KENYATTA UNIVERSITY

UNIVERSITY EXAMINATIONS 2017/2018

FIRST SEMESTER EXAMINATION FOR THE DEGREE OF MASTER OF SCIENCE (FINANCE)

BAC 817: FINANCIAL INTERMEDIATION

DATE: **Thursday 23rd September 2017** **TIME:** **5.30p.m -8.30p.m**

INSTRUCTIONS:

ANSWER ALL FOUR QUESTIONS

QUESTION ONE

a) Explain four key *features of financial intermediation* in the context of *lending markets* (4 marks)

b) Describe the *relationship* between *stock market development* and *economic growth* in view of the two contrasting views on the relationship (5 marks)

c) Using appropriate examples from the *insurance sector*, explain three forms of *adverse selection* (6 marks)

d) Discuss the problem of *information asymmetry* in the *retirement benefits sector* and why regulators are often not able to contain the problem effectively. (4 marks)

e) Describe three key features of informal finance markets especially in a developing economy such as Kenya (6 marks)

QUESTION TWO

a) Describe the following terminology in the context of financial markets:

   i) Hoarding (2 marks)

   ii) Credit crunch (2 marks)

   iii) Insider trading (2 marks)

b) Discuss three forms of *moral hazards* in the *health care insurance* sector (6 marks)

c) Explain two forms of *market failure* in financial markets (4 marks)

d) In view of *agency theory*, explain three ways in which the *management versus shareholder agency problem* could be effectively managed (6 marks)

e) Describe your understanding of *extrapolation* in the context of *forecasting* of security prices (3 marks)

QUESTION THREE

a) Explain two *components* of *any theory* that justifies the *existence of financial intermediation* (4 marks)

b) Describe three possible *sources of conflict* in the *shareholder-auditor agency problem* especially amongst corporations (6 marks)

c) Discuss two *adverse selection problems* in the credit markets in Kenya (4 marks)

d) In view of Stiglitz (1993), explain three reasons why *regulation* of financial markets by government (such as credit markets) may not often yield the intended results (6 marks)

QUESTION FOUR

a) Discuss the 2 *principles* governing transactions in the *informal finance sector* (4 marks)

b) Explain four *features* of an *efficient capital market* based on the classical views of Fama (1969, 1970). (4 marks)

c) Describe two key *functions* of Insurance Regulatory Authority (IRA) in Kenya (4 marks)

d) Using an appropriate example, discuss *currency arbitrage* as a practice in inefficient money markets (4 marks)

e) Discuss two key *features of public information* in credit markets which largely qualify the same to be a *public good* (4 marks)

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