

MASINDE MULIRO UNIVERSITY OF SCIENCE AND TECHNOLOGY
(At the Vision Institute of Professionals, Nairobi, Kenya)
FINANCIAL INSTITUTIONS AND MARKETS (INSTRUCTOR: JOHN K. KARUITHA, 0736 917 717)

Financial institutions and markets channel Billions of Shillings through the economy, affecting business and consumer decisions and the economic well being of our country, Kenya and foreign countries as well. The purpose of this course is to guide students in developing critical thinking skills as applied to financial institutions and markets. Topics include regulation; the efficient markets hypothesis; financial derivatives, exchange rates, risk and evaluation of financial institutions/ markets.

COURSE OBJECTIVES

After going through the course, the student should be able to;

- Identify & critically analyze the emerging issues in financial institutions and markets.
- Value financial instruments.
- Apply the concepts learnt in the course in a management setting.
- Read and understand advanced academic research articles touching on financial institutions and markets.
- Identify grey areas in financial institutions and markets for future research.

TERM DATES

For the semester starting May 2012 to August 2012.

COURSE OUTLINE

No	TOPIC/ SUBTOPICS	REFERENCES
1	Introduction to the financial system. a. The financial system. b. Components of the financial system. c. Clients/ participants in the financial system. d. Funds flow within the financial system. e. Do we really need a financial system?	Lecture notes, Hubbard chapter 1
2	Financial intermediation a. Why financial intermediation? (Information asymmetry- Moral Hazard, Adverse selection; Transaction cost economics). b. Agency theory in financial intermediation. c. Financial intermediaries in Kenya (highlight).	Lecture notes.
3	Financial institutions. a. Financial institutions as firms b. Financial institutions as 'intermediaries' c. The creation of assets and liabilities d. Financial institutions in Kenya and their roles.	Howells/ Bain, Chapter 1
4	Financial markets 1- Introduction. a. Financial markets vs. commodity markets. b. OTC vs. exchange markets. c. The role of financial markets. d. Financial markets in Kenya, Eastern and Southern Africa, Key global financial markets.	F&D, September 2008, pp 34-5 (Over-the-counter?)
5	Financial markets II- Money Markets a. Money market instruments. b. The microstructure of money markets- Trading in the money markets (Case of GoK T-bills). c. International money markets.	Howells/ Bain Chapter 5.

