

The
Management
University
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UNDERGRADUATE UNIVERSITY EXAMINATIONS
SCHOOL OF MANAGEMENT AND LEADERSHIP
DEGREE OF BACHELOR OF ARTS IN DEVELOPMENT STUDIES

FIN 312: CORPORATE FINANCE

DATE: 13TH APRIL 2026

DURATION: 2 HOURS

MAXIMUM MARKS: 70

INSTRUCTIONS:

1. Write your registration number on the answer booklet.
2. **DO NOT** write on this question paper.
3. This paper contains **SIX (6)** questions.
4. Question **ONE** is compulsory.
5. Answer any other **THREE** questions.
6. Question **ONE** carries **25 MARKS**, and the rest carry **15 MARKS** each.
7. **Write all your answers in the Examination answer booklet provided.**

QUESTION ONE

Read the case study below carefully and answer the questions that follow:

CHUMA INDUSTRIES LTD

Chuma Industries Ltd. is a well-established manufacturing company in Nairobi, listed on the Main Investment Market Segment (MIMS) of the Nairobi Securities Exchange (NSE). The board is currently evaluating a significant expansion project: Investing in a new, state-of-the-art production line.

The new production line requires an initial outlay of KES 25,000,000 at time $t=0$. This investment includes the cost of machinery, installation, and initial training. The line is expected to generate net cash inflows of KES 6,000,000 per year for the next 6 years. At the end of its useful life (Year 6), the machinery is projected to have a salvage value of KES 5,000,000. For simplicity, assume all cash flows occur at the end of the year.

The company's target capital structure is 60% equity and 40% debt. Chuma Industries currently has 10,000,000 ordinary shares outstanding, trading at KES 50 per share. They are considering raising the necessary financing through a combination of a new bond issue and a rights issue.

- Debt Financing: Chuma Industries can issue new 5-year bonds with a face value of KES 1,000 and an 8% annual coupon rate (paid annually), and they expect these bonds to be issued at a discount, selling for KES 960 each. Flotation costs for debt are negligible.
- Equity Financing (Rights Issue): The company is contemplating a rights issue to raise a portion of the equity. The cost of new equity raised through a rights issue is estimated to be 14.5%.
- Retained Earnings: The company expects to generate sufficient retained earnings to cover some of the equity portion, with an estimated cost of 13%.

Chuma Industries Ltd. operates in a stable political environment; however, it has recently observed increased competition from imported goods. The corporate tax rate is 30%.

Required:

- a) Calculate the after-tax cost of debt for Chuma Industries Ltd. **(4 Marks)**
- b) Determine the company's optimal cost of equity, assuming they exhaust retained earnings before issuing new equity. **(5 Marks)**

- c) Calculate Chuma Industries Ltd.'s Weighted Average Cost of Capital (WACC), considering the funding requirements for the new project. **(6 Marks)**
- d) Calculate the Net Present Value (NPV) for the proposed production line using the WACC determined in (c). Advise Chuma Industries Ltd. on whether to accept or reject the project based on the NPV. **(8 Marks)**
- e) Briefly explain the role of the Central Depository & Settlement Corporation (CDSC) in facilitating share trading on the Nairobi Securities Exchange (NSE), particularly concerning the rights issue being considered by Chuma Industries. **(2 Marks)**

QUESTION TWO

- a) Explain any three primary roles of the Capital Markets Authority (CMA) in the Kenyan financial system. **(5 Marks)**
- b) Discuss the concept of "agency theory" in corporate finance, identifying at least three common agency problems that arise between shareholders and management. **(10 Marks)**

QUESTION THREE

- a) Examine the three key users of financial ratios, showing how they would utilize these ratios. **(9 Marks)**
- b) Discuss the contrast between the "bird-in-hand theory" and "MM dividend irrelevance theory". **(6 Marks)**

QUESTION FOUR

- a) Examine any four significances of the cash conversion cycle (or cash cycle) in working capital management. **(4 Marks)**
- b) Describe three ways a firm can shorten its cash conversion cycle. **(3 Marks)**
- c) Outline two quantitative models used by firms to determine the optimal cash balance. **(8 Marks)**

QUESTION FIVE

- a) Explain three reasons why companies engage in mergers and acquisitions. **(9 Marks)**
- b) Discuss three common barriers that can hinder an effective financial planning process within an organization. **(6 Marks)**

QUESTION SIX

- a) Differentiate between primary and secondary markets within the capital market framework, highlighting their respective functions. **(7 Marks)**
- b) Explain four factors that influence the share prices of companies listed on the Nairobi Securities Exchange (NSE). **(8 Marks)**