PAN AFRICA CHRISTIAN UNIVERSITY

CAMPUS: ROYSAMBU
SEP-DEC SEMESTER, 2019 ACADEMIC YEAR

END OF SEMESTER EXAMINATION FOR THE DEGREE OF
BACHELOR OF BUSINESS LEADERSHIP
BACHELOR OF BUSINESS INFORMATION TECHNOLOGY
BACHELORS OF COMMERCE

DEPARTMENT OF BUSINESS
FINANCIAL MARKETS AND INSTITUTIONS

EXAMINATION SESSION: SEP-DEC 2019; TIME:

INSTRUCTIONS

- This examination script consists of **six (6)** questions.
- Answer question **ONE** and ANY other **four** Questions.
- Do not write on the question paper
- Write your **student number** on the answer booklet provided.

SECTION A: ANSWER ALL QUESTIONS FROM THIS SECTION

QUESTION ONE: COMPULSORY [30MKS]

(a) Explain the following pairs of terms giving examples in each case.

(i) Debt market vs equity market [4mks]

(ii) Defined benefit pension plans vs defined contribution pension plans. [4mks]

(b) Discuss four functions of financial systems in developing economies. [8mks]

(c) Explain three characteristics of T-bills which make them more attractive to investors than other monetary instruments. [6mks]

(d) An investor intends to place Ksh 12 million in the 91 days T-bill at a quoted yield of 7.65% p.a. Calculate the return to the investor if:

(i) The investor is non-withholding taxpayer. [5mks]

(ii) The investor is a withholding tax-payer at 15%. [3mks]

SECTION B: ANSWER ANY THREE QUESTIONS

QUESTION TWO [10MKS]

(a) Explain two reasons why a corporation may prefer to raise investment funds outside domestic market. [4mks]

(b) Discuss three ways in which financial intermediaries help minimize transaction costs in the contest of Kenyan economy. [6mks]

QUESTION THREE

(a) Information asymmetry is very prevalent in both deposit and non-deposit -taking institutions in Kenya. Explain two ways in which information asymmetry problem occur in these institutions. [5mks]

(b) Discuss two ways in which financial intermediaries help in solving the problem of imperfect information identified in (a) above. [5mks]

QUESTION FOUR [10MKS]

(a) Explain the difference between a forward contract and a future contract. [4mks]

(b) An investor enters into a short forward contract to sell 100,000 British pounds for US dollars at an exchange rate of 1.4000 US dollars per pound. Determine how much does the investor gain or lose if the exchange rate at the end of the contract is

(i) 1.3900 [3mks

(ii)1.4200 [3mks]

QUESTION FIVE [10MKS]

(a) An investor observes that the dividends of Company ABC are growing at a constant rate of 12.85%. The information published in the company's financial statement show that the most recent dividend paid was Ksh 1.5 per stock held by investors. If the required return is 15%, calculate the value of the stock. [4mks]

(b) Discuss three problems which you may encounter when valuing ABC stocks. [6mks]

QUESTION SIX [10MKS]

(e) Suppose a bond has a maturity period of four (4) years and pays annual interest of $ 50 at the end of each year plus a principal of $ 1000 at the end of the fourth year. Investors think that the real rate is 2.5% while the inflation premium is 3%. The default risk and the maturity premium is 2% and 0.5% respectively while the liquidity premium is 1%. Since the bond is denominated in USD, the foreign exchange rate is zero. Determine:

(i) The appropriate discount rate for the bond. [2mks]

(ii) The value of the bond. [4mks]

(iii) Suppose a commission of $ 35 is imposed by broker to buy and sell the bond. Calculate the new value of the bond and explain your answer. [4mks]

(iv) Suppose also the government imposes a transfer tax of USD 20 on each transaction. Calculate the new value of the bond and explain your answer. [4mks]