

MID-WESTERN UNIVERSITY  
EXAMINATIONS MANAGEMENT OFFICE  
FINAL EXAMINATION: 2077  
MASTER OF BUSINESS ADMINISTRATION (MBA)  
SEMESTER - IV

R. No.....

Subject: Security Analysis and Portfolio Management  
Full Marks: 100  
Pass Marks: 50

Course Code: MGT 548/FIN 548  
Time: 4:00 Hours

**SECTION A: MULTIPLE CHOICE QUESTIONS (1 × 20 = 20 MARKS) / (TIME: 20 MINUTES)**

Tick the best answer.

- Q1. When the treasury securities in the financial market are yielding 6% and average market return is 10%, the required rate of return on a particular stock is 15%. What is the risk premium?
- 4%
  - 9%
  - 6%
  - 10%
- Q2. The risk on a stock portfolio which cannot be eliminated or reduced by placing it in diversified portfolio is classified as .....
- Diversifiable risk
  - Portfolio risk
  - Stock risk
  - Market risk
- Q3. Which of the following method is used to calculate indices by Nepal Stock Exchange?
- Price weighted index calculation method
  - Equally weighted index calculation method
  - Value weighted index calculation method
  - Geometric series index calculation method
- Q4. Which of the following best describe the term 'Technical Analysis'?
- It is the analysis of stock market based on past trends and charts
  - It is the analysis of stock market based on financial statements
  - It is the analysis of stock market based on the decision making process of investors
  - It is the analysis of stock market based on the insider information of a company
- Q5. Which stock would an investor with high risk tolerance prefer?
- Stock A has a mean return of 7% and a standard deviation of 2%
  - Stock B has a mean return of 7% and a standard deviation of 10%
  - Stock C has a mean return of 12% and standard deviation of 10%
  - Stock D has a mean return of 12% and standard deviation of 20%
- Q6. Which of the following statements is true on bond value and interest rate relationship?
- If the par value is higher than the market price, YTM is lower than coupon rate.
  - If the market price is higher than par value, coupon rate is lower than YTM.
  - If the market price is equals to par value, coupon rate is higher than YTM.
  - If the market price is lower than the par value, YTM is higher than coupon rate.
- Q7. Which of the following are not the characteristics of equity shares?
- Equity shareholders have the first right to claim on assets of the firm after liquidation
  - Equity shareholders have residual claim on firm's cash flow
  - Equity shareholders have voting right to select the members on board of directors
  - Equity shareholders are the ultimate owners of the firm
- Q8. If the intrinsic value of a common stock is Rs. 250 with growth rate of 8% and expected dividend next year as Rs. 10, what will be the expected return from the stock?
- 6%
  - 8%
  - 10%
  - 12%
- Q9. The Dow Theory uses ..... to follow three major types of market movements.
- charting
  - key indicators
  - fundamental analysis
  - none of the above

- Q10. Which of the following events is an example of systematic risk?
- Cost of raw materials has been decreased
  - The workers have declared strike
  - Interest rate in the economy has increased
  - Current CEO has resigned
- Q11. In which form of market efficiency, the information on past price trend is reflected in the current market price?
- Semi-strong form of efficiency
  - Weak form of efficiency
  - Strong form of efficiency
  - Market efficiency
- Q12. Which of the following statements is true?
- In a strong form of efficient market, there are not mispriced assets.
  - In a strong form of efficient market, all information is available to all investors.
- I only
  - II only
  - Neither I nor II
  - Both I and II
- Q13. If you can use ..... information to earn abnormal returns consistently, then the market cannot be ..... form of efficient.
- public, semi strong
  - public, weak
  - private, semi strong
  - private, weak
- Q14. Which type of index can be calculated by using either the arithmetic method or the geometric method?
- Value weighted index
  - Price weighted index
  - Equally weighted index
  - Exponential index
- Q15. If you bought 100 shares of ABC company at Rs. 118 per share at the beginning of the year. In April, ABC company declared 3 for 1 stock split. At the end of the year you sold your holdings at Rs. 65 per share. What is your rate of return on the ABC company shares?
- 21.24%
  - 65.25%
  - 44.92%
  - 10.17%
- Q16. Which of the following is not considered while calculating stock price?
- Intrinsic value
  - Growth rate
  - Dividend
  - Number of shares
- Q17. If the intrinsic value of a stock is greater than its market value, which of the following is a reasonable conclusion?
- The stock has low level of risk
  - The stock offers a high dividend payout ratio
  - The market is undervaluing the stock
  - The market is overvaluing the stock
- Q18. When a market's required rate of return for a particular bond is much less than its coupon rate, the bond is selling at .....
- a premium
  - a discount
  - cannot be determined without more information
  - face value
- Q19. Which of the following institutions is not directly related to the primary share issuance of a company in Nepal?
- Securities board of Nepal
  - Merchant bankers
  - CDS and clearing ltd.
  - Nepal stock exchange ltd.
- Q20. Zero coupon bonds are similar to treasury bills in that both .....
- are issued exclusively by central bank
  - are money market securities
  - are sold at less than par
  - are capital market securities

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**SECTION B: SHORT ANSWER QUESTIONS (5 X 6 = 30 MARKS)**

*Answer any five questions.*

- Q1. What is speculation? How can you differentiate between speculation and gambling?
- Q2. XYZ Company is experiencing a period of rapid growth. Earnings and dividends are expected to grow at a rate of 12% during the next 2 years and 5% thereafter. Company's last dividend was Rs. 10 and required rate of return for the stock is 10%. Calculate current price of the stock.
- Q3. Briefly describe the different types of risk and mention why beta risk ( $\beta$ ) calculated in CAPM measures only systematic risk.
- Q4. Consider a five-year pure discount bond with a face value of Rs. 1000 that yields 10% compounded annually. What is the maximum price will you pay for this bond now? What would be its price if interest rate rise to 11% or falls to 9%? How interest rate affects the price of bond?
- Q5. Consider the following information:

Stock	No. of shares	Price at date 0	Price at date 1
A	50	Rs. 100	Rs. 150
B	75	Rs. 200	Rs. 220
C	60	Rs. 300	Rs. 250

Calculate the index value for the three stocks on date 1 by using price weighted method and value weighted method.

- Q6. Write, in short, about technical analysis and fundamental analysis. How can you link technical analysis and fundamental analysis with three forms of 'Efficient Market Hypothesis'?
- Q7. If you invest in the right shares of a company, is it primary market investment or secondary market investment? Justify. How does listing of a company in a stock exchange help investors?

**SECTION C: LONG ANSWER QUESTIONS (2X15 = 30 MARKS)**

*Answer any two questions.*

- Q8. Money managers and mutual funds regularly need to evaluate their portfolio performance. Why is portfolio performance evaluation important for such institutions? Briefly describe the three methods of portfolio performance evaluation with formula. Differentiate between Sharpe's measure and Treynor's measure and discuss which method could be more effective.
- Q9. Define mutual funds with its types. Describe the benefits of mutual funds for small investors and for whole capital market. Briefly discuss the present situation of mutual funds activities in Nepalese capital market.
- Q10. The following are the expected return on each of the state of economy. You are going to make a portfolio by investing 35% in stock A and remaining in stock B.

State	Probability	Return on stock A	Return on stock B
A	0.2	5%	50%
B	0.5	10%	30%
C	0.3	15%	10%

With the given information, calculate and answer the following questions.

- Expected return and standard deviation of each stock.
- Expected return and standard deviation of the portfolio.
- What is the Beta of the portfolio if Beta of stock A is 1.2 and Beta of stock B is 0.8?
- If more assets are added in the portfolio, suggest which types of assets will help to reduce the risk.

