MAASAI MARA UNIVERSITY

REGULAR UNIVERSITY EXAMINATIONS
2023/2024 ACADEMIC YEAR
FOURTH YEAR FIRST SEMESTER

SCHOOL OF BUSINESS AND ECONOMICS
BACHELOR OF COMMERCE

COURSE CODE: BCM 4114-1
COURSE TITLE: FINANCIAL ECONOMICS

DATE: 7/12/ 2023 **TIME: 1430 – 1630 HRS**

INSTRUCTIONS TO CANDIDATES

Answer question **ONE** and any other **THREE** questions

This paper consists of 3 printed pages. Please turn over

QUESTION ONE

(a) You are the finance manager of Bottom-Up Inc, a construction support company. Discuss the core focus areas mandated for your office. **(6marks)**

(b) An amount of money received today is worth more than the same amount received a year from now**.** Discuss **(6marks)**

(c) Given $FV_n = PV \times (1 + i)^n$. Solve for number of years (n) **(5marks)**

(d) Explain what a banker should look for in a business before extending a loan to it (business) **(3marks)**

QUESTION TWO

(a) You agree to receive Ksh. 80,000 at the end of every year for 6 years in an investment fund that earns 12.5 percent interest.

i. How much should someone offer you now to make you at least as good as earning from the investment fund? **(3marks)**

ii. If you now agree to receive Ksh.50,000 at the beginning of every year, how will your results in (i) change? **(3marks)**

iii. Will a perpetuity with similar terms make you better off or worse off? (show your work clearly) **(3marks)**

(b) Business value is affected by variables relative to specific shareholding. Discuss these variables **(6marks)**

QUESTION THREE

(a) Discuss the two main methods within the asset approach in business valuation **(8marks)**

(b) Suppose you are involved in a project that uses environmentally sensitive chemicals. It may cost you a great deal to dispose of them. And that will mean negative cash flow at the end of the project. Suppose your project has a cash flow as follows:

Period	End of period cash flow (US$)
0	-100
1	260
2	260
3	-490

What is this project's IRR? **(7marks)**

QUESTION FOUR

(a) Modigliani and Miller (MM) argued that a firm cannot change the total value of its outstanding securities by changing the proportions of its capital structure. In other words, the value of the firm is always the same under different capital structures. This is the **MM proposition I.** To prove this proposition, Modigliani and Miller placed several assumptions. Discuss these assumptions. **(8marks)**

(b) The stock of Ole Karei Enterprises has a beta of 2.7 and that of Mau Complex Enterprises has a beta of 1.6. The risk-free rate is 12 percent, and the expected return on the market 23.5 percent. Compute the expected returns on the two securities: **(7marks)**

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