



*“Investing in Africa’s future”*

**COLLEGE OF BUSINESS PEACE LEADERSHIP GOVERNANCE**

**NMEC205: MONEY AND BANKING**

**END OF SECOND SEMESTER FINAL EXAMINATIONS**

**APRIL 2023**

**LECTURER: MR. G. MANDEWO**

**DURATION: 3 HOURS**

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## ***INSTRUCTIONS***

Answer **Question number 1**. Answer **ANY three questions**. Total possible mark is **100**.

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Start **each** question on a new page in your answer booklet.

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The marks allocated to **each** question are shown at the end of the question.

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**Show all your workings.**

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Credit will be awarded for logical, systematic and neat presentations

- 1 (a) What are financial intermediaries? **[5 Marks]**  
(b) Explain with an aid of a diagram the process of financial intermediation

**[10 Marks]**

- (c) What is the role of financial intermediation? **[5 Marks]**  
(d) Why is financial literacy critical in enhancing financial depth? **[5 Marks]**

2. Briefly explain the following terms and demonstrate their application in the financial world

- (a) Interest rate **[5 Marks]**  
(b) Shares **[5 Marks]**  
(c) Equity **[5 Marks]**  
(d) Debentures **[5 Marks]**  
(e) Bond **[5 Marks]**

3. (a) Using your own examples demonstrate how to calculate the value of convertible securities, exchangeable bonds, and warrants and explain why premiums over different values occur. **[15 Marks]**

- (b) What is the relationship between an option instrument and its underlying security? **[10 Marks]**

4. (a) Explain how the retirement (repayment) of bonds and preferred stock may be accomplished in a number of different ways. **[10 Marks]**

- (b) Explain the differences between various types of long-term securities in terms of claims on income and assets, maturities, security holders' rights, and the tax treatment of income from the securities. **[15 Marks]**

5. Discuss the advantages and disadvantages of issuing/buying the three different types of long-term securities from the perspective of both the issuer and investor. **[25 Marks]**

6. (a) What do you understand by capital markets? **[5 Marks]**

- (b) Stock broking is key in enhancing financial capital for firms. Explain **[10 Marks]**

- (c) Treasury bill are debt instrument used by governments to get capital. Explain how this financial product is used **[10 Marks]**

7. Sales.com is an internet company offering on-line book sales. Because it faces intense competition, its new services may or may not be competitive in the market place so its future earnings cannot be predicted very well. Basic Foods distributes essential food

staples to grocery stores and its sales and profits are relatively stable and predictable.

The rate-of-return probability distributions for the two companies are shown below.

Demand for Company's Products	Probability of this demand	Rate of return if this demand occurs	
		Sales.com	Basic Foods P/L
Strong	0.3	100%	40%
Normal	0.4	25%	15%
Weak	0.3	-70%	(10%)

- (i) Calculate the expected rate of return for Basic Food P/L [4]
- (ii) What is the variance and hence the stand alone risk Sales.com [6]
- (iii) Calculate the coefficient of variation for both stocks [2]
- (iv) Explain the term 'investment risk' and explain how managers measure risk.  
What is the relationship between risk and return? [3]
- (v) Suppose you formed a \$30 000 portfolio, investing \$10 000 in Sales.com and the balance in Basic Foods, what is the expected return of this portfolio? (4 marks)
- (vi) What is the meaning of the correlation coefficient,  $\rho$  in relation to the risk of a portfolio? What would be your interpretation if you found that (i)  $\rho = +1$  (ii)  $\rho = -1$  (iii)  $\rho = 0.35$ ? What would be the effect of adding more stocks to the portfolios? Is it possible to form completely riskless portfolios? [6 marks]

8. (a) People and organizations wanting to borrow money are brought together with those having surplus funds in the financial markets. Define the following terms:

- i. Money market (2 marks)
- ii. Capital markets (2 marks)
- iii. Primary markets (2 marks)
- iv. Secondary markets (2 marks)

(b) In general, a quoted interest rate (or nominal interest rate) is composed of real interest rate and a number of premiums. Write down the equation of the quoted market interest rate. Outline and briefly explain these premiums [5 marks]

(c) Mobil Oil Corporation bond has a return of 15% half of the time and 5% the other half of the time whilst the expected return on the Dawn Properties bond has a

return of 12% two-thirds of the time and 8% one-third of the time. Calculate the expected returns for these market instruments. Calculate the risk for the two bonds. Of these two stocks, which is riskier? **[5 marks]**

(d) Snyder Computer Chips P/L is experiencing a period of rapid growth. Earnings and dividends are expected to grow at a rate of 15% during the next two years, at 13% during the third year and at a constant rate of 6% thereafter. Snyder's last dividend was \$1.15 and the required rate of return is 12%.

(i) Calculate the value of the stock today

(ii) Calculate  $P_1$  and  $P_2$ . Calculate the dividend yield and capital gains yield for Years 1 and 2 **[7 marks]**

END OF EXAMINATION