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**University Examinations 2014/2015**

FOURTH YEAR, SECOND SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR OF COMMERCE

**HBC 2226: ISSUES IN FINANCIAL MANAGEMENT**

**DATE: DECEMBER 2014 TIME: 2 HOURS**

**INSTRUCTIONS:** *Answer question* ***one*** *and any other* ***two*** *questions*

**QUESTION ONE**

1. Discuss the difference between capital market line and security market line

(8 marks)

1. Thefollowing table show the returns of three major classes of risky assets, the market and zero beta security under four state of nature:

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **state** | **probability** | **Market return Rm** | **Securities rate of return** | | | | **Return on a zero beta security** |
| **RA** | **RB** | **RC** | **RD** | **RZ** |
| S1 | 0.1 | -30% | -46% | -400% | -40 | -40 | 2% |
| S2 | 0.2 | -10 | -26 | -50 | -20 | -20 | 5 |
| S3 | 0.3 | 10 | 46 | 0 | 0 | 60 | 6 |
| S4 | 0.4 | 30 | 0 | 100 | 70 | 0 | 10 |

**Required:**

Determine which of the three securities you will invest in using CAPM (12 marks)

1. Explain the benefits of E commerce in financial management (6 marks)
2. Explain the differences between the option and a future as tool for hedgind risk

(4 marks)

**QUESTION TWO**

1. Explain the differences between Markowitz model and the market model of portfolio theory (6 marks)
2. The following are the excess return on two securities A and B and that of the market over 4 periods.

|  |  |  |  |
| --- | --- | --- | --- |
| Periods | Excess return on market (%) | Excess return on securities (%) | |
| A | B |
| 1 | 12 | 24 | 0 |
| 2 | 16 | 18 | 10 |
| 3 | 16 | 16 | 20 |
| 4 | 14 | 8 | 28 |

**Required:**

1. Determine the characteristic line for the securities (8 marks)
2. Calculate non market risk for the two securities (6 marks)

**QUESTION THREE**

1. Explain the limitations of composite performance measure (4 marks)
2. The following data is about the returns of two portfolio X and Y and that of the market under four state of nature:

State probability portfolio returns (%) market returns(%)

X Y

1 12 16 8

2 14 8 6

3 18 10 10

4 15 14 9

The risk free rate during the period was 4%

**Required:**

Evaluate the performance of the above three portfolio using

1. Sharpe measure (3 marks)
2. Treynor measure (5 marks)
3. Jensen Alpha (8 marks)

**QUESTION FOUR**

1. Explain the difference between Crown Jewels and White Knight as a defense against hostile takeovers (5 marks)
2. Explain various methods used in determining the value of the target firm (8 marks)
3. Strong ltd wishes to takeover Weak ltd. the financial details of the two companies before takeover were as follows:

|  |  |  |
| --- | --- | --- |
|  | **Strong ltd (000)** | **Weak ltd (000)** |
| Equity shares of ksh 10 each  Share premium account  Profit and loss account  Preference shares  10% debentures  Non-current assets  Net current assets  Market price per equity shares  Price earnings ratio | Ksh 100,000  -  38,000  20,000  15,000  122,000  51,000  24  10 | Ksh. 50,000  2,000  4,000  -  5,000  35,000  26,000  27  9 |

**Required:**

What offer will ltd make to Weak ltd in terms of exchange ratio based on:

1. Net asset value (3 marks)
2. Earnings per share (2 marks)
3. Market price per share (2 marks)

**QUESTION FIVE**

1. Discuss why derivative market is not developed in Kenya (8 marks)
2. Explain the applications of real option in finance (8 marks)
3. Explain the role of credit referencing bureau in Kenya (4 marks)