MAASAI MARA UNIVERSITY

REGULAR UNIVERSITY EXAMINATIONS

2023/2024 ACADEMIC YEAR

THIRD YEAR FIRST SEMESTER

SCHOOL OF BUSINESS AND ECONOMICS
BSc. IN ENTREPRENEURSHIP

COURSE CODE: BSE 3107-1
COURSE TITLE: SMALL BUSINESS FINANCE

DATE: 7/12/ 2023 **TIME: 0830-1030 HRS**

INSTRUCTIONS TO CANDIDATES

Answer Question **ONE** and any other **THREE** Questions

*This paper consists of **4** printed pages. Please turn over.*

Question One

a) With reference to financial markets, discuss **five** functions of the financial system and markets.
(5 Marks)

b) Discuss **five** functions of a finance manager in a company. **(5 Marks)**

c) From the following information, calculate the net present value of project Fugo and Amber and suggest which of the two projects should be accepted at a discount rate of 12%. **(5 marks)**

	Project Fugo	**Project Amber**
Initial Investment	Ksh. 20,000	Ksh. 30,000
Estimated Life	5 years	5 years
Scrap Value	Ksh. 1,000	Ksh. 2,000

The profits after taxation (cash flows) are as follows:

	Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**
	Ksh.	Ksh.	Ksh.	Ksh.	Ksh.
Project X	5,000	10,000	10,000	3,000	2,000
Project Y	20,000	10,000	5,000	3,000	2,000

d) Discuss the steps followed when conducting equity valuation.
(5 Marks)

Question Two

a) Awendo Ltd. Company has raised preference shares capital for perpetuity of sh. 1,500,000 by issuing 12% preference shares of sh. 100 each. The company is in the 35% tax bracket.
Required: Calculate the cost of preference capital when they are issued at:
   i. Par **(2 Marks)**
   ii. 10% discount **(2 Marks)**
   iii. 10 % premium **(2 Marks)**

b) Julio Ltd. Intends to install a new production machine after 10 years. The company plans to deposit sh. 1.5 million at the end of each year into a saving plan that pays a fixed rate of interest of 12% p.a. Calculate the maturity value after 10 years. **(4 Marks)**

Question Three

a) Evaluate **four** main objectives of a business entity. **(4 Marks)**

b) Discuss **three** importance of capital rationing in capital budgeting.

(3 Marks)

c) Assume you are a finance manager advising the Chief Executive Officer of Super Ltd. Company on the merits of using Net Present Value (NPV) to appraise projects. Discuss the content of your talk. **(3 Marks)**

Question Four

a) Joel follows Sono company. The company appears to have a dividend policy of recognizing sustainable increases in the level of earnings with increases in dividends, keeping the dividend payout ratio within a range of 40% to 60%. Joel also notes that:

- The company's most recent quarterly dividend (ex-dividend date: 15th August 2021) was sh. 0.26 consistent with a current annual dividend of sh.1.04 per year.
- Company's forecasted dividend growth rate is 6% per year.
- Beta (β_i) is 1.13.
- Equity risk premium is 4.5%
- Risk free rate is 5%

Joel believes that Gordon growth model would be the most appropriate model for valuing the company.

Required:

i) Company's required return on equity. **(4 marks)**

ii) Gordon growth model value for Sono stock. **(4 marks)**

iii) If the current market price of Sono stock is sh. 30.18. using your answer to part (ii) judge whether Sono stock is fairly valued, undervalued or overvalued. **(2 marks)**

Question Five

a) Ole Mengo has Sh.500,000 that he can deposit in any of three savings accounts for a 3 years period. Bank I compound interest on an annual basis, Bank II compounds interest twice each year, and Bank III compounds interest each quarter. All the three Banks have a stated annual interest rate of 13%.

Compute:

i. The amount in each bank account at the end of 2 years. **(4 marks)**

ii. What is the effective annual rate (EAR) that is earned from each bank? **(2 marks)**

iii. Giving reasons, advise Tom where to deposit his money?

(2 marks)

iv. Bank IV is different from the others only in the sense that compounding is done continuously. What would be the amount at end of 3 years if it was deposited in Bank IV. **(2 marks)**

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