**NATIONAL UNIVERSITY OF SCIENCE AND TECHNOLOGY**

**B.COMM (RISK MANAGEMENT AND INSURANCE) HONOURS DEGREE**

# INTRODUCTION TO FINANCIAL MARKETS & INSTITUTIONS–CIN 2210

**NOVEMBER/DECEMBER 2005 FIRST SEMESTER EXAMINATION**

**DURATION: 3 HOURS**

***<u>INSTRUCTIONS TO CANDIDATES</u>***

1. Answer any four (4) questions from Question 1 to 6.
2. Question 7 is compulsory. All the 5 questions to be answered carry equal marks.
3. Candidates may use a non-programmable calculator.

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## <u>Question 1</u>

(a) Why do Governments want to be credit rated? What underlying factors can lead to a good rating "AAA" contras these to factors that can lead to a worst case rating "D". **[10 marks]**

(b) What are the implications of a consistently huge abundance of payments deficit on the value of a country's currency? Use practical examples to support your assignments. **[5 marks]**

(c ) Discuss the difference between a sterilized foreign exchange intervention and an unsterilized intervention. **[5 marks]**

## <u>Question 2</u>

(a) Discuss the difference between primary and secondary markets for stocks. **[8 marks]**

(b) "The Reserve Bank of Zimbabwe has lifted the bank rate on the 12th of October by a record 125% percentage points to 405%, in a robust reaction to depressing new inflation data. Secured lending bas been pegged at 405% impecured lending at 415%. This raised expectations that short – term rates would soon follow suit. However the rates <u>remained depressed</u> at 50% for 30 days, 100% for 60 days and 160% for 90 days. The Reserve Bank also suspends the issuing of 30-day and 90-day tenders opting for the 100 and 180 days TBs. The RBZ is only issuing the 100 and 180 day tenders and the rates for these are unfavorable. The rate for the

1180 – day TB was 200% and because of that some banks were not taking money at all”.

Critically review the above paragraph. Why are short term rates not responding to the increase in the accommodation rate? Discuss the implications of reinvestment risk in view of the contents of the above paragraph. **[12 marks]**

## Question 3

(a) Describe two ways in which financial intermediaries help lower transacting costs in the economy. **[6 marks]**

(b) Which firms are most likely to use bank financing rates than issue bond or stocks to finance their activities? Why? **[6 marks]**

(c ) “It is recommended that part of the remuneration of the members of the board, in particular of members involved in current management , depend on the results of the company”.

Do you agree with the above statements, motivate your answers? **[8 marks]**

## Question 4

(a) What is the difference between a long – futures position and a short futures position. **[8 marks]**

(b) Differentiate between American and European options. **[4 marks]**

(c ) Why would a fixed rate borrower use an interest rate swap. Illustrate your answer with hypothetical figures to demonstrate your understanding of swaps. **[8 marks]**

## Question 5

(a) An investor sells a European put on a share for \$10. The share price is \$150 and the strike price is \$140.

(i) Under which circumstances does the investor (seller) make a profit?. **[2 marks]**

(ii) When the put option be exercised? **[2 marks]**

(iii) Draw a diagram to show the variation in the investor’s profit/loss at the maturity of the option. **[6 marks]**

(b) You hold 1000 Delta shares that are currently trading at $1870 per share, and you anticipate that they will fall in value over the next three months. The December futures for Delta are trading at $1890. You sell 10 contracts to hedge against the anticipated drop in the market. A day before the contract expires in December you buy the futures back at $1 755 canceling out your short futures position. Shares are also trading at $1755. What is the net result from the transaction?

**[10 marks]**

**<u>Question 6</u>**

The Zimbabwean Government is increasingly playing a significant roll in private sector Financial activities.

(a) Discuss principal ways in which the government of Zimbabwe is intervening in the financial sector, give examples. **[10 marks]**

(b) What problems does the government of Zimbabwe encountered in raising capital for the development of targeted domestic sectors experiencing financial distress.

**[10 marks]**

**<u>Question 7</u>**

**<u>SHORT CASE STUDY</u>**

<u>Destination Resort Group Ltd (DRG)</u>

DRG is a key player in the Zimbabwean tourism industry, an industry currently depressed due to the negative image of Zimbabwe as a tourist destination.

"Following the Extra ordinary General Marketing held in July 2005 when the Chairman announced that the Company would be embarking on a Rights Other, seeking to raise between $65 billion and $80 billion in new funds that would be used to for the refurbishment of the Groups facilities, IT upgrade working capital finance, further details have now been published in the press. A rights other is to be conducted in line with the Company's envisaged "cusuasonud plan", which is intended to recapitalize the group following poor earnings performance over the last few years as a result of the depression afflicting the local tourism industry , hyperinflation and the grossly misaligned exchange rate.

***The details of the other are as follows:***

| | | |
|---|---|---|
| Details of the other | | |
| Ordinary share of $0.10 nominal value at 12/09/05 | | 433 424 |
| New ordinary shares from the Rights other | | 1212 121 |
| Ratio of new shares offered for existing shares | approx. | 2.8 for 1 |
| Rights other price per share | | $66.00 |
| Ordinary shares in issue after Rights other | | 1 645 545 |
| Next Asset Value (NAV) per ordinary share 31/12/04 | | 84.37 |
| Proforma NAV per ordinary share after the other historical Cost | | $70.84 |
| Other proceeds | | $80 billion |

***Timetable***

| | |
|---|---|
| Record date | Friday 16/09/05 |
| Last date of payment, other closes | Friday 30/09/05 |
| Announcement of results | Wednesday 05.10.05 |
| New shares listed on ZSE | Monday 10/10.05 |

***Utilisation of Rights other Proceeds***

| | $ 000's | %% Total |
|---|---|---|
| Refurbishment of the Group's facilitations | 45,600,000 | 57 |
| Working Capital financing | 13,600,000 | 17 |
| Regional Investments | 8,000,000 | 10 |
| IT upgrade | 8,000,000 | 10 |
| Expenses of the Rights Other | 4,800.000 | 6 |
| | 80, 000, 000 | 100 |

***Other information***

| | | |
|---|---|---|
| Share price (market) | 16/09/05 | $85 |
| Annual inflation | 30/09/05 | 359% |
| Share price | 14/10/05 | $100 |
| Share price | 01/01/05 | $50 |

**Destination Resorts Group Ltd – Results of Rights Other**

DRG has announced the results of the renounceable Rights Other madde on the 19$^{th}$ of September 2005. The other was for 1, 212, 121 ordinary shares of a nominal value of 10c at a price of $ 66 to shareholders registered at 15 September 2005.

The results of the other we outlined in the table below.

| ***Details*** | ***No of shares*** | ***%*** |
|---|---|---|
| Rights other shares | 1,212,121 | 100 |
| Rights Other Shares taken up by Existing shareholders | 507,949 | 42 |
| Rights other shares taken up by underwriters placed with institutional shareholders | 635,066 | 52 |
| Rights other shares taken up by Underwriters | 69,106 | 6 |
| Total amount raised | $80,000,000,000 | |

**Question**

What role do underwriters play in risk issues and Initial Public Offerings (IPOs)? Critically review the performance of the underwriter of the DRG Rights Other, did they do a job? Consider all the information given above.

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**END OF EXAMINATION**