The Co-operative University of Kenya

END OF SEMESTER EXAMINATION JANUARY 2022

EXAMINATION FOR THE BACHELOR OF CO-OPERATIVE BUSINESS (YR II SEM II)

UNIT CODE: BCFF 2405

UNIT TITLE: ISSUES IN FINANCIAL MANAGEMENT

DATE: 18TH JANUARY, 2022 **TIME: 8:00 AM – 10:00 AM**

INSTRUCTIONS:

- Answer question **ONE (compulsory)** and any other **TWO** questions

QUESTION ONE

(a) State the assumptions of Capital Asset Pricing Model (CAPM). (6 marks)

(b) Security returns depend on only three risk factors-inflation, industrial production and the aggregate degree of risk aversion. The risk free rate is 8%, the required rate of return on portfolio with unit sensitivity to inflation and zero-sensitivity to other factors is 13.0%, the required rate of return on a portfolio with unit sensitivity to industrial production and zero sensitivity to inflation and other factors is 10% and the required return on a portfolio with unit sensitivity to the degree of risk aversion and zero sensitivity to other factors is 6%. Security L has betas of 0.9 with the inflation portfolio, 1.2 with the industrial production and -0.7 with risk bearing portfolio (risk aversion)

Assume also that required rate of return on the market is 15% and stock I has CAPM beta of 1.1

Required:

Compute security I's required rate of return using

(i) CAPM (4 marks)

(ii) APT (4 marks)

(c) What are advantages of E-commerce to customers? (6 marks)

(d) You have been invited as a guest speaker in a workshop and the theme of the workshop is *mergers and acquisition in the 21st Century.* One of the Chief Executive Officer (CEO) made the following statement, "Many cases of mergers and acquisitions provide some evidence that the act usually results in failure rather than success. Post-merger, the newly formed organization may fail to generate adequate benefits due to the differences in corporate cultures, marketing strategies and regions they serve. When a merger can be seen as an investment, the interesting question to answer will be: Is it possible to achieve a successful merger for sure? The hold-up problem can arise when the firms try to accommodate post-merger and overcome the firms' differences to achieve synergy"

Required;

i) Discuss the types of mergers and acquisitions (6 marks)

ii) Explain any Four reasons for mergers giving relevant examples in each case (4 marks)

QUESTION TWO

(a) Briefly explain your strategies which might be open to a company intending to avoid being acquired by another company (8 marks)

(b) Mahola Company is considering the acquisition by shares of Wasini Company. The following information is also available:

	Mahola Company	Wasini Company
Present earnings	Kshs.20,000,000	Kshs.5,000,000
Shares	Kshs.5,000,000	Kshs.2,000,000
Earnings per share	4	Kshs.2.50
Prince/earnings ratio	16	12
Prince of shares	64	30

Wasini Company has agreed to an offer of Kshs.35 a share to be paid in Mahola company shares.

Required:

Consider the effect of the acquisition to the earnings per share (12 marks)

QUESTION THREE

XYZ ltd. is considering three possible capital projects for next year. Each project has a 1 year life, and project returns depend on next years state of the economy. The estimated rates of return are shown below.

STATE OF THE ECONOMY	PROBABILITY OF OCCURRENCE	RATE OF RETURN A	B	C
Recession	0.25	10%	9%	14%
Average	0.50	14%	13%	12%
BOOM	0.25	16%	18%	10%

Required;

(a) Compute the expected return and standard deviation of each asset. (8 marks)

(b) Compute the covariance of asset

i. A and B (2 marks)

ii. A and C (2 marks)

iii. B and C (2 marks)

(c) Compute the correlation coefficient of the combination of assets in b above. (6 marks)

QUESTION FOUR

(a) Explain the forms which e-commerce may take (6 marks)

(b) Explain the following types of e-commerce.

1. Business-to-Consumer (B2C) (2 marks)
2. Consumer-to-Consumer (C2C) (2 marks)
3. Consumer-to-Business (C2B) (2 marks)
4. Business-to-Administration (B2A) (2 marks)

(c) State the assumptions of Black and Scholes option pricing model (6 marks)