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**UNIVERSITY REGULAR EXAMINATIONS**

**2013 /2014 ACADEMIC YEAR**

**1<sup>ST</sup> YEAR 1<sup>ST</sup> SEMESTER EXAMINATIONS**

**(MAIN EXAMINATION)**

**FOR THE MASTER DEGREE IN BUSINESS ADMINISTRATION**

**COURSE CODE:** MBA 830

**COURSE TITLE:** FINANCIAL INSTITUTIONS AND MARKETS

**DATE:** APRIL 2014      **TIME:**

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Answer question ONE (Compulsory) and any other THREE.

## QUESTION ONE

- a) You have an investment opportunity which you consider a must undertake. You are now considering two sources of finance:
- (i) Sh. 1,000,000 repayable in sh. 126,000 per year for 25 years with a grace period of two years.
  - (ii) Sh. 1,000,000 repayable in 126,000 per year for 25 years with no grace period

### Required:

- (i) Determine the implicit rate of interest in each case. (6mks)
  - (ii) Which loan is cheaper? (1mk)
- b) Briefly explain six variables that determine interest rates in an economy. (12mks)

## QUESTION TWO

- a) You are the manager of Biashara bank. The average duration of the bank's assets are sh.100 billion 4 year, and sh. 90 billion 6 years.

### Required

- (i) Conduct a duration analysis for the bank and show what will happen to the net worth of the bank if the interest rate rises by 2%. (3mks)
  - (ii) What action would you take to reduce the banks interest rate risk? (3mks)
- (b) The statement of financial position of your bank showed the following assets and liabilities as at the end 2013 financial year;

<b>Assets</b>	<b>Sh. Billion</b>
Fixed rate	15
Rate sensitive	25
<b>Liabilities</b>	
Fixed rate	25
Rate sensitive	20

### Required

- (i) Conduct a gap analysis for the bank and show what will happen to the bank profits if interest rates rise by 5%. (4mks)
- (ii) What actions can you take to reduce the banks interest rate exposure. (3mks)

( c) With reference to credit loan contract explain the concept of information asymmetry. Briefly explain the problems that may be caused by information asymmetry and five different ways in which a commercial bank may deal with it. (12mks)

### QUESTION THREE

- a) Briefly explain the following concepts as applied in banking portfolio risk protection:
- (i) Immunization
  - (ii) Full immunization
  - (iii) Dedication (12mks)
- b) The dividends of a common stock are expected to be sh. 100 for each of the 5 years and sh. 200 for each of the following 5 years. The dividends are expected to grow at a fixed rate of 2% per annum thereafter. Assume an annual effective interest rate of 6%.

Required

Calculate the price of the stock using dividend discount model. (12mks)

(Total Marks 24)

### QUESTION FOUR

Read the Short Article attached and answer the questions below.

- a) Briefly explain the stock market and economic events of 1928-1929 and October 1929. (7mks)
- b) According to the passage explain the contribution of 'adverse selection' and 'moral hazard' to the stock market and economic events. (6mks)
- c) How did the loss of one third of banks affect financial intermediation, adverse selection and moral hazard? (8mks)
- d) In the writer's own words 'a short- circuit' occurred in the economy between 1930 and 1933. (5mks)
- e) If current knowledge in economic thinking was available what actions? Could be taken by whom? To reverse the economic fortunes?

(Total Marks 32)