



MAASAI MARA UNIVERSITY

**REGULAR UNIVERSITY EXAMINATIONS
2022/2023 ACADEMIC YEAR
FOURTH YEAR SECOND SEMESTER**

**SCHOOL OF BUSINESS AND ECONOMICS
BACHELOR OF FINANCIAL ECONOMICS**

COURSE CODE: ECF 4206

COURSE TITLE: FINANCIAL ECONOMICS

DATE: 19/4/2023

TIME: 1100-1300 HRS

INSTRUCTIONS TO CANDIDATES

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

*This paper consists of **four** printed pages. Please turn over.*

QUESTION ONE

a) Distinguish between the following terms in relation to financial economics

i. Dividend yield and Capital gain **(2 marks)**

ii. Direct finance and Indirect finance **(2 marks)**

iii. Systematic Risk and Unsystematic Risk **(2 marks)**

b) You are given the following information about CMK Company.

Tangible asset valuation 120,000

Average annual normalized income 600,000

Required return to support tangible assets 10%

Capitalization rate for excess earnings 20%

Given the above information, use the excess earnings method to calculate

the value of the firm **(10 marks)**

c) The social value of financial intermediation can be assessed in terms of its direct relevance to an average person in the process of provision of financial services. Define financial intermediation and discuss its value of to an individual. **(9 marks)**

QUESTION TWO

a) Explain the basic functions that define the practice of corporate finance

(5marks)

b) Dan is trying to sell a piece of land in Narok. Yesterday, he was offered Ksh.10, 000 for the property. He was about to accept the offer when another individual offered him Ksh.11, 424. However, the second offer was to be paid a year from now. Dan has satisfied himself that both buyers are honest

and financially solvent. At the moment, Dan's bank offers a 12 percent interest rate. Which offer should Dan take? **(10 marks)**

QUESTION THREE

a) An investor is interested in investing in a Company listed on the Nairobi Stock Exchange; critically evaluate the variables that they should consider before making decisions on which Company to invest in **(10 marks)**

b) You are given the following information on the expected net cash inflow from a firm

Year	1	2	3	4	5	6
Expected net cash flow (millions KES)	1200	1300	1500	1700	1800	1900

Assume that the discount rate is 20% and the expected long term growth rate following year 6 is 10%; calculate the value of the firm. **(5 Marks)**

QUESTION FOUR

a) Two companies Ocean Ltd and River Ltd are identical in every respect except that Ocean Ltd is unlevered while River is levered with a debt of Kshs 50,000,000 carrying 6% interest. Both firms have an annual operating income of Kshs 10,000,000. Both firms have a Return on Equity (ROE) of 10%. Assuming absence of taxes, show that the value of both firms will be equal when certain market conditions exist **(5 marks).**

b) Discuss the income theory of the valuation of an organizations business
(5 marks)

c) State and explain the assumptions of the capital asset pricing model
(5 marks)

QUESTION FIVE

a) Explain the Gordon growth theory and show how it can be used in valuation of a business
(3marks)

b) Explain the three goals of a financial manager within the context of corporate finance
(6 marks)

c) XYZ Ltd wishes to invest in three projects, A, B and C. All the projects are expected to grow perpetually at 8 percent. The cost of capital is 24 percent, 20 percent and 16 percent for projects A, B and C respectively. The total cost of each project is estimated to be KES 6,000,000.

You have been given the following additional information:

Period	Project A	Project B	Project C
	Net cash flow KES	Net cash flow KES	Net cash flow KES
1	2000000	3000000	2000000
2	3700000	2200000	2100000
3	2400000	2000000	1200000
4	900000	1500000	3400000
5	1100000	800000	1000000

Which project will post the highest returns at the end of their discrete period?
(6 marks)

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