



STRATHMORE UNIVERSITY BUSINESS SCHOOL  
BACHELOR OF FINANCIAL SERVICES  
BFS 1101: INTRODUCTION TO FINANCIAL SERVICES

**Date:** Wednesday, 19<sup>th</sup> August 2020

**Time:** 3 hours

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**Answer question one (compulsory) and any other two questions**

**Question 1**

- a. The Corona Virus has brought into light the abilities of countries to deal with emergence of pandemics. Some countries such as New Zealand have been able to tackle the pandemic in a good manner while countries such as Brazil are overwhelmed by the pandemic. The pandemic is also going to affect the financial assets of different countries differently. Those countries that will not handle the pandemic properly will likely sink into depression and have their financial assets loose value while those that handle the pandemic properly will recover and will experience increase in the prices of their financial assets. Assume that you are hedge fund manager and you have this information, explain the strategy that you would employ to take advantage of this information and how you would employ the strategy. (6 marks)
- b. With the use of an example differentiate between refinancing and reinvestment risk as faced by financial institutions (6 marks)
- c. The insurance industry is very lucrative to the extent that some banks currently are offering insurance products with the hope of tapping into this profit. With this in mind, explain three ways that insurance companies make their profit. (6 marks)
- d. A close-ended mutual fund has 300,000 shares outstanding. The mutual fund has invested the money of the fund in the following financial assets: 15,000 shares of Safaricom whose market price per shares is Sh. 26; 25,000 shares of Sameer ltd whose market price share is Sh. 6 and 12,000 shares of NMG whose market price per share is Sh. 12.65. The current price of the mutual fund share is Sh. 2 per share.
  - i. Determine the Net asset value of the mutual fund share (4 marks)
  - ii. Establish whether the mutual fund share is trading at a premium or at a discount and indicate by how much (2 marks)
- e. Green merchant ltd is a company that deals with the trade of groceries. The company buys the groceries from the farmers and then supply these groceries to supermarkets. The company has recently been facing cashflow (liquidity) issues since the supermarkets take a period of 60 days to pay them while the Green Merchant ltd pays the farmers after 30 days. Explain to Green merchant

two services that are offered by banks that they can take advantage of to avoid the cash flow issues.  
(4 Marks)

- f. A hedge fund manager is managing a fund whose asset value is \$200 million. The fees structure of the hedge fund is (1.5% and 21%). In the year ended 31 Dec 2019, the fund manager generated a return of 18.75% from this fund.

**Required:**

Determine the amount of money that will be received by the fund manager as fees (4 marks)

**Question 2**

- a. James is the Chief operating officer of Bricks ltd bank which has headquarters in Kenya. He has been invited to a board meeting where other directors of bank are. The intention of the meeting is to enable the other board members understand the risks that the company is exposed to based on how it is conducting its operations. James gives the following information as an account of the situation of the bank:

The bank currently has 120,000 customers who have deposited an amount of Sh. 15 billion. The deposits of the bank are divided as current account deposit which account for Sh. 6 billion and fixed deposit account which account for 9 billion. The bank does not pay interest on the current deposits, but it pays interest on the fixed account at a rate of 6% per annum. A large portion of the bank's fixed deposits are for a period of one year. The bank has issued loans worth Sh. 12 billion. Half of this loan is in terms of bank overdraft and bills of exchange. The other half of the loan is long-term in nature with a large part of it being of more than 3 years. Further to this, the long-term loans constitute an amount of Sh. 250 million which was given to a company in South Sudan. This loan was denominated in terms of South Sudan pound.

James also indicated that the bank had spent an amount of Sh. 500 million to acquire a computer information system to make the operations of the bank efficient. Further to this, the bank will be spending an amount of Sh. 80 million to train its staff on how to use the system. The bank will also incur an additional Sh. 50 million per annum for the next ten years for the maintenance of the system.

**Required:**

Using the information presented above about the bank, evaluate various types of risk that the bank is exposed to (10 Marks)

Note: Marks will be awarded based on how well each type of risk has been explained.

- b. The cabinet secretary for treasury (Finance minister) had requested for an inquiry on the state of the macro variables of the country. One of the macro variables that was researched on was inflation and as per the report, the country is experiencing a high level of inflation. The cabinet secretary wants to take corrective measures to reduce the level of inflation in the country. Advise the Cabinet secretary on three measures that the central bank (Federal bank) can take through its influence on commercial banks to reduce the level of inflation in the country. (10 marks).

