



# AFRICAN ECONOMIC RESEARCH CONSORTIUM

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

JOINT FACILITY FOR ELECTIVES  
JUNE – OCTOBER, 2004

## CORPORATE FINANCE & INVESTMENT

### Second Session: Final Examination

Time: 9.00 AM – 12.00 Noon

Wednesday September 29, 2004

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INSTRUCTIONS: Answer four questions (all questions carry equal marks)

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#### Question 1.

Stock markets use different trading systems for their price discovery process. These systems have different types of intermediaries and methods of matching orders. The markets also have various types of investors.

- (a) Distinguish between
  - (i) A stockbroker and market maker (dealer)
  - (ii) A quote driven vs. order driven market
  - (iii) Informed traders vs. noise traders
- (b) What explains the existence of bid-ask spread for market makers?
- (c) What is market liquidity?

#### Question 2.

A major aim in the reform process is to make the stock markets efficient enough so that they can play their role significantly in the development process.

- (a) Borrowing from Fama (1970 and 1991), differentiate between weak form efficiency and semi-strong efficiency.
- (b) Discuss the steps followed in testing the semi-strong efficiency using the events study method.



**Question 3.**

A manager is making a decision to add a new stock in his portfolio so that he can perform as good as the market.

- (a) Discuss how the manager might have arrived to this conclusion
- (b) How would you evaluate his market timing ability?

**Question 4.**

Discuss the agency theory and pecking order hypothesis of capital structure behaviour.

**Question 5.**

- (a) What explains variations in term premium?
- (b) Compare the expectation theory and segmented market theory in explaining the term structure.

**Question 6.**

Why do firms pay dividends? Discuss.

**Question 7.**

- (a) What is underpricing?
- (b) How would we explain underpricing?