GRETSA UNIVERSITY - THIKA

UNIVERSITY EXAMINATIONS
MAY - AUGUST 2023 SEMESTER

BACHELOR OF COMMERCE

COURSE CODE: BCFI 305

COURSE TITLE: FINANCIAL RISK MANAGEMENT

DATE: 4 AUGUST 2023 **TIME: 11:30 AM – 2:30 PM**

INSTRUCTIONS TO CANDIDATES

1. SECTION A IS **COMPULSORY.**
2. SECTION B: ANSWER ANY OTHER **THREE** QUESTIONS.
3. **DO NOT** WRITE ANYTHING ON THIS QUESTION PAPER AS IT WILL BE AN EXAM IRREGULARITY.
4. ALL ROUGH WORK SHOULD BE AT THE BACK OF YOUR ANSWER BOOKLET AND CROSSED OUT.

CAUTION: *All exam rooms are under CCTV surveillance during the examination period.*

SECTION A: COMPULSORY

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Question One

a) Apart from the general types of risk that face firms, financial institutions are confronted with unique types of risk mostly because of the nature of their operations. In this regard:

- **i.** Apart from liquidity risk, explain any four types of risks that financial institutions are exposed to **[12 Marks]**
- **ii.** Explain the various approaches available to financial institutions to manage liquidity risk **[3 Marks]**

b) Explain the benefits that accrue to a firm adopting an active risk management approach **[9 Marks]**

c) Modern Portfolio theory is one of the oldest attempts to quantify risk in an investment. Highlight the assumptions upon which this theory is based **[7 Marks]**

d) Risk arises in capital budgeting because of the difficulties in predicting future cash flows correctly. What factors influence the cash flows in investment projects **[9 Marks]**

SECTION B: ATTEMPT ANY THREE QUESTIONS

Question Two

a) Identify the steps involved in sensitivity analysis as a method of analysing risk in capital budgeting **[6 Marks]**

b) The goal of risk management is not to eliminate risk but to ensure that risk remains at a certain level of acceptability. Explain the various risk management approaches available to risk managers **[14 Marks]**

Question Three

a) An investment project is estimated to cost USD. 3000 and generate net cash flows of USD. 1000, 1400, 800, and 1500 in its 4 year life. The project will be written off after its 4 year life. The rate of return on risk free government securities in this Market is estimated at 6 per cent per annum whereas an analyst has estimated a risk premium of 4 per cent on this project.

- **i.** Using the risk adjusted discount rate, evaluate the feasibility of this project [use NPV method] **[7 Marks]**
- **ii.** How does the method used in [i] above account for risk in capital budgeting **[3 Marks]**

b) Explain the components that constitute return for an asset **[4 Marks]**

c) Distinguish between financial and actuarial risk **[6 Marks]**

Question Four

The following information is available about two assets. Use it to answer the questions that follow

		Returns [%]	
State	Probability	X	Y
A	0.1	8	10
B	0.2	6	15
C	0.4	10	14
D	0.3	12	8

Determine:

a) The risk of individual assets X and Y using standard deviation **[8 Marks]**

b) Define an optimum portfolio **[2 Marks]**

c) The risk of the minimum variance portfolio formed by combining X and Y **[10 Marks]**

Question Five

a) Under what circumstances is the coefficient of variation a better measure of risk **[6 Marks]**

b) State the prescriptions of separation theorem as regards selection of portfolios **[4 Marks]**

c) Describe the components that constitute systematic risk **[10 Marks]**