



FACULTY OF BUSINESS SCIENCES AND MANAGEMENT

DEPARTMENT OF ACCOUNTING

BACHELOR OF COMMERCE HONOURS DEGREE IN ACCOUNTING

PART II FIRST SEMESTER EXAMINATION

CORPORATE FINANCE 1 [BAC2102]

INSTRUCTIONS

1. Answer **all** questions in **Section A**, and any **three** questions from **Section B**.
2. Begin each question on a new page.
3. Show all your workings.
4. Please indicate your study format (Conventional/Block/Parallel) on the cover of your answer script.

INFORMATION

1. Questions may be answered in any order
2. You may use a scientific calculator.

This paper consists of 6 printed pages including cover page

SECTION A COMPULSORY (Answer all questions) [40 marks]

Each question carries 2 marks

1. All constituencies with a stake in the fortunes of the company are known as _____.
 - A. Shareholders.
 - B. Stakeholders.
 - C. Creditors.
 - D. Customers.

2. An increase in the firm receivable turnover ratio means that:
 - A. It is collecting credit sales more than before
 - B. Cash sales have decrease
 - C. Inventories have increased
 - D. It has initiated more liberal credit terms.

3. When a corporation continues to operate regardless of changes in ownership, this is known as:
 - A. the right of perpetual succession.
 - B. perpetual shares.
 - C. perpetual trading.
 - D. unlimited succession.

4. Which one of the following statements relating to debentures is incorrect?
 - A. Debenture stock is transferable.
 - B. A company may not purchase its own debentures.
 - C. A debenture holder is a creditor of the company.
 - D. A debenture is the written document issued by a company setting out the terms of a loan.

5. Which one of the following is not a right of a shareholder?
 - A. To receive a dividend declared by the company
 - B. To attend and vote in meetings
 - C. To receive the company's accounts
 - D. To manage company affairs

6. Shares issued with special rights attached to them are known as:
 - A. Ordinary shares
 - B. Preference shares
 - C. Rights shares
 - D. Debenture shares

7. A business formed between two or more individuals who each have unlimited liability for all of the firm's business debts is called a

- A. corporation.
- B. sole proprietorship.
- C. general partnership.
- D. limited liability company

8. The long-run objective of financial management is to _____.

- A. Maximize earnings per share.
- B. Maximize the value of the firm's common stock.
- C. Maximize return on investment.
- D. Maximize market share.

9. In their traditional role, the finance manager is responsible for _____.

- A. arrange of utilization of funds.
- B. arrangement of financial resources.
- C. acquiring capital assets of the organization.
- D. effective management of capital.

10. _____ is concerned with the maximization of a firm's earnings after taxes

- A. Shareholder wealth maximization.
- B. Profit maximization.
- C. Stakeholder maximization.
- D. EPS maximization.

11. Internal rate of return is ...

- A. Rate at which discounted cash inflow is more than discounted cash outflow
- B. Rate at which discounted cash inflow is less than discounted cash outflow
- C. Rate at which discounted cash inflow is equal to the discounted cash outflow
- D. Rate for discounting cash inflows without including outflows

12. The weighted average cost of capital for a firm is the:

- A. Discount rate which the firm should apply to all of the projects it undertakes.
- B. Rate of return a firm must earn on its existing assets to maintain the current value of its stock.
- C. Coupon rate the firm should expect to pay on its next bond issue.
- D. Maximum rate which the firm should require on any projects it undertakes.

13. A profitability index (PI) of 0.92 for a project means that _____.

- A. the project's costs (cash outlay) are (is) less than the present value of the project's benefits
- B. the project's NPV is greater than zero
- C. the project's NPV is greater than 1
- D. the project returns 92 cents in present value for each current dollar invested (cost)

14. The LMN Corporation is considering an investment that will cost \$80,000 and have a useful life of 4 years. During the first 2 years, the net incremental after-tax cash flows are \$25,000 per year and for the last two years they are \$20,000 per year. What is the payback period for this investment?

