



JARAMOGI OGINGA ODONGA UNIVERSITY OF SCIENCE AND TECHNOLOGY
SCHOOL OF BUSINESS & ECONOMICS
UNIVERSITY EXAMINATION FOR THE BACHELOR OF BUSINESS
ADMINISTRATION WITH IT (FINANCE OPTION)
4TH YEAR 2ND SEMESTER 2024/2025 ACADEMIC YEAR
MAIN CAMPUS

COURSE CODE: BAB 1418

COURSE TITLE: CORPORATE FINANCE

EXAM VENUE: LAB 6

DATE: 16/04/2025

EXAM SESSION: 9.00 – 11.00 AM

DURATION: 2 HOURS.

INSTRUCTIONS

- 1. Answer QUESTION ONE and any other TWO questions**
- 2. Show ALL your workings and be as NEAT as possible.**
- 3. Candidates are advised not to write on the question paper**
- 4. Marks allocated to each question are shown at the end of the question.**

QUESTION ONE (30 MARKS)

- a) Plastic money, which includes credit cards, debit cards, and mobile money services, has become increasingly prevalent in Kenya. This shift towards cashless transactions has significant implications for various financial institutions, particularly Savings and Credit Cooperative Societies (SACCOs). Discuss the impact of plastic money transactions on the financial performance of Savings and Credit Cooperative Societies (SACCOs) in Kenya. (4 marks)
- b) Two firms exist; A and B and are identical except that A does not use any debt in its financing while B has a debt of shs. 300,000, 6% debentures in financing. Both firms have Earnings Before Interest and Taxes (EBIT) of shs. 80,000 and with overall capitalization rate of 10%. Assuming the corporation tax is 35%, determine the value of each firm and explain the difference in firm value in relation to debt usage in its capital structure. (5 marks)
- c) Assume there are 20 firms in the industry, each with 5% market share. Also assume that firms 19 and 20 decide to merge. Calculate the pre – merger and post – merger **Herfindahl – Hirschman Index (HHI)** and discuss the likelihood of an antitrust challenge of the merger. (5 marks)
- d) You have been hired by the management of a multinational company to advise on the management of its foreign exchange exposure.
- Discuss the main types of foreign exchange exposure (6 marks)
 - Advise on the policies which could be considered to provide valid and relevant methods of reducing exposure to foreign exchange risk. (6 marks)
- e) Discuss two assumptions of the Capital Asset Pricing Model (CAPM) and evaluate the extent to which these assumptions hold true in real-world financial markets, considering potential implications for investors and portfolio managers. (4 marks)

QUESTION TWO (20 MARKS)

- a) Kipindi Ltd co wishes to establish a capital structure of shs. 3,000,000. The objective is to install a new factory. The new factory expects to yield annual earnings before interest and taxes of shs. 500,000. In choosing a financial plan, Kipindi Ltd has an objective of maximizing earnings per share (EPS). The company proposes to issuing ordinary shares and raising debt of either shs. 300,000 or shs. 1,000,000 or shs. 1,500,000. The current market price per share (MPS) is shs. 250 and expected to drop to shs 200 if the funds are borrowed in excess of shs. 1,200,000. Funds are procured from the capital markets at the following rates.
- Up to shs. 300,000 @ 6%.
 - Over shs. 300,000 to 1,400,000 @ 8%.
 - Over 1,400,000 to 1,500,000 @ 13%.

The company corporation tax rate is 35%.

Required: Advise the firm as to which option is better for financing their installation of a new factory. (16 marks)

b) Discuss the following pre – offer defence mechanisms employed by managers to resist a hostile takeover in mergers and acquisitions.

- i) Golden Parachute (2 marks)
- ii) Poison Put (2 marks)

QUESTION THREE (20 MARKS)

a) A 1 – year call option on Cross Reef inc. with an exercise price of sh. 50 is trading for sh.8. the current stock price is sh 52. The risk-free rate is 4%. Calculate the price of the Synthetic put option implied by Put – Call Parity. (5 marks)

b) Kuteleza ltd has ksh 6,000,000 in debt at 5% interest. The company’s expected level of Earnings before interest and taxes (EBIT) is ksh 2,000,000. The Overall cost of capital is 10% and is expected to remain constant.

Required: Determine the market value of the firm, hence the cost of external equity. (5 marks)

c) Name after its founders, Fisher Black, Myron Scholes and Robert Merton, the Black – Scholes – Merton (BSM) model earned Scholes and Merton a Nobel prize in 1997 for developing the model, two years after the death of Fisher Black in 1995.

In relation to the above statement, discuss the five inputs of the Black – Scholes – Merton (BSM) model. (10 marks)

QUESTION FOUR (20 MARKS)

a) Ngozi Ltd. is considering the acquisition by shares of Mifupa Ltd.. The following information is also available.

	Ngozi Ltd.	Mifupa Ltd.
Present earnings	Kshs 30,000,000	Kshs7, 500,000
Shares	7,500,000	3,000,000
Earnings per share	Kshs 6	Kshs 3.75
Price/earnings ratio	24	18
Price of shares	Kshs 64	Kshs 30

Mifupa Ltd. has agreed to an offer of Kshs 52.5 a share to be paid in Ngozi Ltd’s shares.

REQUIRED: Consider the effect of the acquisition to the earnings per share. (10 marks)

b) Suppose you have a stock currently priced at sh50, and a two – period European call option is available with a strike price of sh 45. The size of an up move is 1.25. the risk-free rate per period is 7%.

Required; The value of the call option using a two – period binomial option pricing model.

(10 marks)

QUESTION FIVE (20 MARKS)

- a) Distinguish between operating lease and finance leases as financing options for businesses. (4 marks)
- b) Distinguish between Systematic and Non – Systematic risk and explain how each can be managed. (5 marks)
- c) J Kutuny is considering a number of investment opportunities. Assuming that the risk-free rate is currently 6 per cent and the expected return from the market is 13 percent calculate, using the CAPM, the rates of return that J Kutuny should expect each investment to earn.

Security	Beta
A	0.90
B	1.30
C	0.60
D	1.50

Required: Expected return on each security (4 marks)

- d) Zenith and Mackenzie Investment Consultants Ltd employs a two factor Arbitrage pricing theory (APT) model to measure portfolio risk and return for their client's investments. The following information is available;

	Factor 1	Factor 2
Investment Fund beta	1.5	2
Risk premium	0.03	0.0125

The risk free rate is 5%.

Required; The expected return for the investment fund (5 marks)

- e) Explain why an investor will get different return estimates between CAPM and APT when determining expected returns despite using the same data. (2 marks)