



**UNIVERSITI KUALA LUMPUR
BUSINESS SCHOOL**

**FINAL EXAMINATION
MARCH 2025 SEMESTER**

COURSE CODE : EGB30103
COURSE NAME : FINANCIAL ECONOMICS 2
PROGRAMME NAME : BACHELOR OF SCIENCE (HONOURS) IN
ANALYTICAL ECONOMICS
DATE : 30 JUNE 2025
TIME : 9.00 AM – 12.00 PM
DURATION : 3 HOURS

INSTRUCTIONS TO CANDIDATES

1. Please **CAREFULLY** read the instructions given in the question paper.
 2. This question paper has information printed on both sides of the paper.
 3. This question paper consists of **TWO (2)** sections; Section A and Section B.
 4. Answer **ALL** questions from **Section A** and **Section B**.
 5. Please write your answers in the answer booklet provided
 6. All questions must be answered in **English** (any other language is not allowed).
 7. This question paper must not be removed from the examination hall.
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THERE ARE FOUR (4) PAGES OF QUESTIONS, EXCLUDING THIS PAGE.

SECTION A (Total: 30 marks)**INSTRUCTION: Answer ALL questions.****Please use the answer booklet provided.****Question 1**

- (a) Describe what is meant by alignment of parties to a financial deal.
(5 marks)
- (b) Explain the special capabilities needed to cost-effectively govern financial deals.
(5 marks)

Question 2

- (a) Give two (2) examples of the types of markets that would be expected to be allocatively efficient.
(5 marks)
- (b) Justify whether the time horizons of financial deals are related to whether the markets deals are or are not allocatively efficient.
(5 marks)

Question 3

- (a) With respect to risk management, define wealth-based criteria and dispersion-based criteria.
(5 marks)
- (b) Describe the disadvantage of symmetric measures of risk.
(5 marks)

SECTION B (Total: 70 marks)**INSTRUCTION: Answer ALL questions.****Please use the answer booklet provided.****Question 1**

- (a) Explain mean absolute deviation. (5 marks)
- (b) Explain why a decision maker might prefer to use mean absolute deviation rather than variance as a measure of dispersion. (5 marks)

Question 2

- (a) Discuss the implication of the linear pricing rule regarding a firm's share price. (5 marks)
- (b) Assume a finite state economy with three assets whose payoff matrix is given by
- $$X = \begin{matrix} & \begin{matrix} \$30 & \$20 & \$10 \\ \$20 & \$15 & \$0 \end{matrix} \end{matrix}$$
- i. Determine the payoffs of the third asset. (2 marks)
- ii. Explain whether the third asset is redundant. (3 marks)

Question 3

- (a) In a future contract, initial margin is required when first taking a position in the contract. If the equity in the account drops below the maintenance margin, identify how much must be posted to maintain the position. (5 marks)
- (b) Describe why do market participants prefer to use interest rate swaps instead of a package of future/forward contracts to accomplish some risk management objective. (5 marks)

Question 4

- (a) Suppose the market price of Corporation ABC's stock is \$30 per share and that there are 40,000 shares outstanding. Suppose the company's management is considering a preemptive rights offering in connection with the issuance of 10,000 shares. Each current shareholder would receive one right for every four shares owned. The terms of the rights offering are as follows: For Four rights and \$25 (the subscription price) new share can be acquired.
- i. Define pre-emptive right.
(2.5 marks)
 - ii. Identify the value per right.
(2.5 marks)
 - iii. Often a rights offering is designed to have relatively high value per right. What is the firm's consideration behind it.
(5 marks)

Question 5

- (a) Define a dividend re-investment plan and describe the benefit of this plan to the firm and to the shareholders.
(5 marks)
- (b) Describe stock splits and stock dividends.
(5 marks)

Question 6

- (a) Differentiate between the net present value and the adjusted present approaches. (5 marks)
- (b) Suppose management of Company ABC is evaluating a project which has an initial outlay of \$10million and an expected cash flow of \$3million per year for each of the next five years. Assume that the company's (i) marginal tax rate is 40% (ii) debt to equity ratio equal to 1. And (iii) after-tax cost of debt of 4% and a cost of equity of 6%. The cost of equity is estimated using the CAPM, assuming a beta of 1.2, a risk-free interest rate of 3% and an expected return on the market of 7%.
- i. Identify the net present value of this project. (5 marks)
- ii. Calculate the adjusted present value for this project if the effect of financial distress ignored. (5 marks)
- (c) Explain the advantages of using the APV approach. (5 marks)

END OF EXAMINATION PAPER