THE CATHOLIC UNIVERSITY OF EASTERN AFRICA

A. M. E. C. E. A

P.O. Box 62157
00200 Nairobi - KENYA
Telephone: 891601-6
Fax: 254-20-891084
E-mail:academics@cuea.edu

MAIN EXAMINATION

MAY – JULY 2019 TRIMESTER

FACULTY OF COMMERCE

DEPARTMENT OF ACCOUNTING AND FINANCE

SPECIAL / SUPPLEMENTARY EXAMINATION

CFI 221: BUSINESS FINANCE

Date: JULY 2019	Duration: 2 Hours
INSTRUCTIONS: Answer Question ONE and any other TWO Questions	

Question One(30 Marks)

a) Generally, individuals value the opportunity to receive money today rather than in the future. Explain three reasons for such preference. **(3 marks)**

b) Discuss the three types of Efficient Market Hypothesis **(4marks)**

c) What are the limitations of Ratio Analysis **(4 Marks)**

d) Discuss the roles of the following capital Market regulators in Kenya

(i) Central Bank of Kenya **(1 Marks)**
(ii) Insurance regulatory Authority **(1 Marks)**
(iii) Capital market authority **(2 Marks)**
(iv) Retirement Benefit Authority (RBA) **(2 marks)**
(v) SACCO Societies Regulatory Authority (SASRA) **(1 Mark)**

e) Assume that you are a beneficiary of an insurance contract from your grandmother that will pay youKsh5.4 million immediately. However, the contract gives you the alternative of takingKsh1.8 million a year (beginning of year) for the next five years. You think that you will earn 6% on your investments over this period of time. Given this information, advise on the better choice immediate cash or the extended payout. **(6 marks)**

f) Your grandfather put some money in an account for you on the day you were born. You are now 18 years old and are allowed to withdraw the money for the first time. The account currently has Ksh399,600 in it and pays an 8% interest rate.

(i) Calculate how much money would be in the account if you left the money there until your
65th birthday. **(3 marks)**

(ii) Determine how much money your grandfather originally put in the account. **(3 marks)**

Question Two(20 Marks)

a) Name various sources of capital available to a business **(4 marks)**

b) Bakers Ltd is a medium-sized bread-making firm. It has a manufacturing plant in Maua, and from there it distributes to all the supermarkets within a 640 km radius. The distribution is in the hands of an independent transport firm. Currently Bakers Ltd is undergoing changes and its Board of Directors is considering 3 different investment proposals.

1. To buy 5 trucks (lorries) and therefore become independent of the distributing firm.

2. To open up a second branch in Mombasa.

3. To buy a new machine to make different (yet bread related) products. The proposals can be financed in the following manner:

1. Leasing the vehicles;
2. Issuing more shares;
3. A loan from a bank.

Assess at least 3 advantages and 3 disadvantages of financing each proposal in the manner described above. **(6 marks)**

c)The Njoroge & Otieno Company has two divisions: Health Food & Specialty Metals. Each division employ debt upto 30% and preference capital equal to 10% of its total requirements, with equity capital used for the remainder. The current borrowing rate is 15% and companies tax rate is 40%. Presently preference shares can be sold carrying 13% dividends at par. Tata wishes to establish a minimum return standard for each division based on the risk of that division. This standard then would serve as the transfer price of the capital to the division. The company has thought about of using capital asset pricing model in this regard. It has identified two samples of companies having similar capital structure to that of Philips, with betas of 0.902 for health foods and 1.30 for specialty metals. The risk free rate presently is 12% and the expected market rate of return is 17%.

Required

Using the CAPM approach, what weighted average required returns on investment would you recommend for the setwo divisions. **(10 marks)**

Question Three (20 Marks)

a) What are the different forms of Business Organization? What are their advantages and disadvantages? Give at least 2 advantages and 2 disadvantages of each **(8 marks)**

b) Pioneer Steels Ltd. is considering two mutually exclusive projects. Both require an initial cash outlay of Kshs 10,000 each and have a life of five years. The company's required rate of return is 10% and pays tax at a 50% rate. The projects will be depreciated on a straight line basis. The net cash flow expected to be generated by the projects are as follows:

Year	**1**	**2**	**3**	**4**	**5**
Project1	Kshs.4,000	4,000	4,000	4,000	4,000
Project2	Kshs.6,000	3,000	2,000	5,000	5,000

You are required to calculate:

a) The payback of each project **(2 marks)**

b) The average rate of return for each project **(2 marks)**

c) The net present value **(4 marks)**

d) The Internal rate of returns for each project **(4 Marks)**

Question Four(20 Marks)

a) What factors determine working capital requirements for an organization **(5 marks)**

b) Briefly discuss at least five (5) importance of Ratio Analysis **(5 Marks)**

c) The following are the balance Sheet and Income statement for ABC ltd for the period ending 31st Dec 2017.

ABC Balance sheet as at 31st Dec 2017

Assets	**Liabilities & Owner's Equity**
Current Assets	**Current Liabilities**
Cash 300	Accounts Payable 400
Account Receivable 200	Notes Payable 400
Inventory 300	
Total Current Assets800	**Total Current Liabilities** 800
Fixed Assets	**Long Term Liabilities**
Property Plant &Equipment 1,400	Long term debt **300**
Less	**Owners equity**
Accumulated depreciation(100)	Common Stock100
	Surplus Capital 600
Net fixed Asset **1,300**	Retained earnings 300
	Total Owners' Equity **1000**
Total assets2,100	**Total Liability&Owner'sEquity 2,100**

ABC Income statement(Kshs. Millions) for the Period Ending 31st Dec 2017

Sales		2,500
Cost of Sales	(900)	
Administrative Expenses	(200)	
Depreciation	(269)	(1,369)
Earnibg Before Interest and taxes		**1,131**
Interest Expenses	(20)	
Taxable income	**1,111**	
Taxes (205)		
Net Income	906	
Dividends	(8)	
Addition to Retained earning 898		

Other information
Number of shares outstanding (millions 100
Price per share Kshs. 10.63

Required

Calculate the following rations

- **(i)** Current Ratio **(1 Mark)**
- **(ii)** Quick ratio **(1 Mark)**
- **(iii)** Days' receivable ratio **(4 Marsk)**
- **(iv)** Days Inventory Ratio **(4 Marks)**

END