**SECTION D: CASE STUDY (20 MARKS)**

**Q11. Read a case given below and answer the following questions.**

Saving and investment are two parts of same coin. Normally, when a country's economic growth rate is high, financial institutions tends to enjoy the huge amount of saving as deposits. Capital formation and investment activities increase during the higher economic growth. Due to the increasing activities in the capital market, the indicator also goes up. However, the current situation is different.

If we observe in the capital market, we can see the rally. Almost every indicator is in all time high points. The average daily trading volume in NEPSE increases from about NRs. 300 million to NRs. 5 billion. Number of investors in primary and secondary market increases significantly. More than 1.5 million people applied for shares in a recent IPO of a company which is near to 5 times high compare to one year earlier IPO. Amount of market capitalization increases near to the annual GDP of the country. Some of such capital market indicators for last five fiscal years and half of current fiscal year are presented in the following table.

Major indicators of Secondary Market						
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21 (six months)
Trading Amount (Billion)	163.96	205.02	121.39	110.08	150.04	422.25
No of shares traded (Million)	302.02	392.88	293.82	387.51	428.52	1074.26
Market Capitalization (Billion)	1890.13	1856.83	1435.13	1567.50	1792.76	3079.94
No of Listed Companies	229	208	196	215	212	215
NEPSE Index	1718.15	1582.67	1212.36	1259.02	1362.35	2286.55

Source: [www.nepalstock.com.np](http://www.nepalstock.com.np)

However, the economic indicators are not showing better situation. As per World Bank data, the economic growth rate Nepal for FY 2018-19 was 7%, however due to COVID-19 effect, the estimated growth rate of Nepal for FY 2019-20 is 0.2% and it is forecasted to be 0.6% for current fiscal year. The economy is mostly dependent on remittance income. Volume of trade deficit is very high and total export volume is less than 10% of the total import. Almost every consumable goods and services are imported. There is very low foreign direct investment and due to the COVID 19 effect, the revenue from tourism sector is almost zero. The capital market figures are volatile and the total market is hugely concentrated on bank and financial institutions. Speculators are more active than long term investors. All of sudden, Nepal is facing uncertain political situation.

The presented data and facts show adverse situation for Nepalese economy with low level of investment in real sector, low growth rate, huge trade deficit and negligible export. However, the capital market indicators are showing very influencing figures. This could create risk in the market as well as in the economy.

**Questions:**

- a. Briefly discuss the available investment alternatives in Nepalese economy and discuss the possible systematic risk you observe. (4)
- b. Can you invest as per diversified portfolio theory to reduce risk while investing in Nepalese capital market? Point out the causes. (3)
- c. Name any six institutions involved in Nepalese capital market. Write few problems you observe in the market and suggest for the solutions. Do you think the problems in economy as mentioned above be reflected in the capital market? (7)
- d. Suppose you have to suggest your friend to invest NRs. 1000000 in stock market, which sector will you suggest to form a better portfolio? Do you think fundamental analysis and technical analysis is helpful to make investment decisions? (4)
- e. Will you suggest for speculation or long term investment in this current situation? (2)

**THE END**

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**SECTION A: MULTIPLE CHOICE QUESTIONS (1 × 20 = 20 MARKS)/ (TIME: 20 MINUTES)**

Tick the best answer:

- The risk on a stock portfolio which cannot be eliminated or reduced by placing it in diversified portfolio is classified as .....
  - Diversifiable risk
  - Portfolio risk
  - Stock risk
  - Market risk
- Which one of the following methods is used to calculate indices by Nepal Stock Exchange?
  - Price weighted index calculation method
  - Equally weighted index calculation method
  - Value weighted index calculation method
  - Geometric series index calculation method
- Which one of the followings best describe the term 'Technical Analysis'?
  - It is the analysis of stock market based on past trends and charts
  - It is the analysis of stock market based on financial statements
  - It is the analysis of stock market based on the decision making process of investors
  - It is the analysis of stock market based on the insider information of a company
- If the intrinsic value of a common stock is Rs. 250 with growth rate of 8% and expected dividend next year as Rs. 10, what will be the expected return from the stock?
  - 6%
  - 8%
  - 10%
  - 12%
- In which form of market efficiency, the information on past price trend is reflected in the current market price?
  - Semi-strong form of efficiency
  - Weak form of efficiency
  - Strong form of efficiency
  - Market efficiency
- Which one of the following statements is true?
  - In a strong form of efficient market, there are not mispriced assets.
  - In a strong form of efficient market, all information is available to all investors.
  - I only
  - II only
  - Neither I nor II
  - Both I and II
- The Dow Theory uses ..... to follow three major types of market movements.
  - Charting
  - Key indicators
  - Fundamental analysis
  - None of the above
- Which one of the following institutions is not directly related to the primary share issuance of a company in Nepal?
  - Securities board of Nepal
  - Merchant bankers
  - CDS and clearing ltd.
  - Nepal stock exchange ltd.
- The portion of income not spent on ..... is saving.
  - Consumption
  - Production
  - Distribution
  - None
- Which one of the followings is true about risk averse investor?
  - They care only about risk
  - They care only about returns
  - They might hold a risky security as part of a portfolio even if it's expected return is less than the risk-free rate
  - They prefer a risk - free security to a risky security

11. The unsystematic risk of a specific security:
- is likely to be higher in an increasing market
  - results from factors unique to the firm
  - depends on market volatility
  - cannot be diversified away
12. An investor is considering adding another investment to a portfolio. To achieve the maximum diversification benefits, the investor should add, if possible an investment that has the following correlation coefficients with the other investment in the portfolio.
- 1
  - 0.5
  - 0
  - +1
13. Which one of the followings is used to calculate NSESE Float index?
- Total market price per shares of NSESE
  - Total market value of shares of NSESE
  - Total market capitalization of publicly floated shares of NSESE
  - Total price relatives of NSESE
14. A type of an account where shares and securities are held electronically to enable trading transaction & settlements in stock exchange, thereby eliminating the need of physical financial instrument is:
- Current account
  - Margin account
  - Demat account
  - All of the above
15. Bill, Jim and Shelly are all looking to buy the same stock that pays dividends. Bill plans on holding the stock for one year. Jim plans on holding the stock for three years. Shelly plans on holding the stock until she retires in 10 years. Which one of the following statements is correct?
- Bill will be willing to pay the most for the stock because he will get his money back in one year when he sells.
  - Jim should be willing to pay three times as much for the stock as Bill because his expected holding period is three times as long as Bill's.
  - Shelly should be willing to pay the most for the stock because she will hold it the longest and hence she will get the most dividends.
  - All three should be willing to pay the same amount for the stock regardless of their holding period.
16. Everything equal, which variable is negatively related to intrinsic value of a company?
- $D_1$
  - $D_0$
  - $k$
  - $g$
17. A coupon bond that pays interest annually is selling at par value of 1000 matures in, 5 years, and has a coupon rate of 9%. The yield to maturity on this bond is:
- 8 %
  - 8.3 %
  - 9 %
  - 10 %
18. A purely passive strategy is defined as
- holding a well diversified portfolio for short term with buy and hold approach
  - holding a well diversified portfolio for long term with buy and hold approach
  - holding a well diversified portfolio for short term with buy and sell approach
  - holding a well diversified portfolio for long term with buy and hold sell approach
19. Jensen's performance index gives the importance
- To the assets combination
  - Professional management
  - The market condition
  - The predictive ability of manager
20. The chartist believes that charts:
- Spot the current trend for buying and selling
  - Indicates the future action to be taken
  - Shows the past historic movement
  - All the above

