



# MACHAKOS UNIVERSITY

University Examinations for 2021/2022 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ECONOMICS

FOURTH YEAR SECOND SEMESTER EXAMINATION FOR

BACHELOR OF ECONOMICS & FINANCE

EAE 402: ECONOMICS OF MICROFINANCE II

DATE: 8/12/2021

TIME: 11.00-1.00 PM

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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) Assume after graduating with bachelor's degree, you make a decision to follow your long-time nagging dream of being a successful business fellow. One of the disturbing questions is where to get the seed capital to quench your dream. Having done successfully both economics for microfinance I and II, you are aware that there are four sources of funds that can provide the seed capital, i.e internal, external, government and non-government. Discuss the weakness of external sources of capital for your business and state if you may prefer such source for your business. (6 marks)
- b) As a graduate in Bachelor's degree in economics and Finance, John a wealthy man approached you to discuss the business plan. The first that you brushed him with was the key business plan components. Briefly give account of what was brought to John's notice. (6 marks)
- c) Microfinance Institution is a special institution that bridge the gap between the poor and the rich in terms of accessing formal credit. Due to their nature, these institutions demands special management that considered several issues. Briefly explain these special issues. (6 marks)

- d) Consider a risk-neutral bank that lends a total amount  
 $L = \text{Ksh.} 2,000,000$  to the impoverished. The total cost of lending is  
 $C = \text{Ksh.} 200,000$ , the total subsidy from a donor agency to the bank is  
 $S = \text{Ksh.} 60,000$ , and the total income from other investments is  
 $I = \text{Ksh.} 200,000$ . The expected fraction to be repaid is  $(1 - d) = 0.8$ . Assuming that the bank is an  
 NGO that just wants to break even, compute the interest rate charged by the bank when it is  
 subsidized and when it is not. (8 marks)
- e) The success of credit and savings products within the microfinance fraternity has seen the  
 emergence of new micro-products. Amongst the products that are being introduced is  
 insurance. The insurance industry has the same characteristics as financial services when  
 it comes to addressing the needs of the poor - not much access by poor households,  
 inefficient government providers running large losses, and informal mechanisms that are  
 often very costly. In view of these shortcomings briefly discuss health insurance noting the  
 short coming and giving examples in Kenya. (6 marks)
- f) Savings is encouraged among the poor and rich. Saving creates national pool of fund for  
 investments. Without enough savings the country will have to borrow from foreign  
 countries and multinationals that may cause ripple effects during the periods of repayment.  
 However, savings among the poor has come with a number of constrains. Briefly explain  
 why saving may hardly to comeby among the poor. (6 marks)

### **QUESTION TWO (20 MARKS)**

- a) The Women Enterprise Fund (WEF) was established through Legal Notice No. 147 of  
 2007 and began its operations in December 2007. The Fund was established to provide  
 alternative financial services to women who are excluded from the formal and informal  
 financial sectors. Briefly explain the functions of WEF in Kenya (7 marks)
- b) A financial institution's credit risk policy should clearly set out how problem credits are  
 to be managed. The positioning of this responsibility in the credit department of an  
 institution may depend on the size and complexity of credit operations. One of the key  
 aspects the management will like to discuss with credit department is how credit recovery  
 strategy is elaborate. Assume you are tasked by the head of credit department to explain  
 ways that a microfinance institution can use to recover defaulted credit; therefore, give a  
 brief note on the assignment. (5 marks)

- c) There a number of sources for funds that can be used expand the business. Such sources include internal sources such as own savings, salaries and profits. Briefly explain the demerits of this source of internal funds. (5 marks)
- d) Briefly discuss Overdraft as the source of funds to start or expand the business. (3 marks)

### **QUESTION THREE (20 MARKS)**

- a) Mulwa who is running a small business in an informal site, approached you as graduate in Bachelor's degree in economics and finance, to discuss the external sources of capital for his business. Mulwa informs you that he is not good in academic field but has good experiences in business world, however he seriously lacks capital to expand his business. Briefly give concise note about the discussion between you and Mulwa. (6 marks)
- b) A good plan serves as a guide to operations for the first months and even years, creating a management blueprint. Briefly discuss the statement. (4 marks)
- c) The problem in designing incentives for microfinance is made more challenging by the multiple tasks that managers expect their staffs to perform, that is to reducing poverty and achieving financial self –sufficiency. Mosley (1996) investigated these two objectives and found that, rather than being complementary, the objectives often conflict. With the help illustration briefly explain the conflict of the said twin objectives. (7 marks)
- d) What does the term Credit appraisal mean and why it is important exercise? (3 marks)

### **QUESTION FOUR (20 MARKS)**

- a) Assume you are called for an interview with Women Fund. The panelist asked you to discuss the sources of capital for SMEs. Briefly explain the Government as a source of fund for SMEs in Kenya. (6 marks)
- b) Credit appraisal is an importance exercise to reduce the possibility of approving loans that end up into increasing a list of defaulted loans. While developing Credit appraisal criteria there is a list of aspects that has to be focused on. Briefly explain these aspects. (7 marks)
- c) The microfinance institutions credit to the poor is expected to have impact to the village, society, families and entire region. Therefore, it is important to measure the impact of microfinance. Briefly explain the methods of measuring the impact of microfinance credit. (7 marks)

**QUESTION FIVE (20 MARKS)**

- a) Assume the first question, after introduction in the interview with Youth Enterprises Development Fund, was that state and explain the functions of the fund (institution). What will be your answer? (5 marks)
- b) In order to finance the business idea one can resort to borrowing from friends and family members. What are shortcomings of this source of fund for business (5 marks)
- c) Non-governmental organizations (NGOs) had an active role in MSEs' lending in Kenya especially due to donor interest in the field as result there are many NGOs providing credit to MSEs in Kenya. Explain the basis for NGO involvement in MSEs financing. (5 marks)
- d) Microfinance has a number of clients that they serve with different products they have developed. One of the clients is called corporate clients. Explain some of the advice and product this client may have to seek from micro finance institution. (5 marks)