The Management University of Africa

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UNDERGRADUATE UNIVERSITY EXAMINATIONS

SCHOOL OF MANAGEMENT AND LEADERSHIP

DEGREE OF BACHELOR OF COMMERCE

FIN 322: **FINANCIAL RISK MANAGEMENT**

DATE: **9TH DECEMBER 2024**

DURATION: **2 HOURS**

MAXIMUM MARKS: 70

INSTRUCTIONS:

1. Write your registration number on the answer booklet.
2. **DO NOT** write on this question paper.
3. This paper contains **SIX (6)** questions.
4. Question **ONE** is compulsory.
5. Answer any other **THREE** questions.
6. Question **ONE** carries **25 MARKS** and the rest carry **15 MARKS** each.
7. **Write all your answers in the Examination answer booklet provided.**

QUESTION ONE

A Kenyan company has agreed to sell goods to an importer in Zedland at an invoiced price of Z 150,000 (Zed (Z) is the currency of Zedland). Of this amount, Z 60,000 will be payable on shipment, Z 45,000 one month after shipment and Z 45,000 three months after shipment. The quoted foreign exchange rates (Z per KSh.) at the date of shipment as as follows:

Spot	1.690	-	1.692
One month	1.687	-	1.690
Three months	1.680	-	1.684

The company decides to enter into appropriate forward exchange contracts through a bank in order to hedge these transactions.

Required:

i) State the advantages of hedging in this way. **(2 Marks**

ii) Calculate the amount in Kenya Shillings that the Kenyan Company would receive. **(5 Marks)**

iii) Comment with hindsight on the wisdom of hedging in this instance, assuming that the spot rates at the dates of receipt of the two instalments of Z 45,000 were as follows:

Fist instalment	1.69	-	1.69
Second instalment	1.700	-	1.704

(6 Marks)

b) Large companies with significant borrowings or overseas trade often use interest rate swaps and currency swaps. Examine the advantages of interest rate swaps and currency swaps. **(12 Marks)**

QUESTION TWO

Discuss the impact of the following emerging issues on the management of financial risk.

i) Geopolitics **(5 Marks)**

ii) Regulation **(5 Marks)**

iii) FinTech startups **(5 Marks)**

QUESTION THREE

Pwani Limited is planning advertising campaigns in three different market areas. The estimates of probability of success and associated additional profits in each of the three markets are provided below:

	Market 1		Market 2		Market 3	
	Profit	Profitability	Profit	Profitability	Profit	Profitability
	Sh.	**Sh.**	**Sh.**	**Sh.**	**Sh.**	**Sh.**
Fair	10,000	.40	5,000	.20	16,000	.50
Normal	18,000	.50	8,000	.60	20,000	.30
Excellent	25,000	.10	12,000	.20	25,000	.20

Required:

(i) Compute the expected value and standard deviation of profits resulting from advertising campaigns in each of the market areas. **(12 Marks)**

(ii) Rank the three markets according to riskiness using the coefficient of variation. **(3 Marks)**

QUESTION FOUR

a) Discuss any five uses of Value-at-Risk (VaR) analysis in practice **(5 Marks)**

b) Evaluate any five challenges facing financial institutions in the management of financial risk. **(10 Marks)**

QUESTION FIVE

"Total Risk Management (TRM) will become a common term in finance just like Total Quality Management (TQM) has in production and marketing." (Professor Andrew W. Lo. 1999).

Required:

i) Define risk management as used in finance. **(2 Marks)**

ii) Discuss reasons why risk management might increase shareholders wealth. **(8 Marks)**

iii) Evaluate five approaches that can be used by financial institutions to manage credit risk **(5 Marks)**

QUESTION SIX

Mr. Mlachake is currently holding a portfolio consisting of shares of four companies quoted on the Bahati Stock Exchange as follows:

Company	**Number of shares held**	**Beta equity co-efficient**	**Market price per share**	**Expected return on equity in the next year %**
A	20,000	1.12	65	18
B	30,000	0.89	50	23
C	30,000	0.70	45	11
D	20,000	1.60	80	17

The current market return is 14% per annum and the treasury bills yield is 9% per annum.

Required:

i. Calculate the risk of Mlachake's portfolio relative to that of the market. **(6 Marks)**

ii. Explain whether or not Mlachake should change the composition of his portfolio. **(9 Marks)**