



MID-WEST UNIVERSITY
SCHOOL OF MANAGEMENT (MUSOM)
(An Autonomous Institution)

MUSOM EXAMINATION SECTION
FINAL EXAMINATION-2025 (2081)

BACHELOR OF BUSINESS ADMINISTRATION (BBA)
SEMESTER – VIII

Subject: Financial Institutions and Markets

Course Code: MGT387

Full Marks: 100

Time: 3 Hrs.

Exam Roll No.:

Section A: Multiple Choice Questions (1×15 = 15 Marks)

Time: 15 Minutes

Tick (✓) the correct answers

1. Which of the following best illustrates the role of financial markets in resource allocation?
 - a. Random distribution of capital across sectors.
 - b. Efficient transfer of funds from surplus to deficit units.
 - c. Government-controlled allocation irrespective of market demand.
 - d. Equal distribution to all market participants.
2. Capital markets are pivotal for economic development because they _____.
 - a. focus solely on short-term borrowing
 - b. encourage speculative investments
 - c. mobilize long-term funds for productive investments
 - d. operate independently from economic policies
3. In a scenario where inflation consistently exceeds interest rates, what is the most likely outcome for investors?
 - a. Increase in real returns.
 - b. Improvement in purchasing power.
 - c. Negative real returns and diminished savings incentives.
 - d. Stability in consumption patterns.
4. How does a persistent depreciation of domestic currency affect a country's trade balance?
 - a. Enhances imports while reducing exports.
 - b. Deteriorates trade competitiveness.
 - c. Initially worsens but eventually improves export competitiveness (J-curve effect).
 - d. Has no significant impact on trade flows.
5. Identify which institution plays a dual role in accepting deposits and providing credit facilities.
 - a. Investment banks
 - b. Commercial banks
 - c. Insurance companies
 - d. Mutual funds
6. How has technological advancement transformed transaction costs in modern financial markets?
 - a. Led to negligible improvements.
 - b. Increased operational complexity.
 - c. Substantially minimized transaction and information costs.
 - d. Created market inefficiencies.
7. Adverse selection in credit markets often leads to _____.
 - a. allocation of loans to low-risk borrowers exclusively
 - b. favoritism towards borrowers with extensive collateral
 - c. higher interest rates discouraging high-quality borrowers
 - d. perfect credit market equilibrium

8. What primary mechanism does the central bank use to counteract prolonged inflationary trends?
 - a. Curtailing government spending.
 - b. Reducing foreign exchange reserves.
 - c. Adjusting policy rates and employing open market operations.
 - d. Issuing long-term bonds directly to consumers.
9. Which classification of financial market deals with the issuance of new securities?
 - a. Secondary Market
 - b. Primary Market
 - c. Derivatives Market
 - d. Money Market
10. How does the primary market differ from the secondary market in terms of capital formation?
 - a. It redistributes existing financial assets.
 - b. Facilitates direct capital mobilization for issuers.
 - c. Provides speculative opportunities for traders.
 - d. Has no influence on economic growth.
11. An unusually wide bid-ask spread in a normally liquid market suggests _____.
 - a. increased investor confidence
 - b. market stability and transparency
 - c. heightened uncertainty and decreased liquidity
 - d. improved price discovery mechanisms
12. Which situation best reflects a moral hazard issue in financial markets?
 - a. Investors selling high-risk assets after incurring losses.
 - b. Banks issuing low-interest loans to reduce market share loss.
 - c. Insured borrowers engaging in excessively risky ventures.
 - d. Creditors strictly monitoring loan utilization.
13. The IMF's role during a balance of payments crisis primarily involves _____.
 - a. imposing fiscal penalties
 - b. facilitating debt restructuring and financial stabilization
 - c. prioritizing domestic policy changes without external funding
 - d. restricting foreign trade agreements
14. Which international financial institution is known for providing long-term development loans to developing countries?
 - a. International Monetary Fund (IMF)
 - b. World Bank
 - c. Bank for International Settlements (BIS)
 - d. Asian Clearing Union (ACU)
15. Revenue generation for commercial banks predominantly arises from _____.
 - a. Government subsidies
 - b. Interest rate spreads and service fees
 - c. Equity market trading
 - d. Direct taxation benefits



