESTER EXAMINATION
FOR THE DEGREE OF BACHELOR OF SCIENCE
(BUSINESS ADMINISTRATION)

Date: 28th July, 2022
Time: 11.30am –1.30pm

KFI 001 - INTRODUCTION TO FINANCIAL MANAGEMENT

INSTRUCTIONS TO CANDIDATES

ANSWER QUESTION ONE (COMPULSORY) AND ANY OTHER TWO QUESTIONS

QUESTION ONE (30 MARKS)

- a) The finance manager spends most of his time making managerial finance decisions as opposed to routine functions. Discuss. (4 marks)
- b) Consider a project, which promises equal receipts of sh 10,000 each year for the next 3 years. If the discounting rate is, 10%.
- i) determine the present value of this annuity. (3 marks)
- ii) Assuming now that the cashflows occur at the beginning of each period then this becomes an annuity due. (3 marks)
- c) Describe three instances in which the interests of the management of a company might conflict with those of the shareholders and suggest mechanisms for their resolutions. (6 Marks)
- d) Highlight any four Principles of corporate governance. (4 Marks)
- e) Assume you bought a 10%, 25 year bond atsh 842 with a promised yield to maturity of 12%. You expect the bond's yield to maturity to decline 8% in 5years. What will be the price of the bond in 5 years, if the bonds par value issh 1000? (6 Marks)
- f) Highlight the reasons why the finance manager should understand the management of working capital. (4 marks)

QUESTION TWO (20 MARKS)

Three Star Ltd wishes to raise funds amounting to s. 10million to finance a project in the following manner: Sh. 6million from debt; Sh. 4 million from floating new ordinary shares The present capital structure of the company is made up as follows: 1. 600,000 fully paid ordinary shares of sh. 10 each 2. retained earnings of sh. 4 million 3. 200,000, 10% preferences shares of sh. 20 each 4. 40,000 6 % long term debenture of sh. 150 each The current market value of the company's ordinary shares is sh. 60 per share. The expected ordinary share dividend in a year's is sh. 2.40 per share. The average growth rate in both dividends and earnings has been 10% over the past ten years and this growth rate is expected to be maintained in the foreseeable future.

The company's long term debentures currently change hands for sh. 100 each. The debentures currently change for sh. 100 each. The debentures will mature in 100 years. The preference shares were issued four years ago and still change hands at face value.

Required;

- a) Compute the component cost of: ordinary share capital, debt capital, preference share capital. (6 marks)
- b) Compute the company's current weighted average cost of capital. (8 marks)
- c) Compute the company's marginal cost of capital if it raised the additional sh. 10 million as envisaged (assume a tax rate of 30%) (6 marks)

QUESTION THREE (20 MARKS)

- a) Company A and B are two mutually exclusive projects requiring an initial cash outlay of Sh 10,000 each and with a useful life of 5 years. The company required rate of return is 10% and the appropriate corporate tax rate is 50%. The projects will be depreciated on a straight line basis. The before depreciation and taxes cashflows expected to be generated by the projects are as follows.

<i>YEAR</i>	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
Project A	Shs 4,000	4,000	4,000	4,000	4,000
Project B	Shs 6,000	3,000	2,000	5,000	5,000

Required:

Calculate for each project

- i. The payback period. (2 marks)
 - ii. The average rate of return (2 marks)
 - iii. The net present value (3 marks)
 - iv. Profitability index (3 marks)
 - v. The internal rate of return. (4 marks)
- b) Several methods exists for evaluating investment projects under capital budgeting. Discuss three features of an ideal investment appraisal method. (6 Marks)

QUESTION FOUR (20 MARKS)

- a) Nice borrowed shs.5m for investment purposes at an interest rate of 12%. The loan is to be repaid within a period of 8 year. Prepare the loan repayment schedule showing clearly the interest and principal repayment. (10 marks)
- b) Examine the forms of informational efficiency. (10 marks)

QUESTION FIVE (20 MARKS)

ABC Ltd. makes cash payments of Shs.10,000 per week. The interest rate on marketable securities is 12% and every time the company sells marketable securities, it incurs a cost of Shs.20.

Required;

- a) Determine the optimal amount of marketable securities to be converted into cash every time the company makes the transfer. (6 marks)
- b) Determine the total number of transfers from marketable securities to cash per year. (6 marks)
- c) Determine the total cost of maintaining the cash balance per year. (4 marks)
- d) Determine the firm's average cash balance.. (4 marks)