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UNIVERSITY EXAMINATIONS 2023/2024

FOURTH YEAR, SECOND SEMESTER EXAMINATION FOR THE DEGREE OF
BACHELOR OF COMMERCE

BFC 3479: FINANCIAL RISK MANAGEMENT

DATE: APRIL 2024

TIME: 2 HOURS

INSTRUCTIONS: Answer Question ONE and any other TWO questions.

QUESTION ONE (30 MARKS)

- a) Explain the risk management process (10 Marks)
- b) Jolly Ltd is considering three possible capital projects for next year. Each project has a 1 year life, and project returns depend on next year state of the economy. The estimated return are shown in the table:

State of the Economy	Probability of occurrence	Rate of Return		
		x	y	z
Recession	0.25	10%	9%	14%
Average	0.50	14	13	12
Boom	0.25	16	18	10



QUESTION TWO (20 MARKS)

Required:

- i. Compute each projects expected rate of return (6 Marks)
- ii. Compute the variance and standard deviation of each project (8 Marks)
- iii. Compute the co-efficient of variation for each project (3 Marks)
- iv. Which is a better project? Why? (3 Marks)

QUESTION THREE (20 MARKS)

- a) Describe different internal and External techniques available to handle currency risk. (12 Marks)
- b) Explain various methods a risk manager may use to identify possible risks. (8 Marks)

QUESTION FOUR (20 MARKS)

- a) Assuming you are a credit manager in a leading financial institution in Kenya, explain how you can manage credit risk in your firm. (10 Marks)
- b) A Kenyan industrialist is planning expansion of his plant. The estimate cost of the machine he should import for the purpose is USD 80,000. Given that the payment shall be due in 90 days' time, explain how a money market hedge may be used to cushion the importer of the volatility of the Kenya shilling against the dollar. The Kenyan money market is currently promising an interest rate of 12% per year. NB. Consider both covered and uncovered money market hedges. (10 Marks)

QUESTION FIVE (20 MARKS)

- a) List and explain various financial risks affecting business firms' outcomes (10 Marks)
- b) An investor wishes to buy 100,000 shares of KPC ltd but is worried that the market is not yet stable. He therefore wishes to explore going it the options way. It has been established that KPC share options are available at an exercise price of Ksh.85 and have an intrinsic value of Ksh.5. It happens that on expiry, the share price dropped by Ksh.20.

Required

- i. Determine the payoff if the investor used a put option. (5 Marks)



- ii. How different would it be if the investor didn't use put option and instead he bought shares on the basis of buy-low sell-high. (5 Marks)