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

Section – B: Short Answer Questions

(8 × 5 = 40 Marks)

Answer any eight questions:

1. Explain how asymmetric information leads to adverse selection and moral hazard in financial institutions. [5]
2. How do central bank interest rate decisions affect inflation, currency value, and investment in developing economies like Nepal? [5]
3. Analyze the relationship between interest rates, inflation, and exchange rates in an open economy. [5]
4. Explain the concept of a "lender of last resort" and its significance during financial crises. [5]
5. Discuss the causes and consequences of bank runs and panics in the financial system. [5]
6. What are the primary functions of a securities market, and how do they contribute to price discovery? [5]
7. Compare the regulatory structures of the Nepalese securities market with those of developed markets like the US or India. [5]
8. What are the major challenges in implementing effective credit risk management in Nepal's commercial banks? Suggest innovative solutions. [5]
9. Discuss the impact of stock market crashes on the overall economy, using historical examples. [5]
10. Analyze the role of international financial institutions (e.g., IMF, World Bank) in promoting global financial stability. [5]

Section – C: Long Answer Questions

(3 × 10 = 30 Marks)

Answer any three questions:

11. Analyze the effectiveness of Nepal Rastra Bank's monetary policy in combating inflation while promoting economic growth. How can conflicting objectives be balanced? [6+4]
12. Financial intermediation is vital for economic progress. Evaluate its contribution to GDP growth in Nepal, focusing on recent economic reforms and financial innovations. [10]
13. Examine the multifaceted impact of global financial institutions (IMF, World Bank) on Nepal's fiscal policies and economic sovereignty. How can Nepal balance external assistance with domestic priorities? [10]
14. Despite growth in Nepal's securities market, global competitiveness remains limited. Propose comprehensive structural and regulatory reforms to address market inefficiencies. [10]
15. Government securities serve multiple purposes beyond debt management. Analyze their role in influencing monetary policy, liquidity conditions, and investor behavior in Nepal's financial markets. [10]

16. Read the following case and answer the questions that follow.

Managing Risks in Nepalese Financial Institutions

Himal Finance Ltd. is one of the leading depository financial institutions in Nepal. Over the past five years, the company has aggressively expanded its loan portfolio to increase its market share. This strategy initially boosted its profitability, but recently, Himal Finance has faced rising levels of non-performing loans (NPLs).

Several internal assessments revealed key issues:

- Asymmetric Information: Borrowers often withheld crucial financial details during loan processing.
- Moral Hazard: Some clients used borrowed funds for purposes other than stated in loan agreements.
- Liquidity Risk: An increase in loan defaults has strained the company's ability to meet withdrawal demands.
- Interest Rate and Exchange Rate Risks: Fluctuations in domestic and international rates have affected the institution's earnings, especially in foreign currency loans.

The Nepal Rastra Bank (NRB) has recently tightened regulatory requirements, mandating stricter loan disbursement criteria and higher capital adequacy ratios. Himal Finance's management is now under pressure to:

- Reduce its NPL ratio
- Strengthen its risk management practices
- Comply with NRB's new regulations
- Maintain profitability amid growing competition from other banks and financial institutions

Additionally, the Nepalese government plans to introduce new regulations regarding liquidity management and deposit insurance to prevent **bank runs** and improve financial system stability.

Questions:

- a. Identify and explain the key risks faced by Himal Finance Ltd. How do these risks impact the institution's financial stability and profitability? [5]
- b. Analyze how the issues of asymmetric information and moral hazard have contributed to the rise in non-performing loans. What measures can Himal Finance adopt to mitigate these issues? [5]
- c. As a financial consultant, recommend strategies that Himal Finance should implement to improve its risk management practices, ensure regulatory compliance, and maintain competitiveness in the market. Consider both national and international best practices. [5]

