



# THE CATHOLIC UNIVERSITY OF EASTERN AFRICA

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**MAIN EXAMINATION**

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**MAY- AUGUST 2021**

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**SCHOOL OF BUSINESS**

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**DEPARTMENT OF ACCOUNTING AND FINANCE**

**REGULAR/ODEL PROGRAMME**

**CFD 082: INTRODUCTION TO FINANCE**

**Date: AUGUST 2021**

**Duration: 2 Hours**

**INSTRUCTIONS: Answer Question ONE and any other TWO Questions**

## **QUESTION ONE**

- a) Highlight the main problems that small scale sole traders' may encounter in a bid to raise finance on Kenya's financial markets. **(05 Marks)**
- b) Within a business finance context, discuss the conflict that might exist in the agency relationships between shareholders and managers **(05 marks)**
- c) Contrast between the use of debt and equity as a source of finance. **(06 marks)**
- d) Suggest the merits of using discounted cash flows in evaluating long term investments **(06 marks)**
- e) The following is the existing capital structure of Company XYZ Ltd.

Shs.

Ordinary shares at Shs.10 par	1,000,000
Retained	800,000
12% preference shares Shs.10 par	400,000

16% debenture Shs.100 par	<u>300,000</u>
Total capital employed	<u>2,500,000</u>

The company's ordinary shares have a dividend cover of 3 times and pays a dividend of 10% on its ordinary share capital. Annual dividend growth rate is 11 % per annum.

Ordinary shares sell at Shs.18

Preference shares sell at Shs.15

Debentures are selling at par. The tax rate is 30%

### Compute

Weighted Average Cost of Capital (W.A.C.C).

**(8 Marks)**

### QUESTION TWO

- a) Discuss the weaknesses associated with profit maximization as a goal of the firm  
(8 marks)
- b) KK Ltd has six projects available for investment as follows:

Project	Initial cost Sh.'M'	Present value cash inflow
1	60	81
2	15	24
3	20	29
4	55	70
5	30	50
6	40	38

The firm has Sh.100 M available for investment.

### Required

Using Profitability Index (P.I) and Net Present Value (NPV) ranking identify which projects should be undertaken. Comment on your answer. **(12 Marks)**

### QUESTION THREE

a) Distinguish between Business risk and financial risk. **(4 Marks)**

b) Discuss the functions of a financial manager in a contemporary corporate set-up.

**(8marks)**

c) Consider the returns of two securities A&B which depend on the states of nature with the following probabilities

		RETURNS	
STATE	PROBABILITY	A	B
Recession	0.3	12	6
Stable	0.4	15	7.5
Expansion	0.3	10	5

a) Advise the investor on which of the two securities to invest in on the basis of risk and expected return. **(8 Marks)**

### QUESTION FOUR

a) Distinguish between Capital structure and financial structure of a firm. **(4 Marks)**

c) Resilou limited intends to purchase a machine worth Shs.1, 500,000 which will have a residue value Shs.200,000 after 5 years useful life. The saving in cost resulting from the use of this machine are:

	Shs.
Year 1	800,000
Year 2	350,000

Year 3	-
Year 4	680,000
Year 5	775,000

Using NPV method, advise the company whether this machine should be purchased if the cut off rate is 14%. **(6 Marks)**

b) Suggest the factors influencing share prices in the stock market

DET MAY 2021