UNIVERSITY OF EMBU

2017/2018 ACADEMIC YEAR

TRIMESTER EXAMINATIONS

SECOND YEAR TRIMESTER EXAMINATION FOR THE DEGREE OF BACHELOR OF COMMERCE

DFI 202: FINANCIAL INSTITUTIONS AND MARKETS

DATE: AUGUST 1, 2018 **TIME: 8:30-10:30AM**

INSTRUCTIONS:

Answer Question ONE and ANY Other TWO Questions.

QUESTION ONE (30 MARKS)

Read the Case Study below carefully and, answer the questions that follow:

Kazana Company is a large manufacturing firm in Nairobi Industrial area that was created 20 years ago by the Kazana family. It was initially financed with an equity investment by the Kazana family and 10 other individuals. Over time, Kazana Company has obtained substantial loans from finance companies and commercial banks. The interest rate on the loans is tied to market interest rates and is adjusted every six months. Thus, Kazana's cost of obtaining funds is sensitive to interest rate movements. It has a credit line with a bank in case it suddenly needs additional funds for a temporary period. It has purchased Treasury securities that it could sell if it experiences any liquidity problems. Kazana Company has assets valued at about KES. 5 billion and generates sales of about KES.10 billion per year. Some of its growth is attributed to its acquisitions of other firms. Because of its expectations of a strong economy, Kazana plans to grow in the future by expanding its business and by making more acquisitions. It expects that it will need substantial long-term financing. Kazana closely monitors conditions in financial markets that could affect its cash inflows and cash outflows and thereby affect its value.

Required:

a) Explain ways in which Kazana is a surplus unit. (3 marks)

b) Explain ways in which Kazana is a deficit unit. (3 marks)

c) Describe three functions of financial system. (6 marks)

d) Discuss how Kazana might use the primary market to facilitate its expansion. (6 marks)

e) Explain how Kazana might use the secondary market to facilitate its expansion. (2 marks)

f) Identify and explain the factors that might influence the market interest rates charged on the Kazana's loans. (5 marks)

g) Discuss how commercial banks might facilitate Kazana's expansion. (5 marks)

QUESTION TWO (20 MARKS)

a) Equity Bank PLC paid a dividend of Sh. 3.70 last year. The dividends in the future are expected to grow perpetually at a rate of 8%. Determine the current share price if the investors' required rate of return is 12%. (4 marks)

b) Describe the different ways in which funds can be transferred from surplus units to deficit units. (4 marks)

c) Differentiate between Primary and secondary markets. (2 marks)

d) Discuss any five factors affecting exchange rates in the forex exchange market. (5 marks)

e) Explain the meaning of "underwriting" as used in stock market. (2 marks)

f) Describe the features of the Over the Counter (OTC) market (3 marks)

QUESTION THREE (20 MARKS)

a) Compare and contrast the Commercial Banks and Deposit Taking Micro-finance institutions in Kenya. (5 marks)

b) Distinguish between financial intermediation and maturity intermediation. (4 marks)

c) Discuss the functions of the foreign exchange market. (5 marks)

g) Discuss the role of the following participants in the Kenyan capital markets;

(i) Credit Rating Agencies (2 marks)

(ii) Stock brokers and dealers (2 marks)

(iii) Collective Investment Schemes (2 marks)

QUESTION FOUR (20 MARKS)

a) Discuss the advantages to deficit and surplus units of using organized financial markets and financial intermediaries. (6 marks)

b) Regulation is needed to inspire consumers' confidence in the capital markets. Identify and explain the main reasons for capital market regulation. (5 marks)

c) Explain the term green shoe option as used in financial markets. (2 marks)

d) Explain the concept of information asymmetry and the problem it presents to lenders. (3 marks)

e) Distinguish between private placement and public placement methods of raising capital. (4 marks)

QUESTION FIVE (20 MARKS)

a) Discuss the economic functions of financial markets. (4 marks)

b) Identify and explain the challenges facing the pension funds in an emerging economy such as Kenya. (5 marks)

c) Identify any three risks faced by financial institutions and clearly explain how financial institutions manage these risks. (6 marks)

d) Discuss the role of Capital Markets Authority (CMA) in in development of capital markets in Kenya. (5 marks)

--END--