### Question 3

- a. Elimu limited is a company listed in the securities exchange. The company has tabled a request to acquire JDL limited which is also another company listed in the securities exchange. Both companies are in the information technology sector of the economy. Assuming that you are a hedge fund manager and you have come across this information, give a well **detailed explanation** of how you would use the information to earn a return for fund. (5 marks)
- b. An open-ended mutual fund has 1,000,000 outstanding mutual fund shares. The mutual fund has invested in the following shares of companies listed in Dar es Salaam Stock exchange: 10,000 shares of EABL at a market price of Sh. 3,380; 20,000 shares of Jubilee Holdings ltd at a market price of Sh. 5150 and 60,000 shares of KCB at market price of Sh. 760.

#### Required:

- i. Determine the net asset value of this mutual fund (3 marks)
  - ii. Assume that mutual fund sells an additional 10,000 mutual fund shares at the current NAV. Assume further that additional funds are used to acquire shares of KCB at the current market price. Determine what will be the Net asset value of the mutual fund (4 marks)
  - iii. Using the information in note (ii) above, assume that the price of the shares changes as shown by the end of next month. EABL to Sh. 3,400; Jubilee Holding to Sh. 5,000 and KCB to Sh. 780. Determine the net asset value of the mutual fund (3 marks)
- c. The current market price for a close-ended mutual fund is Sh. 37.5 per share. The mutual fund has 500,000 outstanding shares. The value of the assets in the mutual fund is Sh. 20 million. The mutual fund charges a load fund cost of 4.5% and fund operating cost of 2% per annum.

#### Required:

- i. Determine the NAV of this mutual fund (1 mark)
- ii. Determine whether it is trading at discount or premium and by how much (1 mark)
- iii. What could be one of the reasons why it is trading like that (1 mark)
- iv. Assume that an investor invests in the mutual fund for a period of three years. What will be the annualized cost to the investor? (2 marks)

### Question 4

- a. Game merchant is a company that is involved in producing soft drinks in the country. The company want to expand its operation by acquiring a new production facility that will cost the company an amount of Sh. 500 million. The company want to raise this money by issuing shares to the public.

#### Required:

- i. Explain how company can use the services of an investment banker to raise the amount of money that they require for the project. (6 marks)
- ii. Explain the role that will be played by securities firms after the company has already issued the shares to the public. (2 marks)

- b. Senzen ltd operates as a bank whereby all its branches are located in the capital of the country. The bank wants to expand and reach new areas by acquiring another bank that has branches in different parts of the country. The bank wants to finance this acquisition by raising funds from the public. The bank has approached an investment banker who is going to facilitate the raising of the funds and the merger process. The investment bank has agreed to underwrite the issue of 400 million shares of Senzen on a commitment basis. The investment banker pays Sh.7.5 per share to Senzen for the 400 million shares. The investment banker then sells those shares to the public for Sh. 7 per share.

**Required:**

- i. Show how much money Senzen ltd receives (1 mark)
  - ii. What is the profit or loss of the investment banker? (2 marks)
  - iii. If the investment banker sold the shares for a price of Sh. 8.5 instead, how much money will Senzen receive? (1 mark)
  - iv. What is the profit or loss to the investment banker if the sold the shares for Sh. 8.5? (2 marks)
- c. Tropical ltd approached an investment banker seeking helps to raise funds. The investment banker agreed to underwrite the issue on a best-efforts basis for the 125 million shares of the company. The investment banker is only able to sell 100 million shares of the company for a price of Sh. 12.5 per share. The investment banker charges Sh. 0.5 per share sold.
- Required:
- i. Show the amount of money that Tropical ltd is going to receive (2 marks)
  - ii. What is the profit of the investment banker? (1 mark)
  - iii. If the investment banker can sell the shares for Sh. 14 per share, how much money does Tropical ltd receive? (2 marks)
  - iv. What is the profit to the investment banker? (1 mark)

**Question 5**

- a. Tom is the managing director of Golden bank ltd. He is currently 47 years and is married with two children. Tom wants to take care of his future by taking an insurance policy that is going to ensure that he has some form of income in the future. He also wants the interest of his family to be taken care of incase he was to die before the age of 60 years. Tom is also worried at the expense that the bank is incurring in paying for the hospital bill of its employees and want to take an insurance policy that will take this into consideration. Tom is also worried by the decreased profit of the bank over the years which he attributes to cases of owners of small businesses dying before the pay for the loan.

**Required:**

- Give a **detailed** advice to Tom on some of the insurance products that he can take to safeguard the financial interest of his future and reduce the risks that the bank is exposed to. (8 marks)
- b. One of the biggest challenges that is facing insurance companies is competition. The competition is from other insurance companies and other financial institutions such as banks that are also venturing into the insurance industry with the aim of increasing their return. Insurance companies therefore have to find a competitive edge that they can leverage to help them overcome this

challenge. One of the competitive edges that the insurance companies can leverage on is technology.

**Required:**

Explain 4 ways on how insurance companies can leverage technology to maintain their competitive edge (8 marks)

- c. Explain two reasons why insurance companies cannot cover a pandemic such as COVID-19. (4 marks)