

#### ST. PAUL’S UNIVERSITY

#### Private Bag 00217 Limuru, 00217, KENYA

**Tel: 020-2020505/2020510/0728-669000/0736-424440**

**FACULTY OF BUSINESS COMPUTER SCIENCE AND COMMUNICATION STUDIES**

**BACHELOR OF BUSINESS MANAGEMENT**

**JANUARY - APRIL 2021 SEMESTER**

**BFI 220 INTRODUCTION TO FINANCE**

**DATE: APRIL, 2021 TIME: 8.00am – 8.00am (24 hours)**

**INSTRUCTIONS:**

1. Answers ALL Questions.
2. Submit your answers in word format unless otherwise instructed. Type your answers in a word document. **Do not PDF your document**.
3. Submit your answers via the Exam Portal.
4. For images (photographs, graphs and calculations etc), use legible writing. Take an image (Photo) of all the answer sheets and submit via the Exam Portal. Remember to number the answer sheet pages.

**NOTE: No submissions will be accepted in any other mode e.g. emails, WhatsApp etc.**

1. The examinations start at 8.00am and all the answer scripts MUST be posted on the portal by 8.00am the following day **(within 24 hours).**
2. Submit your answer sheets as one document. Click the “SUBMIT” button to ensure that your answer sheet is uploaded in the portal.
3. Allow yourself enough time to confirm that your submission has gone through. You will receive an automated email receipt on successful submission.

**NOTE: Submission deadlines must be observed.**

1. On the front page of each answer script you are required to observe the following instructions:
   * Write your student number in full
   * Write the unit code and title
   * Write the date of examination
   * Write the name of the lecturer
   * Write “SUPPLEMENTARY” or “DEFFERED EXAM” as the case may be, (if you are taking a supplementary or deferred examination).

**Question one**

**Case study**

**Corporate Scandals and Maximizing Stock Price**

The list of corporate scandals seems to go on forever: Sunbeam, Enron, ImClone, WorldCom, Tyco, Adelphia, Imperial bank, Nakumatt, Tuskys…. At first glance, it’s tempting to say, “Look what happens when managers care only about maximizing stock price.”

But a closer look reveals a much different story. In fact, if these managers were trying to maximize stock price, they failed dismally, given the resulting values of these companies. Although details vary from company to company, a few common themes emerge. First, managerial compensation was linked to the short-term performance of the stock price via poorly designed stock option and stock grant programs. This provided managers with a powerful incentive to drive up the stock price at the option vesting date without worrying about the future.

Second, it is virtually impossible to take legal and ethical actions that drive up the stock price in the short term without harming it in the long term because the value of a company is based on all of its future free cash flows and not just cash flows in the immediate future. Because legal and ethical actions to quickly drive up the stock price didn’t exist (other than the old-fashioned ones, such as increasing sales, cutting costs, or reducing capital requirements), these managers began bending a few rules. Third, as they initially got away with bending rules, it seems that their egos and hubris grew to such an extent that they felt they were above all rules, so they began breaking even more rules.

Stock prices did go up, at least temporarily, but as Abraham Lincoln said, “You can’t fool all of the people all of the time.” As the scandals became public, the stocks’ prices plummeted, and in some cases the companies were ruined. There are several important lessons to be learned from these examples. First, people respond to incentives, and poorly designed incentives can cause disastrous results. Second, ethical violations usually begin with small steps, so if stockholders want managers to avoid large ethical violations, then they shouldn’t let them make the small ones. Third, there is no short cut to creating lasting value. It takes hard work to increase sales, cut costs, and reduce capital requirements, but this is the formula for success.

Required

With reference to the case above, evaluate the financial and non-financial objectives that managers in an organisation should pursue and the guiding principles that should influence the choice of the objectives.

(10 marks)

**Question two**

Stocks C and F have the following historical returns:

**Year return (HPY) of C return (HPY) of F**

2016 −18.00% −14.50%

2017 33.00% 21.80%

2018 15.00 % 30.50%

2019 −0.50% −7.60%

2020 27.00% 26.30%

Required

1. Calculate the geometric rate of return for each stock during the 5-year period. (6mks)
2. Calculate the standard deviation of returns for each stock. (10mks)
3. Calculate the coefficient of variation for each stock. (2mks)
4. If you are a risk-averse investor then, assuming these are your only choices, discuss whether you would prefer to hold Stock C or Stock F. (2mks)