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**SECTION B: SHORT ANSWER QUESTIONS (5 X 6 = 30 MARKS)**

Answer any FIVE questions:

1. Briefly describe the different types of risk and mention why beta risk ( $\beta$ ) calculated in CAPM measures only systematic risk.
2. Consider a five-year pure discount bond with a face value of Rs. 1000 that yields 10% compounded annually. What is the maximum price will you pay for this bond now? What would be its price if interest rate rise to 11% or falls to 9%? How does interest rate affect the price of bond?
3. Write in short about technical analysis and fundamental analysis. How can you link technical analysis and fundamental analysis with three forms of 'Efficient Market Hypothesis'?
4. If you invest in the right shares of a company, is it primary market investment or secondary one? Justify. How does listing of a company in a stock exchange help investors?
5. "There is nothing wrong with making money but its how you make the money that counts." Comment on the statement.
6. The following information describes the expected return and risk relationship for the stocks of WAHs computers:

Expected return on Treasury bill	7%
Expected return on market portfolio	15%
Standard deviation on market portfolio	20%

Using only the data shown above:
  - a) Draw and label a graph showing the Security Market Line and also position the WAHs computers stock that has systematic risk coefficient beta of 1.25 relative to it. [3]
  - b) Would you consider that WAHs computers stock to be an attractive investment, if the expected rate of return for the stock is forecasted to 14% by an independent estimator? In a market that is striving toward equilibrium, what would happen to the price of stock? [3]
7. Gentry Can Company's (GCC) latest annual dividend of Rs.1.25 a share was paid yesterday maintaining its historic rate of growth. You plan to purchase the stock today because you believe that the dividend growth rate will increase to 12 percent for the next three years and then settle to 8 percent per year forever.
  - a. How much should you be willing to pay for the GCC stock if you require a 12 percent return? [3]
  - b. What is the maximum price you should be willing to pay for the GCC stock if you believe that the 8 percent growth rate can be maintained indefinitely and you require a 12 percent return? [2]
  - c. If the 8 percent rate of growth is achieved, what will the price be at the end of Year 3, assuming the conditions in Part b? [1]

**SECTION C: LONG ANSWER QUESTIONS (2X15 = 30 MARKS)**

Answer any TWO questions:

8. Money managers and mutual funds regularly need to evaluate their portfolio performance. Why is portfolio performance evaluation important for such institutions? Briefly describe the three methods of



portfolio performance evaluation with formula. Differentiate between Sharpe's measure and measure and discuss which method could be more effective.

9. Mr. Rabindra owns a portfolio with the following characteristics. (Assume that returns are generated by two factor model):

Portfolios	Expected return $E(R_i)$	$b_{i1}$	$b_{i2}$
A	11%	1.2	0.2
B	12.4%	2	-0.4
C	10.8%	0.8	0.4

Likely, it is assumed that portfolio E exists with the following risk return characteristics:

Portfolios	Expected return $E(R_i)$	$b_{i1}$	$b_{i2}$
E	15%	2	-0.25

- What is the equation that describes the equilibrium return for Mr. Rabindra? [10]
- What arbitrage opportunities are present? Show how Mr. Rabindra can make profit from them. [5]

10. I) Following is the market information for the securities of three companies:

Stock	2017		2018		2019	
	No. of Share	Price	No. of Share	Price	No. of Share	Price
A	2000	150	6000	70	6000	70
B	6000	80	6000	90	6000	100
C	4000	90	4000	100	4000	70

There have been 3 for 1 stock split in stock A stock during 2017.

- Determine the price weighted index for each year using Dow Jones Industrial Average. [3]
  - Determine the value weighted index for each year using standard and poor's index (S&P) with base value of 100. [3]
  - Determine the equally weighted index for each year with base value of 100. [3]
  - Briefly discuss the differences in the results for the three stock indexes. [1]
- II) Mr. Y purchased a bond with a Rs. 1000 face value, a 10 percent coupon rate and four years to maturity. The bond makes annual coupon payments, the first to be received a year from today. Mr. Y paid Rs. 1080 for the bond.
- What is the bond's Yield to Maturity (YTM)? [3]
  - Calculate the duration of the bond. [2]

### SECTION D: CASE STUDY (20 MARKS)

11. Read the Case given below and answer the following questions:

Saving and investment are the two parts of same coin. Normally, when a country's economic growth rate is high, financial institutions tend to enjoy the huge amount of saving as deposits. Capital formation and investment activities increase during the higher economic growth. Due to the increasing activities in the capital market, the indicators also go up. However, the current situation is different.

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Major indicators of Secondary Market

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**On the basis the of above facts and figures, as well as a student of Finance, answer the following questions:**

- a. Briefly discuss the available investment alternatives in Nepalese economy and discuss the possible systematic risk you observe. [4]
- b. Can you invest as per diversified portfolio theory to reduce risk while investing in Nepalese capital market? Point out the causes. [3]
- c. Name any six institutions involved in Nepalese capital market. Write few problems you observe in the market and suggest for the solutions. Do you think the problems in economy as mentioned above will be reflected in the capital market? [7]
- d. Suppose you have to suggest your friend to invest NRs. 1000000 in stock market, which sector will you suggest to form a better portfolio. Do you think fundamental analysis and technical analysis will be helpful to make investment decisions? [4]
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**SECTION A: MULTIPLE CHOICE QUESTIONS (1 × 20 = 20 MARKS)/ (TIME: 20 MINUTES)**

Tick the best answer:

1. Money market where debt and stocks are traded and maturity period is more than a year is classified as:
  - a. Shorter term markets
  - b. Capital markets
  - c. Counter markets
  - d. Long-term markets
2. In capital markets, major suppliers of trading instruments are:
  - a. Government and corporations
  - b. Liquid corporations
  - c. Instrumental corporations
  - d. Manufacturing corporations
3. The yield curve shows at any point in time:
  - a. The relationship between the yield on a bond and the duration of the bond
  - b. The relationship between the coupon rate on a bond and time to maturity of the bond
  - c. The relationship between yield on a bond and the time to maturity on the bond
  - d. All of the above
4. Which one of the followings is not a depository institution?
  - a. Commercial banks
  - b. Saving institutions
  - c. Credit unions
  - d. Insurance company
5. Which one of the deposits gives highest rate of interest?
  - a. Current deposit
  - b. Fixed deposit
  - c. Recurring deposit
  - d. None of these
6. Transaction cost of trading of financial instruments in centralized market is classified as:
  - a. Flexible costs
  - b. Low transaction costs
  - c. High transaction costs
  - d. Constant costs
7. Markets in which derivatives are traded are classified as:
  - a. Assets backed market
  - b. Cash flow backed markets
  - c. Mortgage backed markets
  - d. Derivative securities markets
8. Transaction cost of trading of financial instruments in centralized market is known as:
  - a. Flexible costs
  - b. Low transaction costs
  - c. High transaction costs
  - d. Constant costs
9. Which one of the followings is an example of direct tax?
  - a. Sales tax
  - b. Commodity tax
  - c. Income tax
  - d. None of these
10. Composite value of traded stocks group of secondary markets is classified as:
  - a. Stock index
  - b. Primary index
  - c. Stock market index
  - d. Limited liability index
11. Indexes in which the price of stock of companies listed in stock market index added together and divided by an adjusted value are classified as:
  - a. Herring indexes
  - b. Group indexes
  - c. John indexes
  - d. Dow Indexes

