MACHAKOS UNIVERSITY

University Examinations for 2019/2020 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ECONOMICS

THIRD YEAR FIRST SEMESTER EXAMINATION FOR

BACHELOR OF ECONOMICS AND FINANCE

BACHELOR OF ECONOMICS

EAE 302: ECONOMICS OF MICROFINANCE I

DATE: 4/12/2019 **TIME: 8.30-10.30 AM**

INSTRUCTIONS:

1. **Answer question one and any other two questions**
2. **Question one is compulsory and carries (30 marks)**
3. **All other questions carry (20 marks each)**

QUESTION ONE (30 MARKS)

a) Distinguish the following terms as used in microfinance

i) Microfinance vs credit finance (2 marks)

ii) Declining balance method vs flat rate method of calculating interest (2 marks)

iii) Agency problems vs adverse selection problems (2 marks)

iv) Nominal interest rate vs effective interest rate (2 marks)

v) Ex- ante efficiency vs efficiency in expectation (2 marks)

b) Name and briefly explain each of the five risk factors the regulator of microfinance institutions looks out for. (10 marks)

c) i) Explain the principle of diminishing marginal returns to capital? (1 mark)

ii) Using the assumed concavity of a production function to show that in theory a micro enterprise should be able to pay a higher interest rate than a large enterprise (4 marks)

iii) Why should a Japanese foreign direct investment (FDI) of US $10 million be more likely to go to Europe or USA than Kenya. Are there any similarities between investment problem of a local commercial bank considering whom to lend within Kenya? (5 marks)

QUESTION TWO (20MARKS)

In Kenya, women constitute approximately 52.2 percent of the population and form the backbone to rural development by providing 80 percent of the labour force.

Why is it that despite these figures, women in Kenya access only 10 percent of the resources and own just 1 percent of these resources (20 marks)

QUESTION THREE (20 MARKS)

"Adoption and adapted imported technology in the informal sector in Kenya will accelerate the attainment of the UN's millennium development goal (MDG) one: having poverty and hunger eliminated by 2025" discuss this statement

QUESTION FOUR (20 MARKS)

a) Suppose after graduation next year you decide to take advantage of the government Kenya's uwezo fund, which aims at advancing soft loans to budding youth and women entrepreneur. The programme offers you a chance to borrow ksh 20,000 a subsidized interest rate of 6 percent per annum. State which of the following two strategies you would choose and why.

   i) invest the 20,000 in your family business and obtain a net return of 15 percent per annum but incur an effort cost equivalent to ksh 2667

   ii) deposit the money in a nearby formal commercial bank that will pay you a yearly rate 2.5 percent (use calculation to arrive at your answer (10 marks)

b) i What are the main difference between a ROSCA and a credit- cooperative? (4 marks)

   ii what are the main disadvantages of ROSCAs vis- a vis credit co-operative (3 marks) iii if they have these disadvantages in 4 (b) II above, why are ROSCAS more common than credit co-operative (3 marks)

QUESTION FIVE (20 MARKS)

"Credit finance advanced by microfinance institutions is a necessary but not sufficient factor in the growth of micro and small enterprises"

Discuss this statement in view of the fact that despite government and agencies support for micro small enterprises (MSEs) in the informal sector, number of studies have shown that more than half of the start- ups in the informal sector do not survive their third birthday (20 marks)