



## **AFRICAN ECONOMIC RESEARCH CONSORTIUM**

**Collaborative MA Programme in Economics for Anglophone Africa  
(Except Nigeria and South Africa)**

### **JOINT FACILITY FOR ELECTIVES JULY - OCTOBER 2003**

### **CORPORATE FINANCE AND INVESTMENT**

#### **Second Session: Final Examination**

**Time: 0900 – 1200noon**

**Thursday, October 2<sup>nd</sup>, 2003**

**Instructions:** Answer 4 questions

---

1. Compare and contrast the following concept.

i)	Stockbrokers and dealers in a stock market	6 Marks
ii)	Informed traders and liquidity traders	6 Marks
iii)	Order-driven and quote-driven trading system	13 marks
		<b>Total = 25 Marks</b>
  
2. 

a)	Explain the concept of market efficiency with reference to Fama (1971) including the conditions under which this is achieved and types.	15 Marks
b)	What factors explain predictability of stock returns in an emerging market?	10 Marks
		<b>Total = 25 Marks</b>
  
3. 

a) Distinguish between the following concepts?		
i)	Fundamental and excess volatility of stock returns	5 Marks
ii)	Persistency and predictability of volatility of stock returns	5 marks
a)	Why is it important to study volatility of stock returns?	5 marks

b) A researcher analyzed volatility of a stock market using a GARCH-M model defined as follows.

$$R_t = \mu + \lambda h_t + \varepsilon_t$$

$$h_t = w + \sum_{i=1}^p \alpha_i \varepsilon_{t-i}^2 + \sum_{j=1}^q \beta_j h_{t-j}$$

The results were as follows.  $\lambda = 0.987(0.0056)$ ;  $\alpha = 0.450(0.0078)$  and  $\beta = 0.670(0.0002)$ .

i) Interpret the result commenting on the risk preference of the investors, clustering, predictability and persistency of volatility. **10 Marks**

**Total = 25 Marks**

4. EITHER

Both the Modigliani and Miller (1961) and Myers and Majluf (1984) theories of capital structure make the conclusion that there is no optimal debt ratio. Discuss these theories and show how they arrive at this conclusion. **25 marks**

OR

The static trade off theory and the agency theory of capital structure indicate that firms observe an optimal debt ratio. Explain how optimal debt ratio is achieved in both theories. **25 Marks**

5. Dividends are said to have a tax disadvantage especially due to double taxation. However, preference for dividend payout is prevalent. How is payment of dividend justified? **25 Marks**

6. When Uchumi Supermarkets made announcement of its earnings this year an immediate decline in stock prices was observed. To be sure that the response of stock prices was significantly attributable to announced company losses, undertaking an event study would be worthwhile.

i) Indicate the stages that you would follow in carrying out such a study including how you estimate the abnormal returns and diagnose the results. **15 Marks**

ii) What are the methodological issues with the event studies? **10 Marks**

**Total = 25 Marks**

7. In the evolutionary process, stock markets have witnessed establishment of statutory regulatory bodies. These institutions are given the responsibility to regulate and develop roles in the stock market.

b) Why is it important to enhance investor's protection and tighten the disclosure rules? **15 marks**

c) What does the development function of these statutory bodies entail?

**10 Marks**

**Total = 25 marks**

8 (i) What factors explain the difference in yield for bonds of the same maturity?

**13 Marks**

(ii) Using the term structure theories, how would you explain an upward sloping yield?

**12 Marks**

**Total = 25 Marks**