



*(Knowledge for Development)*

**KIBABII UNIVERSITY**

**UNIVERSITY EXAMINATIONS  
2017/2018 ACADEMIC YEAR  
FOURTH YEAR SECOND SEMESTER  
SPECIAL/SUPPLIMENTARY EXAMINATION  
FOR THE DEGREE OF MASTER OF BUSINESS  
ADMINSTRATION**

**COURSE CODE: MBA 830**

**COURSE TITLE: FINANCIAL INSTITUTIONS AND MARKETS**

**DATE:** 16/10/2018

**TIME:** 2 HRS

**INSTRUCTIONS TO CANDIDATES**

Answer Question One in Section A and Any other TWO (2) Questions in Section B

TIME: 2 Hours

KIBUCO observes ZERO tolerance to examination cheating

*This Paper Consists of 2 Printed Pages. Please Turn Over.*



## SECTION A (COMPULSORY)

### QUESTION ONE

Q1 a) Assume you are Finance Director of a large Multinational company, listed on a number of International Stock Markets. The company is reviewing its corporate plan. At present, the company focuses on maximizing the shareholders wealth as its major goal. The Managing Director thinks this single goal is inappropriate and asks his co directors for their views on giving greater emphasis of the following:

- i) Cash flow generation
- ii) Profitability as measured by profits after tax and return on investment
- iii) Risk adjusted returns to shareholders
- iv) Performance improvement in a number of such areas such as concern for environment, employees remuneration and quality working conditions and customer satisfaction

Required

Provide the Managing Director with a report for presentation at the next board meeting which:

- a) Evaluate the argument that maximization of shareholder wealth should be only true objective of a company **(10mks)**
- b) Discusses the advantages and disadvantages' of the MDs suggestion about alternative goals**(8mks)**
- c) "The finance manager spends most of his time making managerial finance decisions as opposed to routine functions". Discuss.**(2 mks)**
- d) Agency theory presents the firm as a combination of competing interest groups, two of which are shareholders and management.

### REQUIRED

Discuss how the firm's attitude to risk might vary depending on whether shareholders objectives or management oriented goals predominate in the firm's planning. **(10 mks)**

**SECTION B ANSWER TWO QUESTIONS.**

**QUESTION TWO**

Q2. a) XYZ Company Ltd is short of working capital. The management of the company are considering either selling some of its assets or using them as collateral for raising loans from banks in bid to solve its problems. As a financial advisor to the company you are required to advise the management on the best course to be taken. What factors would you take into account in recommending the alternative sources of financing? (12mks)

b) In relation to capital investment appraisal projects state the areas that could create conflict of interest between the shareholders and the managers of the company (8mks)

**QUESTION THREE**

Q3 a) Four assets have the following distribution of returns.

<i>Probability Occurrence</i>	<i>Rate of return (%)</i>			
	<i>A</i>	<i>B</i>	<i>C</i>	<i>D</i>
0.1	10.0%	6.0%	14.0%	2.0%
0.2	10.0	8.0	12.0	6.0
0.4	10.0	10.0	10.0	9.0
0.2	10.0	12.0	8.0	15.0
0.1	10.0	14.0	6.0	20.0

**REQUIRED:**

- a. Compute the expected return and standard deviation of each asset.
  - b. Compute the covariance of asset
    - i. A and B
    - ii. B and C
    - iii. B and D
  - c. Compute the correlation coefficient of the combination of assets in b above. (10 mks)
- b) Futures contracts and options on futures contracts can be used to modify risk.

**REQUIRED:**

Identify the fundamental distinction between a futures contract and an option on a futures contract and explain the difference in the manner that futures and options modify portfolio risk. **(10 mks)**

#### **QUESTION FOUR**

a) To what extent are firms able to establish definite long run dividend policies? What factors would affect these policies? To what extent might these policies affect the market value of the firm's securities? Explain **(10mks)**

b) What assumptions and arguments are used by Modigliani and Miller in support of the irrelevance of dividends? Are dividends really irrelevant? If not, what are the arguments for relevance of dividend policy **(10mks)**

#### **QUESTION FIVE**

Q5 The Capital Asset Pricing Model (CAPM) has been identified as a method for estimating the cost of Equity Capital.

a) Identify and describe how this model might be applied in actual practice by a company. What is the major weakness in using CAPM as a method of valuing a firm? **(10 mks)**

b) Why would you consider the Arbitrage Pricing Theory to be much more robust than the Capital Asset Pricing Model **(10mks)**