TECHNICAL UNIVERSITY OF MOMBASA

SCHOOL OF BUSINESS

DEPARTMENT OF FINANCE AND ACCOUNTING

UNIVERSITY EXAMINATION FOR

BACHELOR OF COMMERCE

BFI 4410: ISSUES IN FINANCIAL MANAGEMENT A

END OF SEMESTER EXAMINATION

SERIES: APRIL 2025 **TIME:** 2 HOURS

INSTRUCTIONS: ANSWER QUESTION ONE (COMPULSORY) AND ANY OTHER TWO QUESTIONS.

Question ONE

(a) You have been asked for your advice in selecting a portfolio of assets and you have been given the following data.

Year		Return	
	Probability	Asset A	Asset B
2020	0.1	-6	16
2021	0.3	14	-6
2022	0.2	11	8
2023	0.3	8	14
2024	0.1	6	18

You have been told that you can create two portfolios consisting of Assets A and B by investing equal proportions (50%) in each of the two components.

(i) What is the expected return for each asset? **(4 marks)**
(ii) What is the standard deviation for each asset's return? **(4 marks)**
(iii) What is the expected return for the portfolio? **(4 marks)**
(iv) Calculate the covariance between the returns of securities A and B. **(4 marks)**
(v) What is the standard deviation of the portfolio? **(4 marks)**
(vi) What is the correlation of returns of the two assets making up the portfolio? **(4 marks)**

(b) Discuss the exit strategies available to a venture capitalist. **(6 marks)**

Question TWO

(a) Discuss the main limitations of CAPM. **(6 marks)**

(b) Calculate the expected rate of return for security x from the following information.

(4 marks)

Rf= 10% Rm = 22% B = 1.45

(c) From the following data compute beta of security j. **(4 marks)**

σ_j = 2% σ_m = 8% Cor_{jm} = +0.84

(d) An investor holds two equity shares A and B in equal proportion with the following risk
and return characteristics. **(6 marks)**

$E(R_A)$ = 24% $E(R_B)$ = 18%

σ_A = 26L% σ_B = 22%

The returns of these securities have a positive correlation of 0.72. You are required to:

(i) Calculate the portfolio return.

(ii) Calculate the portfolio risk

Question THREE

(a) Explain the stages of venture capital financing. **(8 marks)**

(b) Venture capital activity is a sequential process involving the following steps. Discuss: **(12 marks)**

Question FOUR

(a) Discuss the benefits a merger is expected to generate. **(10 marks)**

(b) Describe the tactics of a target company can use to defend itself from hostile takeover through a tender offer. **(10 marks)**

Question FIVE

As the finance manager of Abbay Ltd., you are investigating the possible acquisition of Oceanic Ltd. You have the following basic data:

	Abbay	**Oceanic**
Earnings per share (expected next year	Shs.5	Shs.1.50
Dividends per share (expected next year)	Shs.3	Shs.0.80
Number of shares	1 million	0.6 million
Share price	Shs.90	Shs.20

Investors currently expect a steady growth of about 6% Oceanic earnings and dividends. Under new management, this growth rate would be increased to 8% per year, without any additional capital investment.

Required:

(a) What is the gain from the acquisition? **(5 marks)**

(b) What is the cost of the acquisition if Abbay Ltd pays shs.25 in cash for each Oceanic share? Should it go ahead? **(5 marks)**

(c) What is the cost of the acquisition if Abbay Ltd offers one of its own shares for every 3 shares of Oceanic Ltd? Should it go ahead? **(5 marks)**

(d) How would the cost of the cash offer after if the expected growth rate of Oceanic were not changed by the takeover? Does it affect the decision? **(5 marks)**