

KABARAK



UNIVERSITY

UNIVERSITY EXAMINATIONS

2009/2010 ACADEMIC YEAR

FOR THE DEGREE OF BACHELOR OF COMMERCE

COURSE CODE: FNCE 414

**COURSE TITLE: MANAGEMENT OF FINANCIAL
INSTITUTIONS**

STREAM: Y4S1

DAY: FRIDAY

TIME: 9.00 – 11.00 A.M.

DATE: 06/08/2010

INSTRUCTIONS:

The paper contains **FOUR** questions

- i. Answer **ALL** the questions
- ii. All the questions carry **EQUAL** marks
- iii. Marks are allocated at the end of each question

PLEASE TURNOVER

QUESTION ONE

- (a) ‘Banks and financial institutions are most heavily regulated of all the corporate entities the world over’. Briefly explain this statement, highlighting the rationale for their regulation and the various forms of regulation which authorities normally use. **(5 Marks)**
- (b) Why is liquidity important to successful management of financial institutions? What is the relationship between liquidity and profitability? **(10 Marks)**
- (c) Experts frequently debate whether the financial position of financial institutions- such as capital adequacy, interest rate exposure, etc- should be evaluated using book or market value measures. Briefly explain the rationale supporting the use of market values rather than historical book values. **(10 Marks)**

(Total Marks: 25)

QUESTION TWO

- (a) Consider the following items from the balance sheet of a financial institution:

| | <u>Assets</u> | |
|------------------------|---------------------------|------------------|
| Cash | | Kshs. 2,500,000 |
| Investments | | 7, 500,000 |
| Loans | | 40,000,000 |
| | <u>Liabilities</u> | |
| Deposits | | Kshs. 35,000,000 |
| Subordinate debentures | | 3,000,000 |
| Equity | | 2,000,000 |

- (i) Suppose the regulators require that the ratio of equity capital to loans must at least be equal to 6% and that the ratio of equity capital to total assets must at least be equal to 4%. Is the financial institution presently meeting both of these standards? **(5 Marks)**
- (ii) Suppose that the financial institution makes an argument to those regulators that equity capital is not the only cushion it has available to protect depositors from loss in the vent of failure. Irrespective of whether or not the regulators agree, do you believe that the financial institution has a legitimate argument? Explain why or not? **(5 Marks)**

b. (i) A very conservative bank manager argues that bank manager should extend loans only to those customers that are 100% able to pay as promised. Is this reasonable? Explain. **(5 Marks)**

ii) In your SACCO society's discussion about its new loan policy, it is suggested that complete information on the creditworthiness of customers should be acquired. Is this reasonable? Explain what attacks might be made on this situation.

(10 Marks)

(Total Marks: 25)

QUESTION THREE

(a) What is portfolio immunization and what role does duration play in an immunization attempt? **(5 Marks)**

(b) If a firm has assets 90% financed by liabilities with a portfolio of 2.3 years and liabilities with a portfolio of 4.3years, what would you expect to happen to the firm's profit margin if interest rates drop? Explain. **(5 Marks)**

(c) It has been said the "what gets measured gets managed, and what we do not measure tends to be ignored" in addition to the familiar financial measures of performance, what are the other dimensions that should be included in a comprehensive evaluation of the performance of financial institutions? Explain the relevance for each.

(15 Marks)

(Total Marks: 25)

QUESTION FOUR

(a) Using the Kenyan examples, explain the principal factors responsible for innovations.

(5 Marks)

(b) What are some of the weakness of the repricing model? How have large banks solved the problem of choosing the optimal time period for repricing? What is runoff cash flow, and how does this amount affect the repricing model's analysis?

(10marks)

(c) You are talking with a fellow B. Com student who is in the BMIT degree programme. You mention that you are studying the management financial institutions. The other student is surprised and asks: "why is there such a course? What is so special about financial institutions that a separate course is required? Answer this inquiry by explaining the features of financial institutions that make their management unique compared to non-financial firms.

(10Marks)

(Total Marks: 25)
