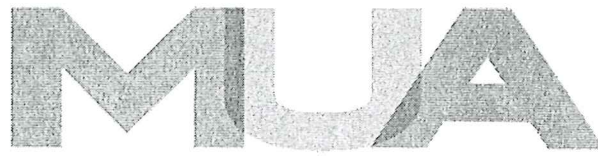


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POSTGRADUATE UNIVERSITY EXAMINATIONS

SCHOOL OF MANAGEMENT AND LEADERSHIP

DEGREE OF DOCTOR OF PHILOSOPHY IN BUSINESS ADMINISTRATION

DBF 901: THEORIES OF BANKING AND FINANCE

DATE: 29<sup>TH</sup> JULY 2022

DURATION: 3 HOURS

MAXIMUM MARKS: 50

INSTRUCTIONS:

1. Write your registration number on the answer booklet.
2. **DO NOT** write on this question paper.
3. This paper contains **FOUR (4)** questions.
4. Question **ONE** is compulsory.
5. Answer any other **TWO** questions.
6. Question **ONE** carries **30 MARKS** and the rest carry **10 MARKS** each.
7. Write all your answers in the Examination answer booklet provided.

## QUESTION ONE

Read the Case Study below carefully and answer the questions that follow:

A) MUA is considering two projects:

Project A requires an initial investment of Ksh1, 500,000 to yield estimated annual cash flows of:

- Ksh150,000 in Year 1
- Ksh300,000 in Year 2
- Ksh500,000 in Year 3
- Ksh200,000 in Year 4
- Ksh600,000 in Year 5
- Ksh500,000 in Year 6
- Ksh100,000 in Year 7

The appropriate discount rate for this project is 10%.

Project B also requires an initial investment of Ksh3,000,000 to yield estimated annual cash flows of:

- Ksh100,000 in Year 1
- Ksh500,000 in Year 2
- Ksh1,000,000 in Year 3
- Ksh1,500,000 in Year 4
- Ksh200,000 in Year 5
- Ksh500,000 in Year 6
- Ksh1,000,000 in Year 7

The appropriate discount rate for this project is 13%.

The company is only able to undertake one project. Using the profitability index method, which project should the company undertake? **(10 Marks)**

- B) Back in the nineteenth century and during the first few decades of the twentieth century (around and during the Great Depression), putting your money in a bank could be nerve-wracking. Imagine that the net worth of your bank became negative, so that the bank's assets were not enough to cover its liabilities. In this situation, whoever withdrew their deposits first received all of their money, and those who did not rush to the bank quickly enough, lost their money. Depositors racing to the bank to withdraw their deposits, is called a bank run. In the movie *It's a Wonderful Life*, the bank manager, played by Jimmy Stewart, faces a mob of worried bank depositors who want to withdraw their money, but manages to allay their fears by allowing some of them to withdraw a portion of their deposits – using the money from his own pocket that was supposed to pay for his honeymoon.

Explain how deposit insurance and lender of last resort are two strategies to protect against bank runs **(10 Marks)**

- C) Many banks make mortgage loans so that people can buy a home, but then do not keep the loans on their books as an asset. Instead, the bank sells the loan. These loans are "securitized," which means that they are bundled together into a financial security that is sold to investors. Investors in these mortgage-backed securities receive a rate of return based on the level of payments that people make on all the mortgages that stand behind the security.

Discuss pros and cons of securitization to a bank **(10 Marks)**

## QUESTION TWO

- a) Discuss how Information Asymmetry Affect Business **(5 Marks)**
- b) Signaling refers to the act of using insider information to initiate a trading position. It occurs when an insider releases crucial information about a company that triggers the buying or selling of its stock by people who do not

ordinarily possess insider information. The actions of the insider are considered a market signal to outsiders. Discuss (5 Marks)

### QUESTION THREE

- a) Distinguish between Consumption and investment (5 Marks)
- b) A financial crisis or economic crisis refers to the sudden loss in the value of numerous monetary assets like realty and stocks. It causes a loss in the paper wealth but does not essentially bring major economic modifications. Moreover, its prominent instances are the great depression in 1929 and the global financial crisis of 2008. Discuss economic crisis timelines between 1929 and 2008 (5 Marks)

### QUESTION FOUR

- a) The spread of COVID-19 is alarming. But not surprising. Globalization creates systemic risks. More flows between countries make risks more contagious. Discuss (5 Marks)
- b) Explain the difference between Debt Securities and Equity Securities (5 Marks)