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UNIVERSITY EXAMINATIONS 2024/2025

FIRST YEAR FIRST SEMESTER EXAMINATION FOR DEGREE OF BACHELOR OF
SCIENCE IN FINANCE

BFS 3100: PRINCIPLES OF FINANCE

DATE: DECEMBER 2024

TIME: 2 HOURS

INSTRUCTIONS: Answer Question ONE and any other TWO questions.

QUESTION ONE (30 MARKS)

- a) Explain how the Capital Market Authority can ensure:
- Faster growth and development of the Nairobi Stock (6 marks)
 - Discuss four major goals of an organisation. (4 marks)
- b) Masuko intends to purchase a machine worth Shs. which will have a residue value Shs.200,000 after 5 years useful life. The saving in cost resulting from the use of this machine are:

	Shs.
Year 1	800,000
Year 2	350,000
Year 3	-
Year 4	680,000
Year 5	775,000

Using NPV AND PI investment appraisal methods, advise the company whether this machine should be purchased if the cut off rate is 14% and acceptable saving in cost is 12% of the cost of the investment. (10 marks)

- c) What are the advantages of leasing an asset compared to borrowing to buy an asset? (10 marks)



QUESTION TWO (20 MARKS)

- a) Define agency relationship from the context of a public limited company and briefly explain how this arises. (6 marks)
- b) Highlight the various measures that would minimize agency problems between the owners and the management. (6 marks)
- c) Evaluate any three factors that may be responsible for the slow growth in the number of companies seeking listing at the Nairobi Stock Exchange or Stock Exchange in your country. (8 marks)

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 subproject 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:

- i. Determine the net present value (NPV) of each project. (6 marks)
- ii. Compute the internal rate of return (IRR) for each project. (6 marks)
- iii. Advise Magma Ltd. on which project to invest in, and justify your choice (4 marks)
- e) Discuss the main functions of a financial manager in a profit making entity (4 marks)

QUESTION FOUR (20 MARKS)

Consider two investments A & B each having the following characteristics:

Investment	Expected Return (0%)	Proportion
A	20	2/3
B	40	1/3



REQUIRED:

Compute the portfolio standard deviation if the correlation coefficient between the assets is

- i. 1
- ii. 0
- iii. -1 (15 marks)

b) Discuss the reasons why individual prefer to have money now, rather than have the same amount at a future date (5marks)

QUESTION FIVE(20MARKS)

Mukongoro co. Ltd requires 20,000 units of a component in its manufacturing process in the coming year which costs Sh.500 each. The items are available locally and the leadtime in one week. Each order costs Sh.500 to prepare and process while the holding cost is Shs. 150 per unit per year for storage plus 10% opportunity cost of capital.

Required

- i. How many units should be ordered each time an order is placed to minimize inventory costs?
 - ii. What is the reorder level?
 - iii. How many orders will be placed per year?
 - iv. Determine the total relevant costs. (15 marks)
- b) Discuss the factors that affect the cost of capital to an organization (5 marks)

