



# MACHAKOS UNIVERSITY

University Examinations for 2018/2019 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ECONOMICS

SECOND YEAR SUPPLEMENTARY EXAMINATION FOR

BACHELOR OF ECONOMICS

BACHELOR OF ECONOMICS & FINANCE

BACHELOR OF ECONOMICS & STATISTICS

**EAE 202: FINANCIAL INSTRUMENTS & RISK MANAGEMENT**

**DATE:**

**TIME:**

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**INSTRUCTIONS:**

- (i) Answer question one (Compulsory) and any other two questions
- (ii) Do not write on the question paper
- (iii) Show your working clearly

**QUESTION ONE (COMPULSORY) (30 MARKS)**

- a) Explain the factors that shift the bond demand curve (10 marks)
- b) Explain two main characteristics of ordinary shares (4 marks)
- c) Give three areas of distinction between futures and forwards, apart from one being an OTC and the other being conducted under organized exchanges. (6 marks)
- d) Distinguish between the following terms;
  - i) Coupon and fixed payment bond
  - ii) Corporate bond and Commercial paper
  - iii) Base rate and receivables
  - iv) Investment bank and Stockbroker
  - v) Contingent capital instruments and derivative (10 marks)

**QUESTION TWO (20 MARKS)**

- a) If you buy 1000 preferred shares of TPS Serena Ltd, what are you entitled to? (12 marks)
- b) Explain the factors that affect the option price. (6 marks)
- c) What is an initial public offer (IPO) in relation to issuance of Equities? (2 marks)

**QUESTION THREE (20 MARKS)**

- a) Financial risk is managed by use of financial instruments. Briefly outline these instruments in relation to how they can be used to manage risk (9 marks)
- b) What are the specifications of a negative covenant? (5 marks)
- c) Discuss the various ways of pricing different types of bonds. (6 marks)

**QUESTION FOUR (20 MARKS)**

- a) Explain 5 various categories of risks faced by financial institutions. (10 marks)
- b) There are various types of financial markets operational in the Kenyan Economy. Discuss this statement. (10 marks)

**QUESTION FIVE (20 MARKS)**

- a) There is a 5 % yield on a 1 year bond and a 7% yield on a 30 year bond. Which bond is better) show your workings. (5 marks)
- b) Define the yield curve. (3 marks)
- c) Briefly explain the risks faced by bondholders (3 marks)
- d) Under which circumstances will an embedded derivative be accounted as a derivative? (3 marks)
- e) Explain the use of financial instruments (6 marks)