TECHNICAL UNIVERSITY OF MOMBASA

SCHOOL OF BUSINESS

DEPARTMENT OF BUSINESS ADMINISTRATION

UNIVERSITY EXAMINATIONS FOR DEGREE IN

BACHELOR OF COMMERCE/BUSINESS ADMINISTRATION

BFI 4406 **:** FINANCE RISK MANAGEMENT

END OF SEMESTER EXAMINATIONS

SERIES: AUGUST 2019

TIME: 2 HOURS

INSTRUCTIONS:

You should have the following for this examination

-Answer Booklet, examination pass and student ID

 Attempt Question ONE and any other TWO Questions.

Do not write on the question paper

Question ONE(COMPULSARY)

a) Interest rate risk is the risk arising from changes in the rate of interest of borrowed or invested (including lent) money: Discuss the Sources of Interest Rate Risk? **(8 Marks**

b) Discuss the following terms **(6marks**

i) Credit risk

ii) ii) Sovereign risk

iii) iii)Default risk

Madam Kahonzi has an investment capital of Sh.1,000,000. He wishes to invest in two securities, A and B in the following proportion; Sh.200,000 in security A and Sh.800,000 in security B.

The returns on these two securities depend on the state of the economy as shown below:

State of Economy	Probability	Returns on Security A	Returns on Security B
Boom	0.4	18%	24%
Normal	0.5	14%	22%
Recession	0.1	12%	21%

Required:

- **i.** Compute the expected portfolio return **(3 marks)**
- ii. Determine the correlation coefficient between security A and security B **(6 marks)**
- iii. Calculate the portfolio risk **(3marks)**
- **iv.** Calculate the reduction in risk due to portfolio diversification **(4 marks)**

(**Total 30 marks)**

Question TWO

a) The extent to which a firm is exposed or vulnerable to fluctuations in exchange rate (foreign exchange risk) is referred to as the exchange rate exposure discuss any three different ways through which foreign exchange exposure can be perceived **(6 Marks**)

b) : The Kenya shilling has been quoted against £ as follows **(8 Marks)**

Spot rate £1: Ksh 135 – 140
3 months forward rate £1: Ksh 155 – 160

Required:

1. Determine the amount required in sterling pound to buy 2 million Kenya shilling
   - At the spot
   - In 3 months time under the forward exchange contract.
2. Compute the amount a customer would get if he were to sell 2 million Kenya currency.
   - At the spot rate
   - In 3 months time under forward exchange contract

c) Discuss ways in which foreign exchange exposure can be managed **(6marks**

(**Total 20 marks)**

Question THREE

a) Discuss market efficiency and explain the aspects of market efficiency. **(10 marks)**

b) Compare and contrast the weak-form, semi-strong-form, and strong-form market efficiency **(10 Marks)**

(**Total 20 marks)**

Question FOUR

a) Explain what derivative is and their uses in risk management **(8Marks)**

b) Calculate the value of a three-month futures contract on a foreign currency where the spot price is R180, the domestic risk-free rate is 7% per annum, and the foreign risk-free rate is 6% per annum. **(4marks)**

c) Criticise the back Scholes model as a method of valuing options **(8Marks)**

(**Total 20 marks)**

Question FIVE

a) Discuss the three generic approaches in risk management process **(6 marks)**

b) Discuss any four components of systematic risk **(8marks)**

c) Discuss the qualitative methods of Risk Assessment **(6Marks)**