

UNIVERSITY OF COLOMBO, SRI LANKA
FACULTY OF MANAGEMENT AND FINANCE

Bachelor of Business Administration in Finance (Level II - Semester VII) Examination

June, 2017

FIN 2207- Risk Management and Insurance

Two (02) Hours

Answer all questions

1. Info Whiz (IW) is a Sri Lankan service company with over 1,500 employees operating in 11 urban cities in Sri Lanka and 3 overseas branches in India. The head office is located in Colombo. IW provides full-service information technology (IT) support to small and medium-sized businesses, including on-site troubleshooting, network setup and support, backup services, and website design and hosting solutions.

Info Whiz was formed in 2005 and it has enjoyed strong growth in its segment while achieving an excellent reputation in the industry. In the beginning, IW focused on a particular customer sub segment, small start-up businesses. Later its strategy has shifted more to midsize customers with more sophisticated technology needs. Recently IW has experienced several issues that took special attention of the management.

Throughout the last few years there has been steady decline in customer satisfaction. Following a thorough investigation and follow-up with many of IW's key customers, the Executive Team has concluded that the main cause of this has been high internal staff turnover, leading to gaps in customer services and service continuity. This has led to operating inefficiencies and idle high technology machinery and equipment. Indeed, staff turnover has been a critical issue for IW since they provide new staff members an extensive and costly training in IW's customer service and cross-selling approaches. However IW's practice of using informal mentoring and trainings rather than formal training and skill development has created many difficulties to sustain, given the challenges created by sudden staff departures.

The company's pay package is competitive but not at the very top; instead IW uses its reputation for excellent customer relationship and staff development to attract motivated staff. However IW has been having a particularly difficult time retaining staff in the larger urban centers where there are more competitors and the competitors generally pay more.

Due to the fact that customer satisfaction has been declining, the Executive Team noted that local revenue in numbers and cash flows have also been suffered. However there is an advantage on overseas service centers due to the continuous depreciation of home currency over last 20 months.

Recently, the company suffered a major shock when one of its employees was died in a car crash while rushing to a customer site in hill country. The employee who was died was a well-known and much admired member of the team, and many staff thought that IW's Management didn't respond properly to this event. In fact, one of the leading national newspapers ran a story on workplace tragedy and its impact on morale using Info Whiz as a case study. IW did experience a sudden high rate of employee turnover and some difficulty in replacing them. Also, there is a sense that staff efficiency is not what it should be; in particular, scheduling technicians for on-site technical work has been a problem. Small business customers tend to have diverse and unique technology needs, and finding specialists who can work in multiple areas is difficult.

Most of the IW technicians are specialists in a few areas, and the company has found that its specialists are spending a lot of time behind the wheel traveling from site to site dealing with point solutions to individual technical problems. IW's founder and CEO, Mr. Fernando freely admits that the company's own internal technology has not really kept pace with the growth of the company.

- i. Explain the difference between the following classifications of risk using examples from the above case.
 - a. Pure vs. Speculative risk
 - b. Fundamental vs. Particular risk

(08 Marks)

ii. Briefly describe the types of risks Info Whiz facing, in terms of physical asset exposure, financial asset exposure, human assets exposure and other related exposures.

(15 Marks)

iii. Conduct a risk assessment based on severity and probability for the risks identified above.

(07 Marks)

iv. Organizations vary as to their desire for risk control, and any particular risk may be controlled through a variety of tools and techniques. Briefly describe five (05) broad categories of risk management measures that Info Whiz may adopt to reduce the associated risks at each link of the risk chain.

(20 Marks)

(Total 50 marks)

2. i. Marlon is the newly appointed Head of Risk Management of a reputed organization. From past experiences he knows that some managers are reluctant to reveal situations in their operating units that ultimately could lead to accidental damage or being sued for injury. Explain any four (04) risk identification methods Marlon might use to overcome this natural reluctance of managers to reveal unfavorable information.

(06 Marks)

ii. Risk transfer mechanism is one of the most popular methods of controlling a specific risk of a particular organization or a particular person. Explain the role of insurance as a risk transfer mechanism providing examples where necessary.

(06 Marks)

iii. Assessment of human asset exposures for a business includes assessment of exposures for individuals and their families. Explain why a risk manager of a business may be concerned about possible losses to employees and their families that they could manage on their own.

(08 Marks)

(Total 20 marks)

3. i. Futures and Forwards are financial contracts that are used for mitigating risk and are very similar in nature but there exist a few important differences. Contrast four (04) key features of futures and forward contracts.

(06 Marks)

ii. Althana & Co. is a German multinational general merchandise retailer headquartered in Frankfurt. Althana & Co has a global coverage where its branches located in 4 countries; France, USA, UK and India.

Being a world recognized grocery stores with a huge turnover; there are substantial inter-office payments among head office and other overseas branches. Althana's treasurer has decided to experiment with multilateral netting in order to mitigate foreign exchange risk and to improve intercompany settlement efficiency. Euro has been identified as the common currency.

The net inter-office balances as at 31 May 2017 were agreed at:

Paying Office	Receiving Office	Amount
France	Germany	€ 1,345,500
UK	USA	\$ 190,000
France	UK	£ 121,000
USA	France	€ 676,800
India	USA	\$ 475,600

- a. Determine the net payments resulting if the foreign exchange rates are € 1 = \$ 1.12 = ₹ 72 = £ 0.88

(12 Marks)

- b. Suppose India has to make a payment of € 250,000 on 31 December 2017 for the goods transferred from German headquarters. In order to mitigate the foreign exchange risk the Senior Financial Officer of Indian office decides to buy a Euro call option for € 250,000 at a premium of INR 0.05 per Euro. If the exercise price is INR 76 and the spot price of the Euro at date of expiration is INR 73, what is the profit or loss on the call option for the Indian company? Illustrate your answer using profit/loss table and graphs.

(12 Marks)

(Total 30 marks)