

THE COOPERATIVE UNIVERSITY OF KENYA
UNIVERSITY EXAMINATIONS FOR THE YEAR 2018/2019
YEAR IV SEMESTER II EXAMINATION FOR THE DEGREE OF BACHELOR OF
COOPERATIVE BUSINESS

HCOB 2404: ISSUES IN FINANCIAL MANAGEMENT

DATE: AUGUST 2019

TIME: 2 HOURS

INSTRUCTIONS: ANSWER QUESTION ONE AND ANY OTHER TWO QUESTIONS

QUESTION ONE

- (a) Derivatives have been widely used by firms in hedging rather than speculation. Explain the justifications for the use of hedging. [5 marks]
- (b) Highlight the reasons for financial restructuring [4 marks]
- (c) What are advantages of E-commerce to customers? [5marks]
- (d) Explain the three main types of traders [6 marks]
- (e) What are the factors considered in forecasting the future expected cash flows? [6 marks]
- (f) Highlight the various types of mergers. [4 marks]

[Total: 30 marks)

QUESTION TWO

- a. Consider a nine month futures contract on a non-dividend paying stock with a share price of shs. 60 and a risk free rate of 10% per annum. The theoretical futures price is shs. 64.67.
Determine the cash and carry arbitrage opportunity if the actual future price available in the market is:
- (i) Shs. 65
(ii) Shs. 64

[10 marks]

- b. Phoenix Bora Ltd is an all equity financed company with a cost of capital of 18.5%. The company is considering the following capital investment projects:

Project	Initial outlay Kshs. '000'	Expected cashflow in one year Kshs. '000'	Beta
A	1,000	1,095	0.3
B	1,000	1,135	0.5
C	1,500	1,780	1.0
D	2,000	2,385	1.5
E	2,000	2,400	2.0

The risk free rate is 8% and the expected return on an average market portfolio is 15%.

Required:

Using the Capita Asset Pricing Model (CAPM), show the projects that are acceptable [10 marks]

QUESTION THREE

- a. The possible returns of security i and research returns under three possible states are as follows;

Probability	% market	% security i
0.2	15	10
0.5	13	16
0.3	25	30

The risk free rate is 9%. Determine the required rate of return of security i and state whether it is correctly valued. [12 marks]

- b. Give steps involved in financial restructuring [8 marks]

QUESTION FOUR

- (a) What are the limitations of CAPM

[6 marks]

- (b) Four assets have the following distribution of returns:

Probability of Occurrence	Rate of Return (%)			
	A	B	C	D
0.1	10	6	14	2
0.2	10	8	12	6
0.4	10	10	10	9
0.2	10	12	8	15
0.1	10	14	6	20

Required:

- i) Compute the co-variance of asset
 - A and B
 - B and C
 - B and D
- ii) Compute the correlation co-efficient of each combination of assets in (i) above
- iii) Comment on the best combination of assets above to achieve diversification of portfolio [14 marks]

[Total: 20 marks]