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KIRIRI WOMENS' UNIVERSITY OF SCIENCE AND TECHNOLOGY

UNIVERSITY EXAMINATION, 2024/2025ACADEMIC YEAR
FIRST YEAR, SECOND SEMESTER EXAMINATION
FOR THE DEGREE OF BACHELOR OF SCIENCE
(BUSINESS ADMINISTRATION)

Date: 8th August, 2024
Time: 11.30am –1.30pm

KFI 2101 INTRODUCTION TO FINANCIAL MANAGEMENT

INSTRUCTIONS TO CANDIDATES

ANSWER **QUESTION ONE (COMPULSORY)** AND **ANY OTHER TWO** QUESTIONS

QUESTION ONE (30 MARKS)

a) "Since debt capital is cheaper than equity, companies should resort to one hundred percent use of debt to finance their investments". Discuss the limitations of the above financing policy. (5 Marks)

b) Explain five factors that may be responsible for the slow growth in the number of companies seeking listing at the Nairobi Security Exchange or Stock Exchange in your country. (5 Marks)

c) Define term financial market and enumerate why they are needed for economic development. (5 Marks)

d) Explain four roles of Central Bank as the financial controller to commercial bank. (5 Marks)

e) Salama Ltd. had the following capital structure as at 31 March 2020:

	Shs.
Ordinary share capital (400,000 shares)	4,000,000
10% Preference share capital	2,000,000
14% Debenture capital	2,000,000
	8,000,000

Additional information:

1. The market price of each ordinary share as at 31 March 2020 was Shs. 15.
2. The company paid a dividend of Shs. 4 for each ordinary share for the year ended 31 March 2020.
3. The annual growth rate in dividends is 8%.
4. The corporation tax rate is 30%.
5. The market price for preference shares and debentures are same as the par value.

Required:

i) Compute the weighted average cost of capital of the company as at 31 March 2020. (5 Marks)

ii) The company intends to issue a 15% Shs. 2 million debenture during the year ending 31 March 2021. The existing debentures will not be affected by this issue. The dividend per share for the year ending 31 March 2021 is expected to be Shs. 3 while the average market price per share over the same period is estimated to be Shs. 20. The average annual growth rate in dividends is expected to remain at 8%.

Compute the expected weighted average cost of capital as at 31 March 2021. (5 marks)

QUESTION TWO (20 MARKS)

a) United Ltd. Intends to pay an ordinary dividend of Shs. 5 per share for the year ended 31 March 2020, 2021, 2022. The management of the company projects that the market price of the shares will be as follows:

Year ending 31 December	**Projected market price per share**
2020	40
2021	45
2022	50

Required;

Determine investors' required rate of return for the year 2020, 2021 and 2022. (5 marks)

b) Discuss the functions of the central bank of your country. (8 marks)

c) Explain the necessary conditions for success of venture capital financing in Kenya. (7 Marks)

QUESTION THREE (20 MARKS)

a) Explain the types of agency costs that arise in agent-principle relationship between managers and shareholders. (4 Marks)

b) Highlight the various measures that would minimize agency problems between the owners and the management. (8 Marks)

c) Explain four factors that influence the cost of fund of a firm. (8 Marks)

QUESTION FOUR (20 MARKS)

a) Explain the reasons why firms in the same industry with equal earnings and share capital would pay different amounts of dividends. (8 Marks)

b) Examine the relative merits of leasing versus hire purchase as a means of acquiring capital assets. (8 Marks)

c) Differentiates between systematic risk and unsystematic risk by giving examples. (4 Marks)

QUESTION FIVE(20 MARKS)

a) Discuss four reasons why a finance Manager should understand the management of working capital. (8 Marks)

b) The management of capacity engineering Ltd. is in the process of evaluating two alternative machine models, model x and model y for possible purchase in order to increase the company's production level.

The following additional information is available:

1. MODEL X costs Shs. 3,800,000 and will have a useful life of Three years.
2. MODEL Y costs Shs. 8,000,000 and will have a useful life of four years.
3. Both machines have no salvage value after their useful lives.
4. An investment in working capital amounting to Shs. 900,000 will have to be made at the beginning of the first year of the machine's life regardless of the model purchased.
5. The estimated pre-tax cash inflows for each of the machines are shown below:

Year	**Machine**	
	Model x	**Model y**
	Shs.	**Shs.**
1.	2,500,000	4,250,000
2.	2,800,000	3,340,000
3.	3,000,000	3,170,000
4.	2,800,000	

6. The cost of capital to the company is 1O % and the corporation tax rate is 30%.

Required;

i) Calculate the undiscounted payback period for each machine model. (5 Marks)

ii) Calculate the net present value (NPV) for each machine model. (5 Marks)

iii) Using the net present values computed in (ii) above, advise the management on which model to purchase. (2 Marks)