MACHAKOS UNIVERSITY

University Examinations for 2020/2021 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ECONOMICS

THIRD YEAR FIRST SEMESTER EXAMINATION FOR

BACHELOR OF ECONOMICS

EAE 302: ECONOMICS OF MICROFINANCE I

DATE: 17/8/2021 **TIME: 11.00-1.00 PM**

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) Microfinance Institutions are facing Agency problem in their business of leading money to loanee. Describe the term **agency problem** and prescribe the amical solutions. (6 marks)

b) Microfinance institutions have been growing faster since 1970s. Describe the reasons behind this fast growth microfinance institutions in developing countries (6 marks)

c) 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. Calculate the average annual cost of the portfolio fund to the MFI. (5 marks)

d) Describe the target population in microfinance (3 marks)

e) Describe Social Surplus (3 marks)

f) The Equity bank operating in a competitive environment its gross interest rate costs 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 Ksh 50 000 per month. The second choice is to borrow ksh 100 000 and invest and earn him 200 000 in three months. Calculate Brayo's Social Surplus for three months. (7 marks)

QUESTION TWO (20 MARKS)

a) Define the following terms as used in microfinance

i. Effective rate of interest (2 marks)

ii. Moral hazard problem (2 marks)

iii. Adverse selection problem (2 marks)

b) It is possible for policy makers to trade off the distributional goal with the goal of efficient allocation of resources" Discuss this statement. (5 marks)

c) Expalin why loan portfolio diversification is importance in Microfinance institution in Kenya. (5 marks)

d) Why do government insist on liquidly requirements in microfinance institution regulation (5 marks)

QUESTION THREE (20 MARKS)

a) Describe on the origin and emergence of microfinance around the world picking out the economic support of microfinance (6 marks)

b) The capital adequacy is once the importance guidelines issued by government of Kenya to be followed by microfinance institutions. Briefly describe capital adequacy. (6 marks)

c) In microfinance the problem of Market failure has necessitated the government intervention. Briefly explain the market failure problem and how government has intervened to bring in necessary solution. (8 marks)

QUESTION FOUR (20 MARKS)

a) Many people think that money lender is as profitable venture, then why do money lenders don't face greater competition as suggested by economic theory? (6 marks)

b) Differentiate between flat rate methods from declining balance method of calculating interest rate in microfinance institutions. (4 marks)

c) The bank lends 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 % and goes ahead and lend 100 00/= to risk borrower, calculate the expected return to the bank. (10 marks)

QUESTION FIVE (20 MARKS)

a) Ownership and Governance risk is among a number of risks microfinance institutions faces in operations and sustainability. Explain what it means by Ownership and Governance risk in microfinance (5 marks)

b) Define the following terms as used microfinance institutions

i. Fungibility (1 mark)

ii. Group lending (1 mark)

iii. Social surplus; (1 marks)

iv. Assortative matching. (2 marks)

c) Briefly explain how the government has provided the solution to high interest rate charged to microfinance institutions (5 marks)

d) "Microfinance institutions face agency problem". Discus this statement (5 marks)