Ref No. :Ex/PG/ECO-42/2019

MASTER OF ARTS EXAMINATION, 2019

(2nd Year, 2nd Semester)

ECONOMICS

CORPORATE FINANCE AND FINANCIAL INSTITUTION

Time : Two hours | Full Marks : 30

Answer question ***No. 1*** and any ***two*** from the rest

1. State, prove and economically interpret Modigliani-Miller hypothesis of irrelevance of capital structure. In which circumstances will the results remain unaltered in the presence of taxes? 6+4

2. Let there be two firms with total returns: 60 units and 30 units respectively. The market discount rate r=5%. Show that under symmetric information, Modigliani-Miller hypothesis will hold, but it will not hold under asymmetric information. Show that if the managers' compensation scheme is given by :
   $(1+r)\ 4.2\ V_0 + 3.8\ V_1$ if $V_1 \geq F$ or
   $(1+r)\ 4.2\ V_0 + 3.8\ (V_1 - L)$ if $V_1 < F$ (the symbols have their usual meaning) ,
   Then there exists an L such that the managers will choose different levels of debts and signal their types. 3+7

3. Why have the results derived by Myers & Majluf , come to be known as pecking order hypothesis? Explain theoretically how this pecking order emerges. 2+8

4. Suppose just before the merger of the two companies A & B we observe the following :

	Firm A	Firm B
Market price per share	Rs.250	Rs.100
Number of shares	1,000,000	500,000
Market value of the firm	Rs. 250 m	Rs 50 m

   (a) If the present value of the new firm after merger becomes Rs. 375 m and the shareholders of the company B are asking for Rs. 60 million in cash for their shares , will the merger be feasible? How will the gains from merger (if any) be distributed between the two parties?
   (b) What will be the gain from merger if company A offers 0.26 million shares instead of Rs 60 million in cash?
   (c) Explain the problem that arises in determining the exchange value in mergers in the presence of asymmetric information. 3+4+3