



(Knowledge for Development)
KIBABII UNIVERSITY
UNIVERSITY EXAMINATIONS
2017/2018 ACADEMIC YEAR
SECOND YEAR FIRST SEMESTER

MAIN EXAMINATION
FOR THE DEGREE OF MASTERS IN BUSINESS
ADMINISTRATION

COURSE CODE: MBA 832

COURSE TITLE: CORPORATE FINANCE

DATE: 15/01/2018

TIME: 2.00 A.M – 4.00 P.M

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) For a future contract, the futures exchange specify in detail the exact nature and terms of the agreement between two parties. Discuss the various specifications of future contracts **(5mks)**

(b) Security returns depend on only three risk factors—inflation, industrial production and the aggregate degree of risk aversion. The risk free rate is 8%, the required rate of return on a portfolio with unit sensitivity to inflation and zero-sensitivity to other factors is 13.0%, the required rate of return on a portfolio with unit sensitivity to industrial production and zero sensitivity to inflation and other factors is 10% and the required return on a portfolio with unit sensitivity to the degree of risk aversion and zero sensitivity to other factors is 6%. Security i has betas of 0.9 with the inflation portfolio, 1.2 with the industrial production and -0.7 with risk bearing portfolio—(risk aversion)

Assume also that required rate of return on the market is 15% and stock i has CAPM beta of 1.1

REQUIRED:

Compute security i's required rate of return using

- a. CAPM
- b. APT **(5mks)**

c) "The finance manager spends most of his time making managerial finance decisions as opposed to routine functions". Discuss. **(5 mks)**

d) If you were a president of a large publicly owned corporation would you make decisions to maximize shareholder welfare or your own personal interest? What are some actions stockholders could take to ensure that management's interest and those of stockholders coincided? **(5 mks)**

e) What are the benefits corporate governance from the point of capital markets. Discuss some of the objectives **(5mks)**

f) Explain why and how a firm's cost of capital may decrease when the firm's stock is cross listed on the foreign securities exchange **(5mks)**

SECTION B

ANSWER TWO QUESTIONS.

QUESTION TWO

Q2. a) There are different categories of participants who make the derivatives market more transparent, increase liquidity and hence increase depth in the market. What are these categories of participants? Explain how they help in development of derivatives markets discussing the various types and their uses **(10 marks)**

b) How can finance function of international business improve the firm's competitive position in the global market place **(10mks)**

QUESTION THREE

Q3a) 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 FOUR

Q4 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. (5 mks)

b. Compute the covariance of asset

i. A and B

ii. B and C

iii. B and D (10 mks))

c. Compute the correlation coefficient of the combination of assets in b above. (5 mks)

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 (5 mks).

c) How can you describe empirical evidence concerning the three forms of efficient market hypothesis (5 mks)

End