



THE CATHOLIC UNIVERSITY OF EASTERN AFRICA

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MAIN EXAMINATION

JANUARY – APRIL 2019 TRIMESTER

FACULTY OF COMMERCE

DBA PROGRAMME

CAF 700: FINANCE THEORY AND PRACTICE

Date: APRIL 2019

Duration: 3 Hours

INSTRUCTIONS: Answer any THREE Questions

- Q1. a) You have recently graduated with a DBA from CUEA and have been appointed the Financial Manager of Biashara Limited, a large corporation in the manufacturing industries. Discuss your role in the organization. **(10 marks)**
- b) The goal of shareholder wealth maximization is more superior to profit maximization goal. Discuss. **(10 marks)**
- Q2. Krest Limited is a newly listed company at the Nairobi Securities Exchange. Last year the company had a successful initial public offer (IPO) and raised \$20m. The company however requires additional funds for new investment projects already identified. The finance manager is considering raising the additional funds and has the following information:
- i) Issue 10% preferred stock of \$5m at the market price of \$150 per share.
 - ii) Issue debentures of \$8m at a market price of \$250 per stock debt. The interest to be paid is 10% per annum.
 - iii) The share capital was issued at \$100 each with a floatation cost of \$20 per share.
 - iv) The expected ordinary dividend is \$5 growing annually at a constant rate of 2%.
 - v) The corporate tax rate is 40%.

Required:

- a) Discuss the process to be followed in raising capital through an IPO. **(4 marks)**
- b) What are the advantages and disadvantages of raising capital through the IPO. **(4 marks)**
- c) Calculate the expected weighted average cost of capital for Biashara Limited. **(4 marks)**
- d) What would you advise Biashara Limited if the required rate of return is 8%. **(4 marks)**
- e) Are there any other important matters that the management of Biashara Limited should consider in choosing the mode of financing other than the cost? **(4 marks)**
- Q3. a) The Capital Asset Pricing Model (CAPM) has been identified as a method for estimating the cost of Equity Capital. Identify and describe how this model might be applied in actual practice by a company. **(8 marks)**
(8 marks)
- b) What is the major weakness in using CAPM as a method of valuing a firm? **(6 marks)**
- c) Why would you consider the Arbitrage Pricing Theory (APT) to be much more robust than the Capital Asset Pricing Model? **(6 marks)**
- Q4. The Efficient Market Hypothesis states that the market price is always correct and therefore it is not possible for an investor to make money from investing in shares. Outline the main points you would make on a discussion on the statement. **(20 marks)**

END