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Formation of Quality Innovations

UNIVERSITY EXAMINATIONS 2023/2024

SECOND YEAR SECOND SEMESTER EXAMINATION FOR DEGREE OF BACHELOR OF SCIENCE IN APPLIED ACCOUNTING

BFH 3254: FINANCIAL DECISION MAKING I

DATE: APRIL 2024 **TIME: 2 HOURS**

INSTRUCTIONS: Answer Question ONE and any other TWO questions.

QUESTION ONE (30 MARKS)

A firm needs to disburse Kenya shilling 10,000,000 during the year and would incur Kshs 400 per trip to withdraw cash. There is an opportunity cost of investing cash at a bank interest rate of 5%.

Required:

a) Using Baumol's model $c = \sqrt{\frac{2AXF}{0}}$ determine the optimal cash to be withdrawn (9 marks)

b) Discuss the Motives of holding cash (6marks)

c) What are debentures, explain giving any four types (10 marks)

d) List and explain the main reason why firms need working capital (5 marks)

QUESTION TWO(20MARKS)

A firm is in the process of issuing a bond, the face value of the bond is Kshs 2,500,000 and a coupon rate of 11% per annum, the bond will have a term of 10 years and interest will be paid semiannually. The prevailing market rate of interest is 12 % per annum.

Required

a) Will the bond be sold at a discount or premium (8 marks)

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b) What determines the price of the bond? (8 marks)

c) Explain the term Internal Rate of Return (4 marks)

QUESTION THREE(20MARKS)

End of Year	1	2	3	4	5
Mwema	160,000	480,000	640,000	960,000	640,000
Mrembo	500,000	500,000	500,000	500,000	500,000

Axom is considering investing in alternatives projects each costing Kshs.l, 920,000. End of year cash flows after taxation are expected to be as show below while the firms' after tax weighted average cost of capital is 12%.

You are required to suggest which machine should be preferred if any based on:

a) NPV Method (6 marks)

b) Profitability Index (3 marks)

c) Clearly list and explain the main roles and functions of a finance manager. (11marks)

QUESTION FOUR(20MARKS)

Miller and Modigilian (1961) proposed that an organization's dividend policy is irrelevant to that organization's share value. This view was dependent on a number of key assumptions;

a) What are the key assumptions on which Miller and Modigilian based their views? (5Marks)

b) Explain the legal constraints in relation to companies paying out dividends. (5 Marks)

c) Makutano Ltd has currently 25,000 outstanding shares of Sh100 each. At the end of year, the company wants to declare dividends payment at the rate of Sh5 per share. The capitalization rate for the risk class to which the firm belongs is 10%. It expects to have a net income of Shs 25,000,000 and has a proposal for making new investment

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of Sh5m. Show that under MM assumptions the payment of dividend does not affect the value of the firm. (10 marks)

QUESTION FIVE(20MAKRS)

a) Discuss the importance and limitation of executive share option plan (ESOPs) to the achievement of goal congruence within the corporation. (8 Marks)

b) Critically evaluate the functions of the board of directors in relation to the enhancement of corporate governance within the organization. (7 Marks)

c) Explicate the differences between debts and equities as a source of finance to corporations. (5 Marks)

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