



TECHNICAL UNIVERSITY OF MOMBASA

SCHOOL OF BUSINESS

DEPARTMENT OF BUSINESS ADMINISTRATION

**UNIVERSITY EXAMINATIONS FOR DEGREE IN
BACHELOR OF COMMERCE/BUSINESS ADMINISTRATION**

BFI 4304: CORPORATE FINANCE

END OF SEMESTER EXAMINATIONS

SERIES: AUGUST 2019

TIME: 2 HOURS

INSTRUCTIONS:

You should have the following for this examination

-Answer Booklet, examination pass and student ID

Attempt Question ONE and any other TWO Questions.

Do not write on the question paper

Question ONE(COMPULSARY)

- a) Discuss the factors to be considered while deciding the capital structure of the firm.
- b) Given that a firm has 4%, Sh. 120,000 debentures, 8% preference shares amounting to Sh. 150,000, ordinary share worth 12%, Sh. 180,000 and retained earnings with 11%. Assume the tax rate is 50%. Compute the WACC.
(7 marks)
(10 marks)
- c) An agency relationship may be defined as a contract under which one or more people (the principals) hire another person (the agent) to perform some services on their behalf, and delegate some decision making authority to that agent. Within the corporate finance management framework, discuss the conflict of interest that exist in the agency relationship between:

- i. Shareholders and Managers (4marks)
- ii. holders and Shareholders (4marks)
 - d) Mr. Charo expects to receive Kshs 40,000 in four years' time. The discount rate is 14%. Compute the amount he requires to deposit today. (3 marks)
 - e) Saumu is offered a bond that pays coupon payments of Sh. 100 per year and continues for an infinite amount of time. Assuming a 5% discount rate determines the present value of the perpetuity. (2marks)

Question TWO

- a) Bahari Ltd., needs Sh. 3,000,000 for the installation of a new factory. The new factory expects to yield annual earnings before interest and tax (EBIT) of Sh. 500,000. In choosing a financial plan, Bahari Ltd., has an objective of maximizing earnings per share (EPS). The company proposes to issuing ordinary shares and raising debt of Sh. 300,000 and Sh. 1,000,000 of Sh. 1,500,000. The current market price per share is Sh. 250 and is expected to drop to Sh. 200 if the funds are borrowed in excess of Sh. 1,200,000. Funds can be raised at the following rates. –up to Sh. 300,000 at 8% –over Sh. 300,000 to Sh. 1,500,000 at 10% –over Sh. 1,500,000 at 15% Assuming a tax rate of 50% advice the company (14marks)
- b) Why is shareholder wealth maximization a more appropriate goal than a profit maximization (6marks)

Question THREE

Urber investments wants to investments in two securitie A and B. The following information relates to the two securities.

<i>Investment</i>	<i>Expected Return (%)</i>	<i>Proportion</i>
A	10	2/3
B	20	1/3

REQUIRED:

- a) Compute the expected return of a portfolio of the two assets. (3marks)
- b) Compute the portfolio standard deviation if the correlation coefficient between the assets is (7marks)
- c) The Capital Asset Pricing Model (CAPM) specifies the relationship between risk and required rate of return on assets when they are held in well-diversified portfolios. Discuss the limitations of CAPM (10marks)

Question FOUR

Write short notes on the following dividend theories:

- a) Residual dividend theory (4marks)
- b) Dividend irrelevance theory (MM) (4marks)
- c) Information Signaling Effect Theory (4marks)
- d) Bird in hand theory (4marks)
- e) Clientele theory (4marks)

Question FIVE

- a) The Black and Scholes option pricing model (OPM) was developed in 1973 explain its assumptions (12marks)
- b) Discuss the factors that affect the value of a call option (8marks)