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(Knowledge for Development)

**KIBABII UNIVERSITY
UNIVERSITY EXAMINATIONS**

2021/2022 ACADEMIC YEAR

THIRD YEAR SECOND SEMESTER

SPECIAL/SUPPLEMENTARY EXAM

**FOR THE DEGREE OF BACHELOR COMMERCE/BUSINESS
MANAGEMENT**

COURSE CODE: BCF312/BBM312

COURSE TITLE: CORPORATE FINANCE

DATE: 25TH JULY 2022

TIME: 8.00AM - 10.00AM

INSTRUCTIONS TO CANDIDATES

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

2. Question **one** carries **30**marks and each of the other two questions carry **20** marks each.

TIME: 2 Hours

KIBU observes ZERO tolerance to examination cheating

SECTION A

QUESTION ONE (COMPULSORY)

- a) Developing corporate governance structures and companywide ownership decisions that benefit shareholders (corporate governance function) is one of the key functions of Corporate Finance. In relation to this function you are required to:
- i) Discuss the types of agency problems **(3 marks)**
 - ii) Explain five causes of agency problems **(5 marks)**
- b) Reference to financial markets, explain the differences between money markets and capital markets. **(5 marks)**
- c) Asili Bank Limited has provided a proposal to Hardy real estates Limited whereby they intent to give Hardy an interest per annum of 5% for a placement of Kshs 100 million for 5 year period. Hardy are able to get 120 million after five years from Exotic venture capitalists.

Required:

Advice Hardy on the better option.

(4 marks)

- d) Evolution Micro Credit bank is expected to pay you dividend of Kshs6.60 per share in the coming year and to trade for Kshs55.50 per share at the end of the year. Investment with equivalent risk to Evolution bank have expected return of 7.8%.

Required:

Compute the price you would pay today for Evolution Micro Credit bankshare.

(4 marks)

- e) Blue Limited has four subsidiaries in which it has invested in the following properties:

Subsidiary	Proportion of investment - %	Beta
Green	50	0.7
White	30	0.9
Black	15	1.3
Yellow	5	1.5

Required:

- i) Holding Company's beta **(2 marks)**
 - ii) Assuming that the risk free rate is 7% and the market risk premium is 5%. Determine the holding company's rate of return. **(3 marks)**
- f) Discuss the factors that affect the capital structure of a firm **(4 marks)**

SECTION B

QUESTION TWO

- a) One of the advantages of analysis of financial statements of a corporate entity is to help avert financial failure. Discuss the causes of financial failure. **(5 marks)**
- b) Pacific group co-operative society has accumulated Kshs200,000 from member savings. The treasurer approaches you for advice since she wants to invest this money on fixed deposit which is offering 15% interest rate per annum for 4 years.

Required:

Advise her on how much income per year she should receive to recover her investment. **(5 marks)**

- c) Reference to the valuation theory; explain the factors that can affect the value of a security. **(4 marks)**
- d) Eagle Limited has investment capital of Kshs 20,000,000. It wishes to invest in two projects Y and Z in the following proportion Kshs 12 million in Y and Kshs 8 million in Z. The returns on these securities depend on the state of the economy as shown below:

State of the economy	Probability	Returns of Y	Returns of Z
Boom	0.4	18%	24%
Normal	0.5	14%	22%
Recession	0.1	12%	21%

Required:

Compute the expected portfolio returns **(5 marks)**

QUESTION THREE

- a) B&P limited have given you a 4 year contract as a Finance Director. They have offered you a consolidated monthly salary of Kshs 250,000 which translates to annual salary of Kshs3,000,000. The negotiated annual increment is 10%. The cost of capital is provided at 12%.

Required:

Calculate the present value of your salary. **(5 marks)**

- b) Millennium Ltd plans to pay Kshs 23 per share in dividends during the current financial year. Its equity cost of capital is 7% and the dividends grow at 5%. You are required to compute the value of Millennium stocks **(4 marks)**

- c) Discuss the assumptions of Gordon's model of dividend relevance theory. **(5 marks)**
- d) Explain three approaches to working capital management **(6 marks)**

QUESTION FOUR

- a) i) Distinguish between business risk and finance risk **(3 marks)**
ii) Discuss the factors that can affect business risk **(5 marks)**
- b) Evamba Limited investments are an all equity financial company with cost of capital of 12%. The company is considering the following capital projects:

Project	Initial capital outlay (' 000)	Expected cash flow in one year	Beta
A	4,000	4,380	0.3
B	4,000	4,520	0.5
C	6,000	7,120	0.1
D	8,000	9,540	1.5
E	8,000	9,600	2.0

The risk free rate is 10% and expected return on average market portfolio is 15%

Required:

- i) Using Capital Asset Pricing Model, evaluate the projects and show the ones that are acceptable. Justify your decision. **(10 marks)**
- ii) Compute the Evamba beta factor **(2marks)**

QUESTION FIVE

- a) Reference to international corporate finance, discuss the characteristics of multinational operations. **(5 marks)**
- b) Splendid Limited is a blue chip company whose growth prospects are good. It floated its shares to the public and last year made excellent earnings. The management board is in the process of drafting a dividend policy to be tabled before the shareholders at the forthcoming annual general meeting. Discuss the various dividend payment policies that they can adopt. **(10 marks)**
- c) Discuss the features of capital budgeting decisions **(5 marks)**