**MERU UNIVERSITY OF SCIENCE AND TECHNOLOGY**

**P.O. Box 972-60200 – Meru-Kenya.**

**Tel: 020-2069349, 061-2309217. 064-30320 Cell phone: +254 712524293, +254 789151411**

**Fax: 064-30321**

**Website:** [**www.must.ac.ke**](http://www.must.ac.ke) **Email:** **info@must.ac.ke**

**University Examinations 2016/2017**

SECOND YEAR FIRST SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR OF COMMERCE

THIRD YEAR FIRST SEMESTER DEGREE OF BACHELOR OF BUSINESS

 ADMINISTRATION

FOURTH YEAR FIRST SEMESTER DEGREE OF BACHELOR OF PURCHASING AND

 SUPLLIES MANAGEMENT

 **BFC 3226: INTRODUCTION TO FINANCIAL MANAGEMENT**

 **DATE: DECEMBER 2016 TIME: 2HOURS**

**INSTRUCTIONS:** *Answer question* ***one*** *and any other* ***two*** *questions*

**QUESTION ONE (30 MARKS)**

1. What are the advantages of leasing an asset compared to borrowing to buy an asset?

(10 marks)

1. Discuss any five factors that affect capital structure of a firm (5 marks)
2. Within a financial management context, discuss the problems that might exist in the relationships (sometimes referred to as agency relationships) between

 University of Science & Technology is ISO 9001: 2015 Certified

 Foundation of Innovations Page 1

1. Shareholders and managers and
2. Shareholders and creditors

How might a company attempt to minimize such problems? (10 marks)

1. In relation to the financing of a firm, differentiate the following pairs of terms:
2. Financial structure from capital structure
3. Business risk from financial risk (5 marks)

**QUESTION TWO (20 MARKS)**

1. The following is the capital structure of Mirr Ltd as at 31/12/2013

Shs.’’Millions’’

Ordinary share capital shs. 10per value 400

Retained earnings 200

10% preference share capital sh. 20 par value 100

12% debenture sh. 100 par value 200

 900

 **Additional information**

1. Corporate tax rate is 30%
2. Preference shares were issued 10 year ago and are still selling at par value MPS=Par value
3. The debenture has a 10 year maturity period. It is currently selling at Sh. 90 in the market.
4. Currently the firm has been paying dividend per share of sh.5. the DPS is expected to grow at 5% p.a in future. The current MPs is sh. 40

**Required:**

1. Determine the WACC of the firm (12 marks)

Discuss the core function of a finance manager in a profit making organization (8 marks)

 University of Science & Technology is ISO 9001: 2015 Certified

 Foundation of Innovations Page 2

**QUESTION THREE (20 MARKS)**

Gakoromone Ltd. Wishes to make a choice between two mutually exclusive projects. Each of these projects requires sh. 400,000,000 in initial cash outlay. The details of the two projects are as follows:

**Project A**

This project is made up of two sub-projects. The first sub-project will require an initial outlay of sh. 100,000,000 and will generate sh. 25,600,000 per annum in perpetuity. The second sub-project will require an initial outlay of sh. 300,000,000 and will generate sh.85,200,000 per annum for the 8 years of its useful life. This sub-project does not have a residual value at the end of the 8 years. Both sub-projects are to commence immediately.

**Project B**

This project will generate sh.87,000,000 per annum in perpetuity

The company has a cost of capital of 16%

**Required:**

1. Determine the net present value (NPV) of each project (6 marks)
2. Compute the internal rate of return (IRR) for each project (6 marks)
3. Advice Gakoromone Ltd. On which project to invest in and justify your choice

(4 marks)

1. Discuss the main goals/objectives of a profit making entity (4 marks)

**QUESTION FOUR (20 MARKS)**

1. Describe three sources of debt capital available to a publicity listed company

(6 marks)

 University of Science & Technology is ISO 9001: 2015 Certified

 Foundation of Innovations Page 3

1. Heka ltd. Owns a hardware stores which keeps cement and iron sheets, every year he purchases, 50,000 bags of cement and 50,000 pieces of iron sheet each of these items on average costs shs.600 per piece, the cost of holding each piece in store per annum is shs. 35. The cost of reordering and delivery of a batch is shs. 20,000 regardless of the size of the order.

**Required:**

1. Calculate the economic order quantity (EOQ) (5 marks)
2. The total cost of inventory management on the assumption that usage is predictable and there is instantaneous replenishment of stock (5 marks)
3. What are the assumptions of EOQ model (4 marks)

**QUESTION FIVE (20 MARKS)**

1. Describe the importance of cost of capital to a firm (6 marks)
2. Business firms are faced with various types of risks. Discuss any four of these risks (8 marks)
3. Consider the following two investments A&B

State of economy Probability Returns (%)

A B

1 0.2 12 13

2 0.1 8 16

3 0.3 9 -6

4 0.2 17 12

5 0.2 2 -8

 University of Science & Technology is ISO 9001: 2015 Certified

 Foundation of Innovations Page 4

**Required:**

For each asset,

1. Calculate the expected return (2 marks)
2. Calculate the risk (4 marks)

 University of Science & Technology is ISO 9001: 2015 Certified

 Foundation of Innovations Page 5