



MAASAI MARA UNIVERSITY

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

**SCHOOL OF BUSINESS AND ECONOMICS
BACHELOR OF COMMERCE**

COURSE CODE: BCM 4114

COURSE TITLE: FINANCIAL ECONOMICS

DATE: 9TH DECEMBER 2022

TIME: 1430-11630HRS

INSTRUCTIONS TO CANDIDATES

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

This paper consists of 3 printed pages. Please turn over

QUESTION ONE

(a) Financial intermediaries help solve a number of special problems, in the process of indirect finance. Discuss these problems. **(9marks)**

(b) Discuss the flaws that profit maximization as a goal suffers from. **(6marks)**

(c) If we have the option of receiving \$100 today, or \$100 a year from now, we will choose to get the money now. Explain why you would prefer to get your money now. **(10marks)**

QUESTION TWO

(a) Given; $FV_n = PV \times (1 + i)^n$, solve for the number of years **(7marks)**

(b) Explain the basic variables that affect business value **(8marks)**

QUESTION THREE

(a) You decide to put \$12,000 in a money market fund that pays interest at the annual rate of 8.4%, compounding it monthly. You plan to take the money out after one year and pay the income tax on the interest earned. You are in the 15% tax bracket. Find the total amount available to you after taxes. **(8marks)**

(b) The net cash flow is the preferred measure of economic benefit in the income approach. Explain the reasons for the general preference to use net cash flow as the economic benefit to be capitalized or discounted in the income approach: **(7marks)**

QUESTION FOUR

(a) You have just opened an IRA in which you plan to deposit KSh.100 a month, at the beginning of every month. The IRA will pay 9% annually, with monthly compounding. Approximately, how long will it take you to accumulate KSh.20,000 in this account? **(7marks)**

(b) Explain the steps in applying the Excess Earnings Method in asset valuation **(8marks)**

QUESTION FIVE

(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**. Using mathematical illustration, prove this proposition. **(8mks)**

(b) Down-Town limited is considering the purchase of a new wood processing machine. Two alternatives, European model and Japan model have been suggested each having initial capital of KSh. 400,000 and requiring KSh. 200,000 each as additional working capital at the end first year. Earnings are expected as follows:

	Cash Flows	
Year	European model	Japan model
1	400,000	1,200,000
2	1,200,000	1,600,000
3	1,600,000	2,000,000
4	2,400,000	1,200,000
5	1,600,000	800,000

Assume 10% return on capital, compute the profitability of the machine and make your suggestions **(7marks)**

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