Kasarani Campus
Off Thika Road
Tel. 2042692 / 3
P. O. Box 49274, 00100
NAIROBI
Westlands Campus
Pamstech House
Woodvale Grove
Tel. 4442212
Fax: 4444175

KIRIRI WOMENS' UNIVERSITY OF SCIENCE AND TECHNOLOGY

UNIVERSITY EXAMINATION, 2023/2024 ACADEMIC YEAR
FOURTH YEAR, SECOND SEMESTER EXAMINATION
FOR THE DEGREE OF BACHELOR OF SCIENCE
(BUSINESS ADMINISTRATION)

Date: 15th December, 2023
Time: 2.30pm –4.30pm

KFI 405 - SEMINAR IN FINANCE

INSTRUCTIONS TO CANDIDATES

ANSWER **QUESTION ONE (COMPULSORY)** AND **ANY OTHER TWO** QUESTIONS

QUESTION ONE (30 MARKS)

Case study

Elections Anxiety and Housing Stress

A country in Central Africa has an impending national elections early next year. Due to political uncertainty, demand for housing has dampened; supply for housing has equally taken a break with developers adopting a *'wait and see' approach* to new developments! Several people are contemplating moving closer to the cities to cushion themselves against political risk which is more prevalent in rural areas. The government has equally introduced new policies to protect investment risk in real estate. Mortgage lenders have been on a go-slow in lending to individuals who intend to build their residential houses. The federal governments (also called County Governments) have urged residents to shun political violence: but most of the electorate are quite charged! The situation is quite uncertain for Insurance firms too. Most of the private insurance firms have introduced political risk insurance policy covers for the real estate sector. Though commercial real estate owners are keen on such policy covers, a good number of individual investors may not afford such: they are increasingly becoming vulnerable to political risk. Landlords are keen on holding on to their tenants as the rental market becomes uncertain. The Ministry of Housing has introduced a new law to protect private citizens who have rented property- they may not be evicted if they do not pay rent on time since the economic situation is not that good. This has made most landlords unhappy. The inflation rate is rising steadily. The prices of construction inputs are unbearable to many developers. They are considering importation of the inputs though the government has equally introduced import tax on such inputs. The sales price for residential housing has declined significantly; the same case applies to commercial housing though the latter has better prices. Real income has dampened hence a good number of citizens may not afford high end rental units (they are opting for suburbs and rural housing). The government is not having it easy either. For the regional summit scheduled at the capital city has been cancelled due to insecurity. For the opposition has threatened to run a parallel government if the incumbent 'steals the vote'. Consequently, money markets have since reported shortages. The government is contemplating borrowing externally for local borrowing has declined massively. The Minister for Finance is keen on raising taxation rates for individual income and corporate income. The situation is getting economically unstable. The country's stability is at stake for wealthy locals are fleeing to the neighbouring countries as they adopt a 'wait and see' attitude. The political, social and economic struggle continues.

(Note: this case study has been coined purely for academic purposes)

Having read the case study above, you are required to:

a) Discuss any three financial risks which form the core of the case study. (6 marks)

b) Explain how people's expectations (on political uncertainty) can negatively affect the value of rental housing in the country. (6 marks)

c) Describe three political risk management initiatives that the government could put in place to mitigate the risk. (6 marks)

d) Discuss credit risk (from the perspective of mortgage lenders) considering the political uncertainty (6 marks)

e) Describe any three financial risk management practices that property developers could adopt to cushion themselves against adverse effects of the political risk (6 marks)

QUESTION TWO (20 MARKS)

a) Corporate governance has gained a lot of attention in Kenya (in the recent past) following financial malpractices in the banking sector-discuss any four such issues (8 marks)

b) Describe the contributions of Modigliani and Miller (1961) in the dividend policy and firm value by invoking perfect market conditions and homemade dividends (6 marks)

c) Describe the aspect of agency costs as a solution to the shareholder-manager agency problem in view of Jensen and Meckling (1976) (6 marks)

QUESTION THREE (20 MARKS)

a) Explain three key differences between Pecking order theory of capital structure and the Trade-off theory (6 marks)

b) Discuss three information asymmetry problems which are prevalent in credit markets (6 marks)

c) Discuss two key features of an efficient financial market (in view of Fama (1969. 1970)) giving a clear exposition of the three forms of market efficiency (8 marks)

QUESTION FOUR (20 MARKS)

a) Discuss the expectations theory of exchange rates in the context of social, economic and political developments in an economy such as Kenya (8 marks)

b) Explain three reasons why regulating financial sectors may not often yield the desired results (6 marks)

c) Explain the superiority of Arbitrage Pricing Theory (APT) over Capital Asset Pricing Model (CAPM) in the context of financial asset pricing (6 marks)

QUESTION FIVE(20 MARKS)

a) Stigliz (1993) proposes a 'model' for and against government intervention in financial markets. In view of the stock market in Kenya, explain three justifications for government intervention based on the need to 'correct' market problems (6 marks)

b) In view of Modigliani and Miller (1958), explain why debt-equity mix may not affect firm value. (6 marks)

c) Critique four key contributions of Markowitz (1952) in risk diversification and portfolio Selection. (8 marks)