JARAMOGI OGINGA ODINGA UNIVERSITY OF SCIENCE AND TECHNOLOGY

SCHOOL OF BUSINESS & ECONOMICS

UNIVERSITY EXAMINATION FOR THE DEGREE OF BACHELOR OF BUSINESS ADMINISTRATION WITH IT

4TH YEAR 2ND SEMESTER 2019/2020 ACADEMIC YEAR

COURSE CODE: ABA 420

COURSE TITLE: Corporate Finance

EXAM VENUE: **STREAM: (BBA FINANCE)**

DATE: **EXAM SESSION:**

TIME: 2 HOURS

Instructions:

1. **Answer questions ONE and ANY other 2 questions**
2. **Candidates are advised not to write on the question paper.**
3. **Candidates must hand in their answer booklets to the invigilator while in the examination room**

<u>Question One</u>

(a) Briefly explain the following types of exchange rate exposures as used in international financial management;

(i) Transaction exposure. (2 marks)

(ii) Translation exposure. (2 marks)

(iii) Economic exposure. (2 marks)

(b) Highlight any THREE advantages of using ordinary share capital in financing. (6 marks)

(c) Identify and briefly explain any THREE managerial functions of a finance manager. (9 marks)

(d) Assume that the direct quote between the \$ and £ is £1 = \$ 1.580 and that the inflation rate in UK is 9% and the inflation rate in the US is 5%.

Required

Compute the % change in the direct quote and determine the new exchange rate. (4 marks)

(e) "Discounted payback ensures that you don't accept an investment with negative NPV, but it can't stop you from rejecting projects with a positive NPV." Illustrate why this can happen. (5 marks)

(Total: 30 marks)

<u>Question Two</u>

Chinche plc. has bought goods from a US supplier and must pay \$4,000,000 for them in three months' time. The company's finance director wishes to hedge against the foreign exchange risk, and the three methods which the company usually considers are;

- ✓ Forward exchange contracts.
- ✓ Money market borrowing or lending.
- ✓ Lead payments.

The following annual interest rates and exchange rates are currently available to Chinche plc.

	US dollar		Sterling	
	Deposit rate	Borrowing rate	Deposit rate	Borrowing rate
	%	%	%	%
1 month	7	10.25.	10.75	14.00
3 months	7	10.75	11.00	14.25

Exchange rate per £1

Spot	$1.8625 - $1.8635
1 month forward	$1.8565 - $1.8577
3 months forward	$1.8445 - $1.8460

Required:
Evaluate the cheapest method for Chinche plc.

(Total: 20 marks)

Question Three

(a) Briefly explain the following THREE major types of mergers;
   (i) Horizontal merger. (3 marks)
   (ii) Vertical merger. (3 marks)
   (iii) Conglomerate merger. (3 marks)

(b) Identify and explain any TWO takeover defenses available to a target company threatened by an unwelcome suitor. (4 marks)

(c) Give brief explanations on the following motives and benefits of mergers and acquisitions;
   (i) Enhanced profitability. (4 marks)
   (ii) Diversification of risk. (3 marks)

(Total: 20 marks)

Question Four

(a) Distinguish between debt and equity capital. (6 marks)

(b) What are the advantages of leasing an asset compared to borrowing to buy an asset? (6 marks)

(c) Market for venture capital is not yet well developed in developing countries. Give any FOUR reasons for this slow development. (8 marks)

(Total: 20 marks)

Question Five

(a) Explain fully the effect of the use of debt capital on the weighted average cost of capital of a company. (4 marks)

(b) Millennium Investments Ltd. wishes to raise funds amounting to Sh.10 million to finance a project in the following manner:

Sh.6 million from debt; and

Sh.4 million from floating new ordinary shares.

The present capital structure of the company is made up as follows:

1. 600,000 fully paid ordinary shares of Sh.10 each
2. Retained earnings of Sh.4 million
3. 200,000, 10% preference shares of Sh.20 each.
4. 40,000 6% long term debentures of Sh.150 each.

The current market value of the company's ordinary shares is Sh.60 per share. The expected ordinary share dividends in a year's time is Sh.2.40 per share. The average growth rate in both dividends and earnings has been 10% over the past ten years and this growth rate is expected to be maintained in the foreseeable future.

The company's long term debentures currently change hands for Sh.100 each. The debentures will mature in 100 years. The preference shares were issued four years ago and still change hands at face value.

Required:

(i) Compute the component cost of:
- Ordinary share capital; (2 marks)
- Debt capital (2 marks)
- Preference share capital. (2 marks)

(ii) Compute the company's current weighted average cost of capital. (5 marks)

(iii) Compute the company's marginal cost of capital if it raised the additional Sh.10 million as envisaged. (Assume a tax rate of 30%). (5 marks)

(Total: 20 marks)