12. Which one is the monetary policy instrument of central banks?
- The money multiplier
  - The reserve ratio
  - The GDP deflator
  - The inflation rate
13. In capital markets, major suppliers of trading instruments are:
- Government and corporations
  - Liquid corporations
  - Instrumental corporations
  - Manufacturing corporations
14. The yield curve shows at any point in time:
- The relationship between the yield on a bond and the duration of the bond
  - The relationship between the coupon rate on a bond and time to maturity of the bond
  - The relationship between yield on a bond and the time to maturity on the bond
  - All of the above
15. The term structure of interest rates is:
- The relationship between the rates of interest on all securities
  - The relationship between the interest rate on a security and its time to maturity
  - The relationship between the yield on a bond and its default rate
  - All of the above
16. Speed with which prices of stocks are adjusted to unexpected news related to interest rates is called:
- News efficiency
  - Adjusted efficiency
  - Expected efficiency
  - Market efficiency
17. If the central bank buys financial securities in the open market to increase the monetary base, this is an example of ...
- lender of last resort
  - financial intermediation
  - open market operations
  - financial regulation
18. A 14-day repurchase agreement of Treasury 8% 2007 Units of ..... must be listed on the stock exchange.
- Open ended fund
  - Closed ended fund
  - Hedge fund
  - Liquid fund
19. A bank is solvent as long as it .....
- has enough capital to pay off depositors
  - has mostly good loans
  - does not experience a run on its deposits
  - is able to meet all demands by depositors for payment
20. Companies take savings as premium, invest in bonds and make the payments to beneficiaries are classified as:
- debit unions
  - life insurance companies
  - credit unions
  - auto purchases

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Examinations Management Office  
Surkhet, Nepal  
Chance Examination-2078  
Master of Business Administration (MBA)  
Semester - IV

Subject: Financial Institution and Market  
Full Marks: 100 Pass Marks: 50

Course Code: MGT 546/FIN 546

Time: 4: 00 Hours

You are required to answer in your own words as far as applicable. The figures in the margin indicate full marks.

**SECTION B: SHORT ANSWER QUESTIONS (5X6 = 30 MARKS)**

Answer any FIVE questions:

1. Examine the major roles of Nepal Stock Exchange. List the important Stock Exchanges operating across the world and also highlight the various types of stock market indices.
2. Examine how the money market provides a means for lenders and borrowers to satisfy their short-term financial needs.
3. How do central bank and monetary policy relate with each other? Examine the roles of Central Bank to facilitate the microfinance in Nepal.
4. How do you explain the term structure of interest rates? Explain the interest rates vary through time because inflation rates are expected to differ through time.
5. Determine the various roles of depository financial institutions and non depository financial institutions to grow the financial market. Highlight the scope of depository financial institutions in Nepalese context.
6. Identify the various forms of capital market securities, and derivative securities. Explore how they relate and differ with each other with examples.
7. What are the various credit risk for financial institutions? Explain how the credit crisis led to concerns about systemic risk.

**SECTION C: LONG ANSWER QUESTIONS (2X15 = 30 MARKS)**

Answer any TWO questions:

8. Monetary policy is a policy statement, through which central bank targets a key set of indicators to ensure price stability in the economy. Explain the concept of Money Supply. What are the tools the central bank can use to achieve the price stability objective of the monetary policy?
9. How do you think the mutual fund and investment bank are interrelated with each other? Examine the following statement and highlight the reasons for investing through mutual funds and benefits of mutual funds on the light of the concept "Mutual Fund is the most suitable investment for the common man as it offers an opportunity to invest in a diversified, professionally managed basket of securities at a relatively low cost".
10. Investment Banking is a combination of Banking and consultancy services. It helps expand and modernize the business and give expert advice on mergers, acquisition and takeovers, diversification of business, foreign collaborations. It helps restructure a business, assist to revive sick business units and markets the securities they are initially sold. On the backdrop explain the functions of investment banking. How do the investment Banks Facilitate New Stock Issues?

**SECTION D: CASE STUDY (20 MARKS)**

11. Read the Case given below and answer the following questions:

**Issues on Nepalese financial System and NRB**

Turning to the question of supervision of the financial system, the 'soundness' of money is not only on the maintenance of the purchasing power of money but also on confidence in individuals, banks and in the banking and financial sector as a whole, and hence on the adequacy of supervision of that sector. It is this idea which leads to the proposition that the central bank should also have a supervisory role. It is possible to argue that there is no short-term gain available to politicians from the supervisory function in the same way that there is from generating inflation through a relaxed monetary policy. Thus, the supervisory role may be placed in the hands of a non-independent government agency while the independent central bank is left to deal only with monetary policy. It has been argued, indeed, that the separation of the monetary policy and supervisory roles has positive advantages for the control of inflation since where central banks are not involved in bank supervision, financial sector representatives will be less inclined to lobby central banks for easier monetary policy to reduce the regulatory burden on banks and financial companies. Whether this is true or not, under present circumstances, the separation of the two roles does not matter; however, if an attempt is made to recapture monetary policy for the political system they would need to be brought together. Even if they are kept separate, it should be conceded that the two roles are complementary and that the supervisory role is at least as important. Whoever carries out the supervisory role, severe problems emerge with respect to the power of the supervisor to control the banking and financial sector. Here, two difficulties stand out immediately. The first one relates to competitive deregulation. No single authority is in a position to exercise firm control over the sector, for fear that the market will simply move to other financial centre. The other difficulty is the lack of information held by supervising authorities. Financial markets continue to evolve so rapidly and capital moves with such ease that there is only a slight possibility that the authorities can know precisely what is happening. The role of the central bank, is therefore, not so much as one of controlling the market as it is one of limiting the damage to the reputation of the market and containing the fallout, when things go wrong. Putting together what is happening to monetary policy and the way in which financial markets are developing produces a paradox. At a time when more and more attention is being drawn to central banks and the demand for their independence from the government is growing, implying that central banks have considerable power which cannot be trusted to politicians, they are being shown to be virtually impotent. The debate over the form of control of central banks seems then to be barely relevant to the question of control of economic policy and of economies. The question of why politicians everywhere, and also bureaucrats in our context, seem to be adopting central bank independence with such enthusiasm in most cases can be addressed here. One possible answer is that they are aware that, in allowing central bank independence, they are merely giving up a nominal power—a power which has, in effect, already been lost to the markets. Thus, they lose nothing but gain by publicly shifting responsibility for the control of inflation on to a non-elected body.

Recently, banks are facing a liquidity crunch. A few years ago the banking sector had problems of excessive liquidity. Nepal's overall banking sector is weak regarding the problems related to liquidity despite certain progress. The state of banks has been unstable in recent years. The liquidity problems of financial institutions are yet to improve. According to figures released by Nepal Bankers Association (NBA), the umbrella organization of 28 commercial banks of the country, commercial banks have a combined Rs 41.61 billion (rupees) left for lending (approximately \$640 million). Out of this, Rastriya Baniya Bank Ltd (RBBL), a government owned bank, holds Rs 24.78 billion, while remaining 27 commercial banks have only Rs 16.83 billion which can be used for credit purposes. An ideal bank should always keep its deposits more than its grants. Financial institutions came into this state of liquidity crunch because of their negligence on maintaining this deposits/grants balance.

There has been exponential growth in the number of financial institutions in Nepal in the last decade. The existing legal framework and institutional setup in Nepal was not conducive to the overall financial sector and private sector development. Banks and financial institutions established and licensed without long-term planning have started to fold back after the World Bank and IMF guided the Nepal Rastra Bank (NRB) to reduce the number of financial institution. They suggested making few but stronger institutions rather than many weak institutions. NRB developed policies and guided banks and financial institutions to strengthen their position. Some policies, like an increase in the level

capital to establish and continue a bank and encouragement of mergers and acquisitions of banks, are developed to overcome the problems. As a result, numbers of banks started decreasing and strengthening their capital and position. In 2014 there were 30 Commercial Banks, 84 Development banks and 53 Finance Companies. In 2015 there were 30 Commercial Banks, 76 Development banks and 48 Finance Companies. According to more recent data, there are 28 Commercial Banks, 55 Development Banks and 38 Finance Companies.

