

LAIKIPIA



UNIVERSITY

UNIVERSITY EXAMINATIONS

1ST SEMESTER 2023/2024 ACADEMIC YEAR

THIRD YEAR EXAMINATION FOR THE DEGREE
OF BACHELOR OF COMMERCE

BUST 311: BUSINESS FINANCE

STREAM:

TIME: 2 HRS

DAY: MONDAY [14.30-16.30 P.M]

DATE: 4/12/2023

THIS QUESTION PAPER CONSISTS OF THREE (3) PAGES

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Instructions: Answer Question ONE and any other TWO questions

QUESTION ONE (Compulsory 30 marks)

- (a) Explain any five negotiated sources of short-term finance **(10 Marks)**
- (b) Distinguish dead weight national debt from reproductive debt. **(4 Marks)**
- (c) Discuss the agency problem between managers and shareholders, explaining the ways that the business owners may resolve it. **(10 marks)**
- (d) Explain three factors that affect or influence the dividend policy of the firm **(6 Marks)**

QUESTION TWO (20 marks)

The following relates to two securities (security P and Q) being offered for subscription with their respective characteristics.

State of the Economy	Possibility of occurrence	Security P	Security Q
U	0.15	10%	25%
V	0.25	15%	10%
W	0.2	30%	15%
X	0.25	25%	40%
Y	0.15	20%	10%

- (i) Calculate the expected return on each security. **(6 Marks)**
- (ii) Calculate the standard deviation of the returns on security P and Q. **(10 Marks)**
- (iii) Which security do you recommend for the company to invest in and why? **(4 Marks)**

QUESTION THREE (20 marks)

- (a) The capital of a Kwenda Co. Ltd. is all Equity and consists of 800,000 shares of Shs.120. each. The anticipated growth rate is 10% and last year’s dividend was Shs.4 per share. What is the cost of Equity? **(3 Marks)**
- (b) Kwenda Co. Ltd has decided to adjust its capital structure proportions to 25% debt of 36,000 irredeemable debentures, 25% preferred stock in form of 200,000 preference shares and 50% equity while maintaining the same level of capital. The company anticipates the same growth



rate as above and its preferred stock and 10% and 6% respectively. The corporate income tax rate is 30%.

- (i) Calculate the cost of equity. **(4Marks)**
- (ii) Calculate the dividend per share of preferred stock. **(3Marks)**
- (iii) Calculate the cost of debt. **(3Marks)**
- (c) What is Kwenda’s Co. Ltd. Weighted Average cost of Capital(WACC)? **(7Marks)**

QUESTION FOUR (20 marks)

- (a) Wealth maximization objective is superior to profit maximization objective. Discuss. **(10 Marks)**
- (b) An investor has an investment fund of Kes2million.He intends to apportion this fund into two securities, x and y as follows; Kes1.2 million in security x, Kes800,000 in security y. There turns on each security are dependent on the state of the economy as shown below;

State of the Economy	Probability	Return on Security	
		X	Y
Boom	0.2	15%	20%
Normal	0.5	12%	18%
Depression	0.3	8%	25%

Required:

- (i) The expected return on the portfolio **(2 Marks)**
- (ii) The Risk of each security **(4 Marks)**
- (iii) Comment on the results obtained in (ii) above. **(4 Marks)**

