



MACHAKOS UNIVERSITY

University Examinations for 2022/2023 Academic Year

SCHOOL OF BUSINESS, ECONOMICS AND HOSPITALITY AND TOURISM

MANAGEMENT

DEPARTMENT OF ECONOMICS

THIRD YEAR SECOND SEMESTER EXAMINATION FOR

BACHELOR OF ECONOMICS AND FINANCE

EAE 302: ECONOMICS OF MICROFINANCE I

DATE:

TIME:

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) Opiyo a graduate of Machakos University with Bachelors degree in Economics and Finance was invited for interview for the position of finance officer with Sacco Societies Regulation Authority. During the interview Opiyo was asked to clearly explain why it is importance for the government to insists on maintenance of liquidity requirements by Microfinance Institution in Kenya. Assume you were Opiyo how would have answered the panelist to secure the job? (6 marks)
- b) The bank lend to risky borrower by raising interest rate by 20 % from safer interest rate of 15 % per annum. Given that the Bank knows that the probability of risky borrowers to be successful is 75 % .However the bank goes ahead and lend 100 000/= to risk borrower. You are required to calculate the expected return to the bank. (6 marks)
- c) During the revision for the main examinations, Muli, a student who did not attend a lecture due to unavoidable circumstances, approached you humbly requesting you to explain to him the definition of the following terms as used in Economics of Microfinance I. Having attended the lecture how did you define the terms?
 - I. Effective rate of interest (2 marks)
 - II. Moral hazard problem (2 marks)

III. Adverse selection problem (2 marks)

- d) Assume the MFI's portfolio fund is Ksh 100 million which is raised as follows: Ksh.70 million from commercial banks at 12% per annum interest rate, Ksh.30 million from clients' saving deposits at 6% per annum interest rate. You are required calculate the average annual cost of the portfolio fund to the MFI. (5 marks)
- e) The Equity bank operating in a competitive environment its gross interest rate is 12 % and other marginal costs is 20% for every money lead out. Brayo who completed his degree programme from Machakos university is having a choice to make between taking an employment offer that earns him salary of Ksh 50 000 per month. The second choice is to borrow ksh 100 000 and invest and expected to earn him 200 000 in three months. Calculate Brayo's Social Surplus for the three months. (7 marks)

QUESTION TWO (20 MARKS)

- a) At the beginning of this important course in micro finance and SME business in the world you learnt that Microfinance Institutions have been growing faster since 1970s. A number of reasons were given that explained why such fast growth was experienced. State and explain those reasons behind this fast growth in Microfinance Institutions in developing countries (6 marks)
- b) Using hypothetical numerical example explain the importance of Social Surplus in SME business (5 marks)
- c) Wamalwa entered an interview room for senior manager position with Hustler Fund Authority. Wamalwa was asked by head of panelist to be relaxed. The interview commenced where the fifth question was about the Ownership and Governance risk as one of the risks Microfinance Institutions are facing in Kenya as they endeavor to attain better operations and sustainability of their institutions. Wamalwa was tasked to explain what it means by Ownership and Governance risk in the context of Microfinance Institutions in Kenya. Give brief note on what Wamalwa told the panelist (5 marks)
- d) Government of Kenya regulating MFI has put out some rules to be followed such as portfolio diversification. You are required to explain why loan portfolio diversification is importance in Microfinance institution in Kenya as was put in government of Kenya regulations of MFI. (4 marks)

QUESTION THREE (20 MARKS)

- a) One of the main challenges facing the politician and senior policy makers in Government is the hard tradeoff between the distributional goal and efficient allocation of resources goal. Assume you are a junior and newly recruited in Government as a policy analyst you are tasked to explain and give direction on this tradeoff (5 marks)
- b) This course has taught you that in some instances Market can form, partially form or completely fail to form, hence causing market failure problem. In Microfinance has faced the problem of the Market failure. This problem has necessitated the government intervention. Briefly explain the market failure problem and how government has intervened to bring in necessary solution. (8 marks)
- c) Assume you attended an exam for economics of Microfinance 1. The first question you encountered which was compulsory was about how Microfinance Institutions are facing Agency problem in their daily business of lending money to loanee. During the lecture it was clear that the agency problem causes moral Hazards and adverse selection. Describe the term **agency problem** and propose a number of amical solutions. (7 marks)

QUESTION FOUR (20 MARKS)

- a) Theoretically Money lenders is risky areas and more worse to the poor borrowers however lenders faces monopolistic demand and supply curves hence making super normal profit hence. Many people perceive such business of lending to the poor has a profitable venture. You are required to give and explains briefly the causes of monopoly to this kind of business? (8 marks)
- b) Assume you are newly recruited to FAULU MFI and before you settle the manager calls you to her office. After a long talk she tasks you to give brief differences between flat rate methods and declining balance method of calculating interest rate for the approved loans and suggest the methods to adopt for new loans to be approved. What did you tell your new boss? (7 marks)
- c) Define the following terms as used microfinance institutions
- i. Fungibility (2 marks)
 - ii. Group lending (1 mark)
 - iii. Assortative matching. (2 marks)

QUESTION FIVE (20 MARKS)

- a) Pricing of loan is a general concept that uncovers the components considered so as to arrive at cost of loan (credit) before profit margin. Describe the concept of Loan pricing in Microfinance Institutions as we learned in class (6 marks)
- b) There have been a number of efforts to reduce high interest rates charged to the poor by MFIs. Briefly explain how the government has attempted to provided the solution to high interest rate charged by Microfinance Institutions to poor borrowers. (8 marks)
- c) Assume you are in an interview with Hustler Fund Authority for position of loan officer. A supervisor asks why you would prefer leading to Group members as opposed to individual loanee? Briefly give explanation to your answers to the panelist. (6 marks)