**Required:**

- a. Discuss the following statement "the role of the central bank, not so much as one of controlling the market as it is one of limiting the damage to the reputation of the market and containing the fallout, when things go wrong"
- b. Examine the real life Nepali Cases of Bank and Financial Institutions and explore what has made the reduction in numbers of Commercial Banks in Nepal in recent period of time..
- c. Based on the above explanation what would you suggest about the role of NRB at Karnali Province of the country?

**THE END**

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EXAMINATIONS MANAGEMENT OFFICE  
FINAL EXAMINATION: 2077  
MASTER OF BUSINESS ADMINISTRATION (MBA)  
SEMESTER – IV

R.No.....

Subject: Financial Institution and Market

Course Code: MGT 546/FIN 546

Full Marks: 100

Pass Marks: 50

Time: 4:00 Hours

**SECTION A: MULTIPLE CHOICE QUESTIONS (1 × 20 = 20 MARKS)/ (TIME: 20 MINUTES)**

*Tick the best answer.*

Q1. Many banks' issues either Bonds or Debentures in your opinion are.....

- the same
- for Investor, Bonds are more safe
- for Investor, Bonds are less safe
- cannot say with certainty

Q2. The distinguishing feature of a treasury bill is issued.....

- at premium
- at discount
- at par value
- for longer period

Q3. The nature of the relationship between Interest rate and Bond price is.....

- bond price goes up when interest rate goes down
- bond price goes down when interest rate goes down
- bond price remains the same, when interest rate goes down
- bond price remains the same, when interest rate goes up

Q4. From the standpoint of Stock Market, IPO represents Primary Markets. Similarly, right issue represents:

- Primary Market
- Secondary Market
- Both the Markets
- None of the above

Q5. Commercial Banks are mandatorily required to undertake deprived sector lending amounting to..... of their total loans and advances

- 3.00 %
- 4.00 %
- 5.00 %
- 6.00 %

Q6. We often hear about Off Balance Sheet risks. What are they?

- Failure to recover loan
- Fraud by bank staff
- Loss in Forex Transaction
- Loss in LC, Bank Guarantee transactions

Q7. No other sector in financial area is rigorously regulated as the banking sector. It is mainly due to:

- Prevent crash in stock price of Banks
- Avoid budgetary support for Banks
- Protection of Depositors
- Protection of Borrowers

Q8. Central Bank often undertakes Repo transaction. It is undertaken for.....

- injecting liquidity
- absorbing liquidity
- stopping interest rate from falling
- helping the stock market

Q9. In Nepal we have large number of Co-operatives working in the financial sector. They come under:

- B Class Financial Institutions
- C Class Financial Institutions
- D Class Financial Institutions
- None of the above

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- Q10. Negative Yield Curve (being presently observed in USA) is associated with:
- Lower return in Short term and Higher return in Long term bonds
  - Lower return in Long term and Higher return in Short term bonds
  - Equal returns in both Short term and Long term bonds
  - Erratic returns in both Short term and Long term bonds
- Q11. One of the institutions under the World Bank group is MIGA. What does it stand for.....
- Multilateral Investment Guarantee Agency
  - Multinational Investment Guarantee Agency
  - Multilateral Investment Growth Agency
  - Multinational Investment Growth Agency
- Q12. When we say, World Bank group, it includes few agencies. Which of the following is not in that group?
- IMF
  - IDA
  - IFC
  - ICSID
- Q13. The Stock Market Index calculation is based on:
- Movement in the Stock Price
  - Changes in the Market Capitalization
  - Changes in the demand and supply of stocks
  - Number of stocks listed in the Stock Exchange
- Q14. When we say Yield Curve shapes, it does not include :
- Upward Slope
  - Flat Slope
  - Negative Slope
  - Erratic Slope
- Q15. One very peculiar Bond available in the developed countries is called Junk Bond. This Junk bond is:
- Very difficult to do trading
  - Bond giving negligible return
  - Bond giving high return with high risk
  - Bond giving high return with low risk
- Q16. In the Stock Exchanges, Circuit Breakers are applied, when Stock Prices go.....
- up
  - down
  - up or down
  - up or down by specified %
- Q17. The main job of CDS (Central Depository System) is to maintain the record of stock.....
- purchaser
  - seller
  - issuer
  - owner
- Q18. After the issuance of Mutual Funds, its trading takes place in:
- The issuing company's premises
  - Directly between the seller and purchaser
  - In the NEPSE
  - In the Derivative Exchange
- Q19. Deposit is the largest item in any bank's liabilities side. Generally it tends to be around.....
- 60 %
  - 70 %
  - 80 %
  - 90 %
- Q20. Loans are the largest item in any bank's asset side. Generally it tends to be around.....
- 40 %
  - 50 %
  - 60 %
  - 70 %

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*You are required to answer in your own words as far as applicable. The figures in the margin indicate full marks.*

**SECTION B: SHORT ANSWER QUESTIONS (5X6 = 30 MARKS)**

*Answer any five questions.*

- Q1. Presently, 39 of Insurance Companies are doing business in Nepal. Insurance Board, the regulator for the Insurance companies, provides the license of two categories: Life (#19) & Non-Life (#20). In your opinion, this classification makes sense or not? Answer it by giving your reasons.
- Q2. The history of Mutual Funds in Nepal is not very long. It has picked up only in the recent period. As per the information made available by SEBON, we have 12 Mutual Funds in operation. What are these Mutual Funds? How are they useful for retail (especially small) share investors?
- Q3. Even though the popular name for the Annual Reports of Banks are Balance Sheets, however, Banks all over the world are required to provide information on Off Balance Sheet activities also. Explain the conceptual framework of these Off Balance Sheet activities, along with their significance and risks for the banks
- Q4. One of the important Monetary Operations of Nepal Rastra as a Central Bank is to conduct Repo or Reverse Repo operations. Explain the features of both these operations. Why do you think commercial banks ask NRB to undertake these operations?
- Q5. CDS (Central Depository System) has now become an integral part of the Stock Trading in Nepal. What exactly is the role being played by this institution? How has the system been benefited by this CDS?
- Q6. Risks and Rewards are always integrated in any financial market instruments. One of the fundamental financial truths is: there cannot be any reward without risk. In this context, explain the typical risks a bond investor is required to face.
- Q7. One of the components of financial markets is Money Market. Does it indicate only one instrument or multiple instruments? Explain it by giving related examples.

**SECTION C: LONG ANSWER QUESTIONS (2X15 = 30 MARKS)**

*Answer any two questions.*

- Q8. When we say, International Financial Institutions, the three institutions which always gets attentions are IMF, World Bank and ADB.
  - a. Explain the important functions of all these three institutions.
  - b. How are they different from each other?
  - c. How many institutions are there within the organizational framework of World Bank Group? What are the typical functions which each of them perform?
- Q9. Central Banks are always at the top in any financial structure. That way, In Nepal, Nepal Rastra Bank (NRB) is at the top.
  - a. What are the typical functions of a central bank? Explain all these functions in brief.
  - b. In your opinion, does NRB perform all these functions: Yes or No? Explain.
- Q10. The following data provide information on one topic known as *NEPSE Index*. Go through the data and answer the following:

Date	Day	Nepse	+/- Points	+/- %
13-Dec-XX	Sun	1118.57		
14-Dec-XX	Mon			
15-Dec-XX	Tue		1.61	0.14
			0.84	0.07
Date	Day	Market Cap	+/- Points	+/- %
13-Dec-XX	Sun	1,186,886.40		
14-Dec-XX	Mon	1,188,601.65	1715.25	0.14
15-Dec-XX	Tue	1,189,489.65	888.00	0.07

- What do you think NEPSE index is?
- What is Market Cap? How is it calculated?
- Based on the given data, fill in the NEPSE for 14 and 15 Dec.XXXX.

