TECHNICAL UNIVERSITY OF MOMBASA

School of Business
Department of ACCOUNTING & Finance

UNIVERSITY EXAMINATION FOR:
BACHELOR OF COMMERCE
BFI 4410: ISSUES IN FINANCIAL MANAGEMENT
SUPPLEMENTARY AND SPECIAL EXAMINATIONS
SERIES: NOVEMBER 2024
TIME: 2HOURS

Instructions to Candidates
You should have the following for this examination
-Answer Booklet, examination pass and student ID
This paper consists of **FIVE** questions. Attempt question ONE (Compulsory) and any other TWO questions.
Do not write on the question paper.
QUESTIONS 1. (COMPULSORY)

a) Explain the importance of risk in capital budgeting (5 marks).

b) The returns on investment in two projects, X and Y have standard deviations of 30% and 45% respectively. The correlation coefficient between the returns on the two investments is 0.2. What is the standard deviation of a portfolio containing equal proportions of the two investments? (8 marks).

c) Which of the following shares are over-valued?

	Beta	**Current Rate of Return**
A	0.7	7%
B	1.3	13%
C	0.9	9%.

The risk-free rate is 5%, and the return on the market index is 10%. (4marks).

d) What are the important features of a convertible security? What reasons are generally given for issuing convertible securities? (8 marks).

e) What is the market value of a warrant that gives the right to buy one new share for every four shares held, given the market price per share is sh8, and the exercise price is sh5? (5 marks)

(Total = 30 marks).

QUESTION 2.

The following figures relate to monthly observations of the percentage return on widely used stock market index (R_m) and the return on a particular ordinary share (R_j) over a period of six months.

Month	**R_m**	**R_j**
1	5	4
2	-10	-8
3	12	9.6
4	3	2.4
5	-4	-3.2
6	7	5.6

Required

a) Plot these data on a graph and deduce the value of the beta coefficient (8 marks).

b) To what extent are variations in R_m due to specific risk factors? (7 marks).

c) Calculate the systematic risk of the security (NB: systematic risk =$B^2 6^2{}_m$). (5 marks).

QUESTION 3

a) Venture capital (VC) is a significant financial innovation of the twentieth century. What is meant by venture capital (6 marks).

b) Explain importance features of venture capital (6marks).

c) What are the stages in venture capital financing? (8 marks).

QUESTION 4.

An investor holds the following portfolio of four risky assets and a deposit in a risk-free asset. The table shows their respective portfolio weightings and the current returns on the assets, together with their beta coefficient.

Asset	**Weighting (%)**	**Current Returns (5%)**	**Beta**
A	20	12.0	1.5
B	10	18.0	2.0
C	15	14.0	1.2
D	25	8.0	0.9
Risk-free asset	30	5.0	0

The overall return on the market portfolio of risky assets is 11% and this is expected to continue for the foreseeable future.

Required.

a) What is the current return on the whole portfolio and its Beta value? (5 marks).

b) Which of the four risky assets (if any) appear to be inefficient /efficient/super-efficient? (5 marks).

c) In view of the answer to (b), what predictions would you make regarding future assets values and, hence, their rate of return as the market moves to full equilibrium (5 marks).

d) What is the equilibrium return on this portfolio? (Assume the weightings remain unchanged). (5 marks).

QUESTION 5.

Discuss the benefits that a merger is expected to generate? (20 marks).