



(University of Choice)
**MASINDE MULIRO UNIVERSITY OF
SCIENCE AND TECHNOLOGY
(MMUST)**

MAIN/BUNGOMA/WEBUYE/KAPSABET/MUMIAS/NAIROBI CAMPUS

UNIVERSITY EXAMINATIONS

2021/2022 ACADEMIC YEAR

THIRD YEAR SECOND SEMESTER EXAMINATIONS

**FOR THE DEGREE
OF
BACHELOR OF COMMERCE**

COURSE CODE: BCF 352

COURSE TITLE: DEVELOPMENT FINANCE

DATE: Friday 22ND APRIL 2022 TIME: 3-5PM

INSTRUCTIONS TO CANDIDATES

Answer **QUESTION ONE** and **ANY OTHER TWO (2)** questions

TIME: 2 Hours

MMUST observes **ZERO** tolerance to examination cheating

QUESTION ONE: (30 MARKS) COMPULSORY***In favour of Microfinance institutions as a development strategy***

'The documented success in terms of outreach and the increasing popularity of MFIs is attributable to a variety of factors – both economic and humanitarian. From an economic perspective, MFIs provide superb opportunities to correct both capital market failure and efficiency loss due to central planning by governments. This coupled with the direct aid to the poor is the duality that makes microfinance so desirable.

Capital market correction by MFIs operates in three ways. The first is the lack of access to capital by many poor people in LDCs. This forces them to face strict, if not absolute, borrowing constraints. Small businessmen in LDCs often cite lack of access to capital as a primary reason for their inability to expand business. By providing financial services MFIs help correct borrowing constraints. The second way MFIs correct capital market failure is by increasing the efficiency of providing loans and subsequent capital investment. MFIs are able to screen potential borrowers. Most commercial banks lack the resources or economic incentive to screen potential borrowers. MFIs are also willing and able to advise borrowers financially. Generally, this involves offering simple operational or entrepreneurial recommendations. A final manner in which MFIs can benefit financial markets in LDCs is their ability to coordinate loans from the country's commercial institutions. Even if not recovering costs, MFIs do receive donations and hence can enter into sound financial arrangements with domestic financial institutions. Through this conduit, countries are able to expand their financial infrastructure.

Foreign aid in the form of microfinance allows for a circumvention of inefficient central planning by recipient country governments. MFIs stand to utilize donations more efficiently compared to LDCs who either choose to central plan or have a history of central planning. The crippling effect of these policies has been to force small private businesses into the informal sector. By reintroducing individuals into the formal economy by the way of business expansion, MFIs foster economic growth. From a humanitarian perspective MFIs provide great benefits to the poor. These benefits include increased income, an end to handout dependency, and in general terms poverty alleviation.'

(Source: anonymous)

Required:

- A. 'From an economic perspective, MFIs provide superb opportunities to correct both capital market failure and efficiency loss due to central planning by governments.' Discuss this statement. (10 Marks)
- B. Discuss the potential limitations of MFIs as a development strategy. (8 Marks)
- C. The development of the capital market is important from the point of view of encouraging savings and also providing for the most productive use of savings. Explain how MFIs have aided this from the arguments of the above case. (8 Marks)
- D. Highlight how foreign aid in the form of microfinance allows for a circumvention of inefficient central planning by recipient country governments. (4 Marks)

PART TWO: ANSWER ANY TWO QUESTIONS

QUESTION TWO: (20 MARKS)

- A. Development banks have been established by various governments to fill a gap left by undeveloped capital markets and the reluctance of commercial banks to offer long-term financing. Explain any five key roles that they play matters development. (10 Marks)
- B. Economic aid tends to focus on long-term growth assistance by donating money for investment and public projects. Discuss any five advantages of this aid. (10 Marks)

QUESTION THREE: (20 MARKS)

- A. Innovative sources of development finance have been increasingly discussed in view of shortfalls in official development assistance. Discuss their characteristics and their main classifications. (12 Marks)
- B. What do you understand by the term social profit? Discuss how you would calculate social profit from projects producing tangible products. (8 Marks)

QUESTION FOUR: (20 MARKS)

- A. Define a state owned enterprise. Explain the roles they play in development. (12 Marks)
- B. Discuss the prerequisites of a financial system in the development finance architecture. (8 marks)