#### SECTION D: CASE STUDY (20 MARKS)

Q11. Read a case given below and answer the following questions.

The following statistics gives us the stock prices of commercial banks as of 18 Feb 2021

#### A Class Banks: Share Price 18 Feb 2021

	Traded Companies	Closing Price
1	Nabil Bank Limited	1367
2	NIC Asia Bank Ltd.	963
3	Everest Bank Limited	838
4	Standard Chartered Bank Limited	644
5	Himalayan Bank Limited	566
6	Nepal Investment Bank Limited	500
7	Agriculture Development Bank Limited	472
	Nepal Investment Bank <i>Promoter Share</i>	421
8	NMB Bank Limited	474
9	Nepal SBI Bank Limited	455
10	Prime Bank	480
11	Nepal Bank Limited	439
12	Prabhu Bank	490
13	Siddhartha Bank Limited	436
14	Global IME Bank Limited	486
15	NCC bank	334
16	Sanima Bank Limited	399
17	Laxmi Bank Limited	320
18	Mega Bank Nepal Ltd.	334
19	Nepal Bangladesh Bank Limited	329
20	Sunrise Bank Limited	349
21	Bank of Kathmandu Ltd.	326
22	Machhapuchhre Bank Limited	336
23	Citizen Bank International Limited	329
24	Kumari Bank Limited	324
25	Century Commercial Bank Ltd.	271
26	Civil Bank Ltd	245
	NCC Bank <i>Promoter Share</i>	114

Analyze the data and then answer the following questions:

- a. Why are commercial banks shares quoted in the Nepal Stock Exchange?
- b. Why is RBB (Rastriya Banijya Bank)'s stock price missing?
- c. What is the meaning of promoter share?
- d. Why are promoter shares quoted at discount as compared to other shares?
- e. How are promoter shares different from public shares?
- f. Why do you think such a wide differences in the stock prices happened?

**THE END**

MID-WESTERN UNIVERSITY  
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SEMESTER - IV

R.No.....

Subject: Strategic Financial Management  
Full Marks: 100 Pass Marks: 50

Course Code: MGT 547/FIN 547  
Time: 4:00 Hours

**SECTION A: MULTIPLE CHOICE QUESTIONS (1 × 20 = 20 MARKS) / (TIME: 20 MINUTES)**

Tick the best answer:

- Q1. Under COD terms, the seller:
- Extends credit to the buyer on open account.
  - Extends credit to the buyer subject to bank approval.
  - Requires the buyer to make partial payment at fixed intervals.
  - Bears the risk of the buyer's refusing the goods shipped.
- Q2. The type of business most likely to use trust receipt financing would be.....
- a forest products company.
  - an oil refinery.
  - an automobile dealership.
  - a grocery store chain.
- Q3. If a discount date is missed for some reason, when should a rational manager pay the bill?
- As soon as possible after the discount date so as to not upset the supplier.
  - No sooner than six months so as to maximize the use of "free" trade credit financing.
  - On the final due date.
  - None of the above.
- Q4. A leveraged lease is a three-sided agreement among the following:
- lessee, lessor and lender.
  - lessor, commercial bank, and insurance company.
  - a and b.
  - None of the above.
- Q5. What type of long-term financing most likely has the following features: 1) it has a finite life, 2) failure to pay the cash flows could lead to bankruptcy, and 3) its cash flows are expected to be a constant annuity stream?
- Long-term debt.
  - Preferred stock.
  - Common stock.
  - Both b and c.
- Q6. A firm has a DOL of 3.5 at Q units. What does this tell us about the firm?
- If sales rise by 3.5% at the firm, then EBIT will rise by 1%.
  - If EBIT rises by 3.5% at the firm, then EPS will rise by 1%.
  - If EBIT rises by 1% at the firm, then EPS will rise by 3.5%.
  - If sales rise by 1% at the firm, then EBIT will rise by 3.5%.
- Q7. In the long run, a successful acquisition is one that.....
- enables the acquirer to make an all-equity purchase, thereby avoiding additional financial leverage.
  - enables the acquirer to diversify its asset base.
  - increases the market price of the acquirer's stock over what it would have been without the acquisition.
  - increases financial leverage.
- Q8. Empirical evidence on acquisitions indicates excess returns on average to the shareholders of the selling company, and excess returns on average to those of the buying company:
- No; no
  - Substantial; no
  - No; substantial
  - Substantial; substantial
- Q9. A statistical measure of the variability of a distribution around its mean is referred to as.....
- a probability distribution
  - the expected return
  - the standard deviation
  - coefficient of variation

- Q10. The firm of Sun and Moon purchased a share of Acme.com common stock exactly one year ago for \$45. During the past year the common stock paid an annual dividend of \$2.40. The firm sold the security today for \$85. What is the rate of return the firm has earned?
- 5.3%
  - 194.2%
  - 88.9%
  - 94.2%
- Q11. Total portfolio risk is.....
- equal to systematic risk plus nondiversifiable risk
  - equal to avoidable risk plus diversifiable risk
  - equal to systematic risk plus unavoidable risk
  - equal to systematic risk plus diversifiable risk
- Q12. The ..... is the proportion of earnings that are paid to common shareholders in the form of a cash dividend.
- retention rate
  - 1 plus the retention rate
  - growth rate
  - dividend payout ratio
- Q13. A (n) ..... is the expected cash dividend that is normally paid to shareholders.
- stock split
  - stock dividend
  - extra dividend
  - regular dividend
- Q14. Which of the following the examples best represents a passive dividend policy?
- The firm sets a policy such that the proportion of dividends paid from net income remains constant
  - The firm pays dividends with what remains of net income after taking acceptable investment projects
  - The firm sets a policy such that the quantity (dollar amount per share) of dividends paid from net income remains constant
  - All of the above are examples of various types of passive dividend policies.
- Q15. Modigliani and Miller argue that the dividend decision:
- is irrelevant as the value of the firm is based on the earning power of its assets
  - is relevant as the value of the firm is not based just on the earning power of its assets
  - is irrelevant as dividends represent cash leaving the firm to shareholders, who own the firm anyway
  - is relevant as the value of the firm is not based just on the earning power of its assets
- Q16. Which of the following accurately describes the behavior of bond prices?
- For a given change in market required rate of return, the price of a bond will change by proportionally less, the lower the coupon.
  - For a given change in the market required rate of return, the price of a bond will change by a smaller amount, the longer its maturity.
  - If interest rates rise so that the market required rate of return increases, the bond's price will fall
  - When the market required rate of return equals the stated coupon rate, the price of the bond be greater than its face value. (Assume annual interest payments and discounting.)
- Q17. What is the yield on a share of preferred stock, which has a \$100 par value and is currently selling for \$140 in the market place? The share of preferred stock pays a 14% annual dividend.
- 19.6%
  - 14%
  - 10%
  - 5.6%
- Q18. In the formula  $k_e = (D_1/P_0) + g$ , what does  $(D_1/P_0)$  represent?
- The expected capital gains yield from a common stock
  - The expected dividend yield from a common stock
  - The dividend yield from a perfect stock
  - The interest payment from a bond
- Q19. If the intrinsic value of a share of common stock is less than its market value, which of the following is the most reasonable conclusion?
- The stock has a low level of risk
  - The stock offers a high dividend payout ratio
  - The market is under valuing the stock
  - The market is overvaluing the stock
- Q20. By using a ..... the firm can independently control considerable assets with a very limited amount of equity.
- joint venture
  - leveraged buyout (LBO)
  - spin-off
  - consolidation

