



**Riara School of Business**  
*Nurturing business innovators*

**SEPTEMBER – DECEMBER 2019 TRIMESTER**  
**EXAMINATION FOR BACHELOR OF BUSINESS ADMINISTRATION**

**SATURDAY PROGRAMME**

**RFN 303: CORPORATE FINANCE**

**DATE: DECEMBER 2019**

**TIME: 2 HOURS**

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**INSTRUCTIONS**

- i) Answer question one and any other two**
  - ii) Marks allocated to each question are shown at the end of the question**
  - iii) Arrange your work neatly and indicate the questions answered in the Examination booklet**
  - iv) Where applicable use the respective discounting tables provided overleaf**
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**QUESTION ONE: COMPULSORY (30 MARKS)**

- a) To be an effective and successful finance manager, certain functions are a must. Explain  
**(10 marks)**
- b) Briefly explain the four main objectives of most commercial enterprises **(4 marks)**
- c) An agency relationship exists where one person called an agent is given authority by another called the principal to act on his behalf. Often a conflict of interest exists between the agent and the principal. Giving examples, explain how such conflicts can be resolved. **(10 marks)**
- d) Describe the basic financial statements that are used to analyse the various aspects of a firm and elaborate who are the main users of those financial statements. **(6 marks)**

## QUESTION TWO

- a) Why do investors prefer the cash available now rather than in the future? **(3 marks)**
- b) Before committing to any capital budgeting decision, certain factors must be borne in mind. Briefly describe some of those factors **(3 marks)**
- c) Rironi Ltd bought a new asset at a cost of Ksh 1,200,000/=. The asset has 5 years of economic life and is expected to have a salvage value of Ksh. 100,000/= at the end of the 5 years. The asset is expected to generate the following sales revenue during its economic life

Year	1	2	3	4	5
Sales Revenue ( Ksh)	900,000/=	800,000/=	1,000,000/=	900,000/=	700,000/=

The machine is expected to have operating expenses of Ksh 300,000/= p.a. The Company is in the 30% tax bracket and uses straight line method of depreciating its assets. The company's cost of capital is 12%.

Required

- (i) Prepare a schedule to show how the cash flows will be generated. **(6 marks)**.
- (ii) Compute the Accounting Rate of Return (A.R.R) **(2 marks)**
- (iii) Compute the payback period of the project **(2 marks)**.
- (iv) Compute the Net Present Value of the project **(2 marks)**
- (v) Compute the Profitability Index of the Project **(2 marks)**

## QUESTION THREE

- a) Giving examples, explain what you understand by the term floatation costs **(4 marks)**
- b) Tumaini Ltd has a security in form of a debenture whose beta factor is 0.75. The interest rate on Treasury Bills is 6% and the market return is 10% on average. Compute the risk premium of this security and the required rate of return. **(4 marks)**
- c) Umeme Ltd has a 3 year 5% Ksh 1,000/= debenture whose current market value is Ksh 950/=. Using Internal Rate of Return method also known as interpolation method, compute the Yield To Maturity ( YTM). **(8 marks)**
- d) Explain the various short term investment options to which idle cash can be invested on instead of the funds lying in a non interest account. **(4 marks)**

#### QUESTION FOUR

a) The amount of dividends paid differ from one firm to another. Explain the various factors that a business would consider when designing the dividend policy. **(10 marks)**

b) Bonus issue also called dividend re-investment scheme involves capitalization of retained earnings. It does not increase the wealth of the shareholders since it involves transfer of retained earnings to ordinary share capital. The following capital structure relates to Farasi Ltd

<b>Description</b>	<b>Ksh</b>
Ordinary Share Capital – 200,000 shares at Ksh 10/= each	2,000,000/=
Retained Earnings	3,500,000/=
Long Term Debt	2,500,000/=
<b>Total Capital</b>	<b>8,000,000/=</b>

Farasi Ltd has made a bonus issue of 1 share for every 4 shares held. The issue was made out of retained earnings. Show the capital structure after the bonus issue indicating the book entries to be passed. **(10 marks)**

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