- A. 3.2 years.
- B. 3.5 years.
- C. 4.0 years.
- D. 5.2 years

15. Corporate wealth maximization is the value maximization for _____

- A. Equity shareholders
- B. Stakeholders
- C. Employees
- D. Debt capital owners

16. Payback period is superior to other methods, if the objective of the investor is to _____.

- A. consider cash flow in its entirety
- B. consider the present value of future cash flows
- C. consider the liquidity.
- D. consider the inflows in its entirety.

17. A secondary market would be utilized when:

- A. investors buy or sell existing securities.
- B. shares of common stock are exchanged.
- C. securities are initially issued.
- D. a commission must be paid on the transaction.

18. Efficient markets are defined as markets in which

- A. the bid-ask spreads are small.
- B. a market order to buy or sell a stock at the best available price can be executed quickly.
- C. investors are able to sell an asset on short notice at close to the market price.
- D. prices reflect all available information

19. Gwanda State University just paid a dividend of \$1.15. Its stock has a required rate of return of 13.49 % and investors expect a dividend to grow at a constant 8% rate in the future. Calculate the dividends for year 1 and 2 respectively.

- A.\$1.23 and \$1.43
- B.\$1.42 and \$1.43
- C.\$1.24 and \$1.34
- D.\$1.26 and \$1.36

20. The market value of the firm is the result of _____.

- A. Dividend decisions.
- B. Working capital decisions.
- C. Capital budgeting decisions.
- D. Trade-off between risk and return

SECTION B Answer any (3) three questions from this section

QUESTION 2 [20 MARKS]

- a. Explain what is meant by the Agency problem in finance and why it arises. **[3 marks]**
- b. Discuss any four effects of the agency problem in business operations. **[8 marks]**
- c. i. Blue Skies' expected first year dividend is \$3 and the growth rate 8%. With initial stock price of \$75, what is the expected rate of return? **[2 marks]**
ii. Blue Skies has won a lawsuit against its arch rivals, Ntemba manufacturing, which forces Ntemba manufacturing to withdraw as a competitor in a key market. Given that Blue Skies' stock's dividend growth rate for the first 3 years is 8%, the dividend just paid is \$20 and the dividend growth rate is expected to stabilize at 4% from the 4th year on. Determine how this affects the price of the stock given a cost of equity of 12%. **[7 marks]**

QUESTION 3 [20 MARKS]

- a. Financial intermediaries play a number of special roles, and help solve a number of special problems in the financial system as a whole. Discuss any four roles played by financial intermediaries. **[12 marks]**
- b. State and explain any four reasons a business might have for seeking a stock market listing? **[8 marks]**

QUESTION 4 [20 MARKS]

- a. A property owner is faced with a choice of:
 - i. A large-scale investment (A) to improve her flats. This could produce a substantial pay-off in terms of increased revenue net of costs but will require an investment of \$1,400,000. After extensive market research it is considered that there is a 30% chance that a pay-off of \$2,500,000 will be obtained, but there is a 70% chance that it will be only \$800,000.
 - ii. A smaller scale project (B) to re-decorate her premises. At \$500,000 this is less costly but will produce a lower pay-off. Research data suggests a 40% chance of a gain of \$1,000,000 but a 60% chance of it being only \$500,000.

- iii. Continuing the present operation without change (C). It will cost nothing, but neither will it produce any pay-off. Clients will be unhappy and it will become harder and harder to rent the flats out when they become free.

Using a decision tree, evaluate which decision should be taken? **[14 marks]**

- b. Although investment appraisal forces a complete financial analysis of any proposed investment, there are other factors that also need to be considered before a decision to invest is made. Discuss any three qualitative factors. **[6 marks]**

QUESTION 5 [20 MARKS]

- a. Discuss any three measures shareholders can use to encourage their managers to act in a way which is consistent with the objective of shareholder wealth maximization. **[12 marks]**
- b. OK Zimbabwe Limited has a capital structure as follows

	Cost of capital	Book Value	Market Values
	%	\$(millions)	\$(millions)
Bank loans	6	5	5
Loan notes	9	8	6
Ordinary shares	12	18	39

Required:

- i. Calculate OK Zimbabwe Limited's weighted average cost of capital. **[6 marks]**
- ii. Briefly explain to the directors of the company on the suitability of using the WACC calculated in (i) above to discount the expected cash flows of a project.

[2 marks]

END OF EXAMINATION PAPER