6	<p><i>Financial markets III- Capital markets</i></p> <ul style="list-style-type: none"> a. <i>Capital market instruments (Including unit trusts).</i> b. <i>The microstructure of capital markets- Trading at Securities Exchanges (Case of Equity trading at the NSE).</i> c. <i>International capital markets.</i> 	<i>Harris Part I, III, and IV.</i>
7	<p><i>Financial markets V- Derivative markets.</i></p> <ul style="list-style-type: none"> a. <i>Derivative instruments.</i> b. <i>The trading of derivative instruments.</i> 	<i>Mishkin 2 Chapter</i>
8	<p><i>Financial markets IV- Securitization and financial innovation</i></p> <ul style="list-style-type: none"> a. <i>Financial innovation- Introduction.</i> b. <i>Innovations in product development.</i> c. <i>Innovations in regulation.</i> d. <i>Innovations in infrastructure.</i> e. <i>Innovations in the payment system.</i> 	<p><i>F&D, September 2008, pp 78 (What is securitization?)</i></p> <p><i>Deacon Chapter 1, lecture notes.</i></p>
9	<p><i>Financial markets VI- The foreign Exchange markets.</i></p> <ul style="list-style-type: none"> a. <i>Foreign Exchange quotations and trading.</i> b. <i>Forex regimes.</i> c. <i>The law of one price and the PPP.</i> d. <i>Determinants of exchange rates.</i> e. <i>Local versus triangular arbitrage.</i> 	<i>Mishkin 2 Chapter 13.</i>
10	<p><i>Regulation of the financial system.</i></p> <ul style="list-style-type: none"> a. <i>The theory of regulation.</i> b. <i>Regulatory framework in Kenya: relevant regulatory laws and institutions</i> c. <i>Comparative study: Regulatory frameworks in USA, Britain, Australia and Mauritius.</i> d. <i>Consolidated versus unconsolidated regulatory framework.</i> e. <i>Case for and case against consolidated regulatory framework.</i> f. <i>Self regulation</i> g. <i>Emerging issues in regulation after the global financial crisis.</i> 	<p><i>Howells/ Bain Chapter 13.</i></p> <p><i>Mishkin 2, Chapter 20.</i></p>
11	<p><i>The theory of rational expectations and the efficient market hypothesis.</i></p> <ul style="list-style-type: none"> a. <i>Rational expectations.</i> b. <i>Efficient markets hypothesis.</i> c. <i>Forms of market efficiency.</i> d. <i>Evidence for and against the efficient market hypothesis.</i> 	<i>Mishkin 1 Chapter</i>
12	<p><i>Financial markets Indices.</i></p> <ul style="list-style-type: none"> a. <i>Market Indices, Calculating market indices: Price weighted vs. Market weighted indices, Composite indices</i> b. <i>Specific market indices- The Dow Jones Index, S&P Index, NSE 20 Share Index, NASI, NASDAQ and other stock market indices).</i> 	<i>Lecture notes</i>
13	<p><i>Principles of managing banking institutions</i></p> <ul style="list-style-type: none"> a. <i>Managing credit, liquidity risk.</i> b. <i>Managing capital.</i> c. <i>Asset/ Liability management.</i> 	<i>Lecture notes</i>
14	<p><i>Managing non-bank finance institutions.</i></p> <ul style="list-style-type: none"> a. <i>Peculiarities of non-bank finance institutions management.</i> b. <i>Principles of managing non-bank finance institutions.</i> 	<i>Lecture notes.</i>

NOTES

A hard copy of the notes will be given to the students where necessary. In other cases students will be required to refer to textbooks. Students are encouraged to refer to the texts even in cases where notes are provided as this will give deeper insights.

EVALUATION

Two continuous assessment tests will be administered. CAT 1 will cover topic 1 and 6. CAT 2 will cover topic 7 through topic 11. The class assignments will cover the entire outline. In addition, students will write a term paper.

Cat 1	30
Cat 2	30
Assignment	30
Term paper	30
TOTAL (CAT + Assignments + term paper) MARKS (Converted)	30
Final exam	70
TOTAL	100

KEY TEXTBOOKS RECOMMENDED FOR PURCHASE (IN THE ORDER OF IMPORTANCE- THE FIRST THREE TEXTS ARE VITAL)

- Howells/ Bain (2007), *Financial markets and institutions*, Pearson Education LTD, Harlow, England
- Mishkin, Frederic and Stanley G. Eakins, *Financial Markets & Institutions*, 4th edition, Addison Wesley, 2003 (**Mishkin 2**).
- Madura (2008), *Financial markets and institutions*, 8th edition, South-Western, Mason OH, USA.
- Hubbard, R. Glenn (2012). *Money, banking, and the financial system*. Prentice Hall. NY.
- Harris, Larry (2006), *Trading & exchanges*, Oxford University Press, Harlow, UK.
- Deacon, J (2006)., *Global securitization and CDOs*.
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REFERENCES AVAILABLE FOR FREE ON THE WEB

- IMF, *Finance & Development (F&D)* (Various editions). Available free of charge at the IMF, website www.imf.org.
- Misati, R. et al (2010), *Financial innovation and monetary policy transmission in Kenya*. *International research journal of finance and economics*, issue 50. <http://www.eurojournals.com/finance.htm>
- Financial Standards Report, *Kenya Peer Review Report*, April 2009, www.eStandardsForum.org

OTHER RESOURCES

- Mishkin, Frederic S. *The economics of money, banking, and financial markets*. The Addison-Wesley series in economics (**Mishkin 1**).
- Bodie, Z., et al (2010), *Investments*, Wiley, NY.
- Other references will be communicated in the course of the semester.