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Full Marks: 100 Pass Marks: 50

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Time: 4:00 Hours

*You are required to answer in your own words as far as applicable. The figures in the margin indicate full marks.*

**SECTION B: SHORT ANSWER QUESTIONS (5X6 = 30 MARKS)**

*Answer any five questions.*

- Q1. Why is preferred stock called hybrid security? Do you agree that it combines the worst features of ordinary shares and bonds?
- Q2. Rakesh Industries is having difficulty paying its bills and is considering foregoing its trade discounts on Rs. 300,000 of accounts payable. As an alternative, Rakesh can obtain a 60-day note with a 14 percent annual interest rate. The note will be discounted, and the trade credit terms are 2/10, net 60. Which alternative has the lower effective cost?
- Q3. The following information is supplied to you, about a company:

Earnings of the company	Rs 15,00,000
Dividends paid	5,00,000
Number of issued shares	1,00,000
Cost of equity ( $k_e$ ) (%)	10
Rate of return on investment (%)	15

- Determine the theoretical market price of the share.
- Q4. Calculate the level of EBIT at which the indifference point between the following financing alternatives will occur:  
Ordinary share capital Rs 10 lakhs or 15% debentures of Rs 5 lakhs and ordinary share capital of Rs 5 lakhs.
- Q5. The operating and cost data of ABC Ltd are:

Sales	Rs 20,00,000
Variable costs	14,00,000
Fixed costs	4,00,000 (including 15 percent interest on Rs 10,00,000)

- Calculate its operating and financial leverage.
- Q6. The M&M Company plans to raise an additional Rs 5 million through a rights offering. The Company whose stock is priced \$80 a share on the market. Currently, the M&M Company has 200,000 shares of common stock. Assuming subscription prices of \$50 a share.
- How many rights will be required to purchase one new share?
  - What is the value of each right?

**SECTION C: LONG ANSWER QUESTIONS (2X15 = 30 MARKS)**

*Answer any two questions.*

- Q7. What is merger and acquisitions? Discuss in brief the concepts of horizontal, vertical and conglomerate merger. Also explain the growing need of mergers and acquisition in bank and financial institutions in Nepal.
- Q8. Rise Against Corporation is comparing two different capital structures: an all-equity plan (Plan I) and a levered plan (Plan II). Under Plan I, the company would have 210,000 shares of stock outstanding. Under Plan II, there would be 150,000 shares of stock outstanding and Rs2.28 million in debt outstanding. The interest rate on the debt is 8 percent, and there are no taxes.
- If EBIT is Rs500,000, which plan will result in the higher EPS?

- b. If EBIT is Rs750,000, which plan will result in the higher EPS?
- c. What is the break-even EBIT?
- Q9. Morang Steel Company is in the business of manufacturing steel utensils. The firm is planning to diversify and add a new product line. The firm either can buy the required machinery or get it on lease. The machine can be purchased for Rs.1,500,000. It is expected to have a useful life of 5 years with a salvage of Rs.100,000 after the 5 years life. The purchase can be financed by 20 percent loan repayable in 5 equal annual installments (inclusive of interest becoming due at the end of each year). Alternatively, the machine can be taken on year-end lease rentals of Rs.450,000 for 5 years. For your exercise, you may assume the following:
- The machine will constitute a separate block for depreciation purposes. The company follows straight line method of depreciation.
  - Tax rate is 40 percent and cost of capital is 20 percent.
  - Lease rentals are to be paid at the end of the year.
    - Calculate the present value of leasing cost.
    - Calculate the present value of buying cost.
    - Advise the company on the option it should choose on the basis of above calculation.

#### SECTION D: CASE STUDY (20 MARKS)

Q10. Read a case given below and answer the following questions.

You have just appointed as a portfolio manager at a portfolio management service (PMS) company. You have given to manage Rs 1,000,000 for portfolio management. Your boss is confident that you can manage this money properly and can earn a good return for the company. For this purpose, you are analyzing two common stock issues – A and B. The rates of return of two stocks over three market conditions with respective probabilities are given in the accompanying table.

	Bear market	Normal market	Bull market
Probability	0.20	0.50	0.30
Stock A	- 20%	18%	50%
Stock B	- 20%	20%	40%

The rate of return on T-bills issued by Nepal Rastra Bank is 5%.

Questions:

- Compute the expected rates of return, standard deviation, and coefficient of variation for each stock. Which stock is most desirable by each measure?
- Assume you invest your Rs 1,000,000 portfolio into Rs 600,000 in stock A and Rs 400,000 in stock B. What is the expected return and risk on your portfolio? Are you able to diversify the risk with this portfolio? Give reasons.
- Assume you invest your Rs 1,000,000 portfolio into Rs 400,000 in stock A, Rs 400,000 in stock B and Rs 200,000 in T-bill. What is the expected return and risk on your portfolio? Compare the risk and return of this portfolio with the portfolio formulated in part 'b'. Which one you should prefer? Why?

**THE END**



Mid-West University  
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Semester – IV

R.No.....

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Time: 4: 00 Hours

**SECTION A: MULTIPLE CHOICE QUESTIONS (1 × 20 = 20 MARKS)/ (TIME: 20 MINUTES)**

Tick the best answer:

1. Interest is deducted in advance on .....
  - a. add-on loan
  - b. simple loan
  - c. discounted loan
  - d. all of the above
2. Tax is deductible on.....
  - a. lease rent
  - b. instalment of loan
  - c. both a & b
  - d. none of the above
3. .... is sold at heavy discount.
  - a. Perpetual bond
  - b. Straight bond
  - c. Zero-coupon bond
  - d. Redeemable bond
4. .... is used to determine the portfolio expected rate of return.
  - a. Security market line (SML)
  - b. Capital market line (CML)
  - c. Sharpe Index
  - d. None of the above
5. Dividend is relevant according to .....theory:
  - a. Birds in hand
  - b. Modigliani and Miller's
  - c. Tax preference
  - d. All the above
6. Stock repurchase is the alternative of .....
  - a. distribution of stock dividend
  - b. raising additional capital
  - c. distribution of cash dividend
  - d. all the above
7. A company repurchase stock when:
  - a. There is an investment opportunity
  - b. There is a sufficient cash and no investment opportunity is available
  - c. Majority of shareholder wants cash dividend
  - d. There is no sufficient cash
8. An acquisition of a company or division of another company financed with a substantial portion of borrowed fund is called.....
  - a. reverse merger
  - b. leveraged buyout
  - c. management buyout
  - d. all the above
9. The process of buying a business by existing management team from its owner is known as:
  - a. reverse merger
  - b. leveraged buyout
  - c. management buyout
  - d. all the above
10. Combined leverage shows the relationship between:
  - a. Sales and EBIT
  - b. EBIT and EPS
  - c. Sales and EPS
  - d. All of the above
11. The type of collateral (security) used for short-term loan is:
  - a. Real estate
  - b. Plant & Machinery
  - c. Stock of goods
  - d. Equity share capital

