1. (a) Explain **five** factors that may affect the capital structure of a firm. (10 marks)

   (b) Baraka Limited intends to borrow Ksh. 5,000,000 at an interest rate of 20% compounded annually. The loan is to be repaid in four equal annual instalments. Prepare a loan amortization schedule. (10 marks)

2. (a) Explain **four** advantages of using the payback period method in project appraisal. (8 marks)

   (b) Elgon Limited intends to invest in either project X or project Y. The following information relates to the two projects:

States of Nature	**Probability**	**Expected returns %**	
		Project X	**Project Y**
1	0.3	20	10
2	0.2	18	20
3	0.4	8	15
4	0.1	25	20

   (i) Calculate the coefficient of variation for each project.

   (ii) Advise the management on the project to invest in based on (i) above. (12 marks)

3. (a) Explain **five** differences between equity and debt as methods of raising finance for a company. (10 marks)

   (b) Forecasting is one of the methods used by management in decision making. Explain **five** reasons for using this method. (10 marks)

4. (a) Explain **five** circumstances under which ratio analysis may be effective in comparing the performance of two companies. (10 marks)

   (b) Ekole Limited has the following capital structure:

	Ksh
Ordinary shares:	
100,000 @ Ksh 20 each	2,000,000
10% preference shares @ Ksh 40 each	1,000,000
18% Debentures @ Ksh 100 each	2,000,000
20% Bank loan	5,000,000

Additional information:

(i) The current market price of ordinary shares is Ksh 30. The ordinary shareholders expect a dividend of Ksh 1.50 per share with a growth rate of 8% per year.

(ii) The market price of preference shares is Ksh 50 each while for debentures is Ksh 120 each. 2

(iii) The corporation tax rate is 30%.

$K_e = \frac{D_0}{P_1} \times G_0$

Determine:

$= \cancel{30}\ \frac{1.5}{30} \times 0.08$

(I) the cost of each component of capital. 2

(II) the weighted average cost of capital using historical values.

$WACC = K_e(e/v) + K_p(p/v) + K_d(d/v)$

(10 marks)

5. (a) Explain **four** reasons for preparing a cash flow statement. (8 marks)

(b) Kapitu Limited makes cash payments of Ksh 250,000 per annum. The interest rates on marketable securities is 10% and every time the company sells marketable securities, it incurs a cost of Ksh 500.

Using Baumol's cash management model determine:

(i) the optimal amount of marketable securities to be converted into cash every time the company makes a transfer.

(ii) the total number of transfers from marketable securities to cash per year.

(iii) the firm's average cash balance.

(iv) the total cost of maintaining the cash balance per year.

(12 marks)

6. (a) Explain **five** difference between domestic and international financial management.

4 (10 marks)

(b) Explain **five** non financial goals of a firm. 6 (10 marks)

7. (a) Explain **five** factors that may have contributed to the failure of indigenous financial institutions in Kenya. 4

(10 marks)

(b) Explain **five** factors that should be considered by management when selecting a source of finance for the firm. (10 marks)

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