Voluntary assignment 1

This is the first of two voluntary assignments given in the course of the semester. The answer (2-3 pages) should be sent as pdf by email to me before Friday, March 14, at 12.00, and then I will comment on what you have written.

This assignment has the same format as the exam, consisting of three distinct problems, each containing two questions. The answers may be formal or verbal at your choice, there are no fixed rules here.

It may be useful to use the following structure when answering (but of course you may use whatever structure you want):

(1) Identify the theoretical problem behind the case,
(2) Give a (very) brief outline of the relevant theory,
(3) Describe what comes from applying the theory.
(4) Comment (if relevant) on possible shortcomings.

Problem 1

A financial institution has introduced a new type of credit contracts tailored for innovative new business. However, it has observed that many of the newly established firms get into problems due to the lack of experience and basic skills in handling the paper work and accounting, something which they could have acquired easily. Give a suggestion for the type of credit contracts needed for the bank to handle this problem.

After some time a local business school sets up a cheap and easily accessible course for new entrepreneurs, and there are indications that it is widely used and has raised the general level of skills. Should the contracts used hitherto be revised and if so, how?

Problem 2

A bank tries to introduce a new line of business, based on credits financing the production of movies. These productions are secured by public guarantees, so that the return is reasonably safe, but the production period of a movie can be quite long.

The bank wants to attract funds for this purpose and hence contacts investors who would themselves have been interested in financing production of movies but whose economic conditions do not permit them to engage in such investments. Which type of contract should be offered to such investors by the bank?

Now a new investment opportunity has emerged, namely the production of TV entertainment programs. Here the production time is short; the demand for the products and consequently the earnings are not well documented at the moment, but it is expected that this uncertainty will be considerably reduced in the near future. Which consequences will the emergence of this new investment opportunity have for the business of the bank and the formulation of its contracts?

Problem 3

In order to attract new borrowers, a bank offers credits earmarked for investment in portfolios of securities. The portfolios of the borrowers are registered and their value can be followed closely on the internet, so that the bank can see its composition at any time. How should the loan contract be set up for this particular segment of costumers?

After some time, it is decided to restructure this particular service, allowing the costumers the use a percentage of the loan for investment in other activities such as trading in antique furniture, paintings etc. How should the contract be adapted to be useful in this new situation?