12. .... is a formal legal commitment between a bank and its customer.
- a. Trade credit
  - b. Line of credit
  - c. Revolving credit
  - d. Commercial Paper
13. Inventory financing is a.....
- a. spontaneous source of financing
  - b. unsecured source of financing
  - c. secured source of financing
  - d. All the above
14. Which one of the followings is a feature of zero-coupon bonds?
- a. Sold at Par
  - b. Sold at premium
  - c. Pays no Interest
  - d. Not Redeemable
15. Beta ( $\beta$ ) of risk-free investment is:
- a. Zero
  - b. 1
  - c. -1
  - d. None of the above
16. Which of the following is true?
- a. Higher the Beta, lower the risk
  - b. Higher the Beta, higher the risk
  - c. Risk is constant
  - d. Beta is constant.
17. Higher OL is related to the use of higher:
- a. Debt
  - b. Equity
  - c. Fixed Cost
  - d. Variable Cost
18. Dividend is irrelevant according to .....theory.
- a. Birds in hand
  - b. Modigliani and Miller's
  - c. Tax preference
  - d. All the above
19. In stock dividend:
- a. Authorized capital always increases
  - b. Paid up capital always increases
  - c. secured source of financing
  - d. Face value per share decreases
  - e. Market price for share decreases
20. A ..... takes place between two firms in the same line of business.
- a. conglomerate merger
  - b. horizontal merger
  - c. vertical merger
  - d. reverse merger
  - e. -1

Mid-West University  
**Examinations Management Office**  
 Chance Examination-2078  
 Surkhet, Nepal  
 Master of Business Administration (MBA)  
 Semester – IV

Subject: Strategic Financial Management  
 Full Marks: 100 Pass Marks: 50

Course Code: MGT 547/FIN 547  
 Time: 4: 00 Hours

*You are required to answer in your own words as far as applicable. The figures in the margin indicate full marks.*

**SECTION B: SHORT ANSWER QUESTIONS (5X6 = 30 MARKS)**

Answer any FIVE questions:

1. Explain the merits and demerits of short term financing. [3+3]
2. Explain the valuation model for super normal growth stock. [6]
3. Stocks X and Y have the following probability distribution of expected future returns:

Probability	X	Y
0.1	(10%)	(35%)
0.2	2	0
0.4	12	20
0.2	20	25
0.1	38	45

- a. Calculate the expected rate of return,  $K_Y$  for Stock Y ( $K_X = 12\%$ ) [2]
  - b. Calculate the standard deviation of the expected returns for stock X. (That for Stock Y is 20.35) [3]
  - c. Calculate the coefficient of variation for Stock Y. Is it possible that most investors might regard Stock Y as less risky than Stock X? Explain [1]
4. The Bajra Textile Company's shareholders' equity account (book value) as of December 31, 2018, is as follows:

Common stock (Rs 100 par value; 50,000 shares)	Rs 50,00,000
Additional paid-in capital	70,00,000
Retained earnings	<u>2,50,00,000</u>
Total shareholders' equity	<u>Rs 3,70,00,000</u>

Currently, Bajra is under the pressure from shareholders to pay some dividends. Bajra's cash balance is Rs 800,000, all of which is needed for transactions purposes. The stock is trading for Rs 380 a share.

- a. Reformulate the shareholders' equity account if the company pays a 25 percent stock dividend. [3]
  - b. Reformulate the shareholders' equity account if the company declares a 5-for-4 stock split. [3]
5. Samsung Company needs to increase its working capital by Rs 8.8 million. The following three financing alternatives are available (assume 365 days year):
- a) Forgo cash discounts (granted on a basis of "3/10, net 30") and pay in final due date.
  - b) Borrow Rs 10 million from bank at 15 percent interest. This alternative would necessitate maintaining a 12 percent compensating balance.
  - c) Issue Rs 9.5 million of six-month commercial paper to net Rs 8.8 million. Assume that new paper would be issued every six months.

Assuming that the firm would prefer the flexibility of bank financing, provided the additional cost of this flexibility was no more than 1.5 percent per annum, which alternative should Samsung Company select? Why? [6]

State of  
Great  
Good  
Ave

6. What do you mean by beta ( $\beta$ ) coefficient? Why does market beta ( $\beta$ ) always become 1? Explain.
7. Mechi Corporation is a fast growing supplier of electronic products. Analysts project the following free cash flows during the next three years, after which free cash flow is expected to grow at a constant 8 percent rate. Mechi's weighted average cost of capital is 12 percent.

Time (in years)	1	2	3
Free cash flow (in millions)	-Rs 30	Rs 45	Rs 50

- a. What is Mechi's terminal or horizon value? [2]
- b. What is the value of the firm today? [2]
- c. Suppose Company has Rs. 157 million in debt and 10 million shares of stock. What is the price per share? [2]

**SECTION C: LONG ANSWER QUESTIONS (2X15 = 30 MARKS)**

Answer any TWO questions:

8. Define merger. What are its types? Explain the benefits of merger and acquisition. [4+3+8]
9. A-10 year, 14 percent semi-annual coupon bond, with a par value of Rs 1,000 may be called in 4 yrs at a call price of Rs 1,060. The bonds sell for Rs. 1,100. (Assume that the bond has just been issued).
- a. What is the bond's yield to maturity? [5]
- b. What is the bond's current yield? [2.5]
- c. What is the bond's capital gain or loss yield? [2.5]
- d. What is the bond's yield to call? [5]
10. Sangrila Development Bank Ltd. is attempting to determine whether to lease or purchase a new Automated Teller Machine (ATM). The firm is in the 40 percent tax bracket and the after-tax cost of debt is currently 6 percent. The term of lease and purchase are given below:
- Lease:** Annual advance lease payments of Rs 2,21,500 are required over its four years life. The lease payment is one deductible for tax purpose until the service is actually received.
- Purchase:** The Automated Teller Machine (ATM) costing Rs 8,40,000 could be purchased. Straight-line depreciation and no salvage value would be used. The purchase would be financed with a Rs 8,40,000, 12 percent loan requiring four annual end of year payments of Rs 2,76,550.
- a. Calculate the after-tax cash outflows associated with each alternative. [6]
- b. Calculate the present value of each of these cash flow streams by using the after-tax cost of debt. [6]
- c. Which alternative would you recommend? Explain. [3]

**SECTION D: CASE STUDY (20 MARKS)**

11. Read the Case given below and answer the following questions:

Surkhet Digit Cable is the one of the pioneer cable company of Mid-Western, Nepal. It is providing cable television service more than 1200 customers since 2001. It has a total investment in assets of Rs. 200 million. Siddhartha Cable is another newly established Cable Company of Mid-Western, Nepal. Siddhartha Cable is providing cable television service more than 2500 customers. The total investment in assets of Siddhartha Cable is Rs 600 million. CEO of both the company agreed to form a new Mid-Western Cable Company through a merger between Surkhet Digit Cable Company and Siddhartha Cable Company.

The share of Surkhet Digit Cable Company and Siddhartha Cable Company in the portfolio represented by the new Mid-Western Cable Company is based on the rate of their total assets prior to merger. The expected returns for two firms are as follows:

State of Nature	Probability	Surkhet Digit Cable Company	Siddhartha Cable Company
Great	0.25	-0.05	-0.10
Good	0.30	0.10	0.15
Average	0.20	0.22	0.14
Bad	0.25	0.35	0.25

**Required:**

- The expected return and standard deviation of Surkhet Digit Cable Company and Siddhartha Cable Company before the merger. [5]
- The Covariance and the correlation between the returns for Surkhet Digit Cable Company and Siddhartha Cable Company before the merger. [5]
- The expected return of Mid-Western Cable Company. [5]
- The standard deviation of return for Mid-Western Cable Company. [5]

**THE END**