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KIRIRI WOMENS' UNIVERSITY OF SCIENCE AND TECHNOLOGY

UNIVERSITY EXAMINATION, 2024/2025ACADEMIC YEAR

FOURTH YEAR, SECOND SEMESTER EXAMINATION

FOR THE DEGREE OF BACHELOR OF SCIENCE

(BUSINESS ADMINISTRATION)

Date: 14th August, 2024
Time: 2.30pm –4.30pm

KFI 2405 SEMINAR IN FINANCE

INSTRUCTIONS TO CANDIDATES

ANSWER **QUESTION ONE (COMPULSORY)** AND **ANY OTHER TWO** QUESTIONS

QUESTION ONE (30 MARKS)

PORTFOLIO SELECTION

a) Portfolio theory and the concept of diversification were introduced by Harry Markowitz (1952). Efficient portfolios maximize expected return for a given amount of risk (which is measured by the variance or standard deviation of the return of the portfolio). Equivalently, they minimize risk for a given expected return. This is done by investing in less correlated assets and grouping correlated assets together with those that move in opposite directions to each another, so as to reduce risk for a given return.

Required:

i) In line with the Harry Markowitz Portfolio theory and the concept of diversification. Using an illustration differentiate between Capital market line and Security Market line. (6 marks)

ii) Harry Markowitz Portfolio theory is a significant concept in corporate finance that directs investment decision-making and risk management. Critique three key contributions of Markowitz (1952) in risk diversification and portfolio Selection. (6 marks)

b) Eugene F. Fama, 2013 Nobel laureate in economic sciences, is widely recognized as the "father of modern finance." His research is well known in both the academic and investment communities. He is strongly identified with research on markets, particularly the efficient markets hypothesis. He focuses much of his research on the relation between risk and expected return and its implications for portfolio management. His work has transformed the way finance is viewed and conducted.

i) Eugene Fama defined a market to be "informationally efficient". Discuss the forms of market efficiency. (6 marks)

ii) As expounded by Eugene Fama on information efficiency, one point of nexus between the efficient market hypothesis and CAPM is the assumption on free access to information by investors. Discuss any three drawbacks of the Capital Asset Pricing Model (CAPM) in light of that and other assumptions made. (6 marks)

iii) As elucidated by Eugene Fama on information efficiency, there has been a discussion on whether or not investors can be able to beat the market and therefore one can be able to predict future price movements. However, financial market anomalies Dimson(1989)challenge the principles of efficient markets. Discuss any three stock market anomalies. (6 marks)

QUESTION TWO (20 MARKS)

a) conflicts as integrated within the dynamics of a listed company in view of Jensen and Meckling(1976). (8 marks)

b) Describe the contributions of Modigliani and Miller (1961) in the dividend policy and firm value by invoking perfect market conditions and homemade dividends (8 marks)

c) Discuss the concept of Chief Executive Officer(CEO) duality and its significance with respect to corporate governance. (4 marks)

QUESTION THREE (20 MARKS)

a) Market failure is largely triggered by investor reaction to adverse developments in financial markets. Discuss any four probable causes of market failure in an economy. (8 marks)

b) Explain three key differences between Pecking order theory of capital structure and the Trade-off theory. (8 marks)

c) Differentiate between corporate finance and behavioral finance. (4 marks)

QUESTION FOUR (20 MARKS)

a) Explain the reasons as to why the Arbitrage Pricing Theory (APT) is considered to be more robust than the Capital Asset Pricing Model (CAPM) in the context of financial asset pricing. (8 marks)

b) Modigliani and Miller (1958) proposed the capital irrelevance theory. Explain the capital irrelevance theory and its apparent weaknesses in relation to debt-equity mix and firm value. (8marks)

c) Differentiate between moral hazard and adverse selection citing relevant examples. (4marks)

QUESTION FIVE(20 MARKS)

a) The financial sector has been witnessed various corporate scandals. Good corporate governance has been touted to be a solution to the corporate malpractices. Discuss any four corporate governance practices in relation to the board composition that can help prevent financial scandals pn firms. (8 marks)

b) Describe types of dividends and factors affecting dividend payout in a listed firm. (4 marks)

c) Researchers across the globe have presented several important ideas and concepts in finance that have been proclaimed and subjected to a lot of research. Some of these concepts include:

i) Pecking order theory
ii) Trade-off theory
iii) Traditionalist theory
iv) Signaling effect theory
v) Clientele effect theory
vi) Bird-in-the-hand theory

Show your understanding on the principles and argument in any of the four concepts above. (8 marks)