# **LAIKIPIA UNIVERSITY COLLEGE**

# **NYAHURURU TOWN CAMPUS**

**BCOM 330: FINANCIAL INSTITUTIONS AND MARKETS CAT 1(November 2, 2011)**

**ATTEMPT ALL QUESTIONS**

**PART A (10 mks)**

**1) Financial markets promote economic efficiency by**

**A) Channelling funds from investors to savers.**

**B) Creating inflation.**

**C) Channelling funds from savers to investors.**

**D) Reducing investment.**

**2) The bond markets are important because they are**

**A) Easily the most widely followed financial markets in Kenya.**

**B) The markets where foreign exchange rates are determined.**

**C) The markets where interest rates are determined.**

**D) The markets where all borrowers get their funds.**

**3) Compared to interest rates on long-term government bonds (treasury bonds), interest rates on three-month (91 day) Treasury bills fluctuate \_\_\_\_\_\_\_\_ and are \_\_\_\_\_\_\_\_ on average.**

**A) More; lower**

**B) Less; lower**

**C) More; higher**

**D) Less; higher**

**4) A share of common stock is a claim on a corporation’s**

**A) Debt.**

**B) Liabilities.**

**C) Expenses.**

**D) Earnings and assets.**

**5) Stock prices are**

**A) Relatively stable trending upward at a steady pace.**

**B) Relatively stable trending downward at a moderate rate.**

**C) Extremely volatile.**

**D) Unstable trending downward at a moderate rate.**

**6) Financial institutions that accept deposits and make loans are called \_\_\_\_\_\_\_\_.**

**A) Exchanges**

**B) Banks**

**C) Over-the-counter markets**

**D) Finance companies**

**7) Financial markets improve economic welfare because**

**A) They channel funds from investors to savers.**

**B) They allow consumers to time their purchase better.**

**C) They weed out inefficient firms.**

**D) Eliminate the need for indirect finance.**

**8) Well-functioning financial markets**

**A) Cause inflation.**

**B) Eliminate the need for indirect finance.**

**C) Cause financial crises.**

**D) Produce an efficient allocation of capital.**

**9) Which of the following can be described as direct finance?**

**A) You take out a mortgage from your local bank.**

**B) You borrow Ksh. 2500 from a friend.**

**C) You buy shares of common stock in the secondary market.**

**D) You buy unit trusts in a mutual fund.**

**10) Which of the following statements about the characteristics of debt/ bonds and equity is FALSE?**

**A) They can both be long-term financial instruments.**

**B) They can both be short-term financial instruments.**

**C) They both involve a claim on the issuer’s income.**

**D) They both enable a corporation to raise funds.**

**PART B (30 mks) (BE BRIEF IN PRESENTING ANSWERS)**

1. **As a financial manager of a large firm, you plan to raise Ksh. 70 million over the next 6 months. List down and BRIEFLY explain three sources of such funds in each of;**
   1. **The money market (6 mks)**
   2. **The capital Market (6 mks)**
2. **When and why would you prefer to raise cash in the money market as opposed to the capital markets? (4 mks).**
3. **List and BRIEFLY discuss briefly the various participants in financial markets, using a diagram where possible (6 mks).**
4. **Distinguish between deposit-taking and non-deposit-taking financial institutions, giving two examples of each. (8 mks)**
5. **Distinguish between moral hazard and adverse selection and give a real world example of each in the context of financial institutions/ markets. (5 mks)**

**PART C (10 mks) (BE BRIEF IN PRESENTING ANSWERS)**

**Italy downgrade deepens contagion fears over euro debt crisis**

**Ratings agency Moody's slashes Italy debt rating by three points, increasing pressure on European governments trying to contain financial crisis**

[Italy](http://www.guardian.co.uk/world/italy)'s sovereign debt rating has been cut for the second time in as many weeks, with ratings agency Moody's citing "sustained and non-cyclical erosion of confidence" as it slashed its forecast for the country.

In a report released after US stock markets closed on Tuesday, Moody's downgraded Italy's government bond ratings from AA2 to A2 with a "negative outlook", suggesting further cuts could be to come. The move threatens to increase Italy's cost of borrowing, and will add yet more pressure to European finance ministers now wrestling with a [financial crisis](http://www.guardian.co.uk/business/financial-crisis) that has spread across the continent.

(**Source**: *The Guardian Newspaper, October 4, 2011*)

**Questions**

1. In your opinion, what would drive a credit rating agency such as Moody’s to lower the credit rating of a country or organization. (2 mks)
2. Cite the implications of the cutting of the credit rating for Italy. (2 mks).
3. Highlight the role played by credit reference bureaus in the economy. (3 mks).
4. Distinguish between direct finance and indirect finance. Which of these is the most important source of funds for corporations in Kenya? (3 mks)