

UNIVERSITY OF COLOMBO, SRI LANKA
FACULTY OF MANAGEMENT AND FINANCE

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

July, 2016

FIN 2207- Risk Management and Insurance

Two (02) Hours

Answer all questions

1. Techno Serve (TS) is a Sri Lankan service company with over 1,000 employees operating in 12 urban cities in Sri Lanka and 2 overseas branches in Bangladesh, where head office is located in Colombo. TS 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.

Techno Serve was formed in 2000 and it has enjoyed strong growth in its segment and has an excellent reputation with its customers. In the beginning, TS focused on a particular customer sub segment, small start-up businesses. Lately its strategy has shifted more to midsize customers with more sophisticated technology needs. Recently TS 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 TS'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 TS since they provide new staff members an extensive and costly training in TS's customer service and cross-selling approaches. However TS'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 TS uses its reputation for excellent customer relationship and staff development to attract motivated staff. However TS 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 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 killed in a car crash while rushing to a customer site in hill country. The employee who was killed was a well-known and much admired member of the team, and many staff thought that TS'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 Techno Serve as a case study. TS did experience a sudden rise in staff departures and some difficulty in recruiting replacements. 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 TS 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. TS's founder and CEO, Mr. Jayasinghe 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 given case.

- a. Pure vs. Speculative risk
- b. Fundamental vs. Particular risk

(08 marks)

ii. Briefly describe the types of risks Techno Serve 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 control measures that Techno Serve may adopt to reduce the associated risks at each link of the risk chain.

(20 marks)

(Total 50 marks)

2. i. 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)

ii. Risk Avoidance is a conscious decision not to be exposed to a particular risk of loss. Avoidance is not always feasible, and even when it is, avoidance is often not desirable. Using your own examples explain the situations in which risk avoidance becomes an unacceptable option.

(06 marks)

iii. Explain at least four (04) basic principles under which an insurance policy must operate, differentiating principles applied to general insurance and life insurance.

(08 marks)

(Total 20 marks)

3. Tiara PLC is an American multinational grocery and general merchandise retailer headquartered in New York. Tiara PLC has a global coverage where its branches located in 4 countries; UK, France, Germany and Sri Lanka.

Being a world recognized grocery stores with a huge turnover, there are substantial inter-office payments among head office and other overseas branches. Tiara PLC's treasurer

has decided to experiment with multilateral netting in order to yield significant savings from reduced foreign exchange trading and improved intercompany settlement efficiency. US \$ has been identified as the common currency.

The net inter-office balances as at 30 June 2016 were agreed at:

Paying Office	Receiving Office	Amount
UK	USA	\$ 275,000
France	Germany	€ 735,000
USA	France	€ 576,500
Sri Lanka	USA	\$ 1,544,000
France	UK	£ 104,400

- i. Determine the net payments resulting if the foreign exchange rates are \$ 1 = € 0.85 = Rs. 140 = £ 0. 635

(14 marks)

- ii. Suppose Sri Lanka has to make a payment of US \$ 300,000 on 31 December 2016 for the goods transferred from US headquarters. In order to mitigate the foreign exchange risk the Senior Financial Officer of Sri Lankan Tiara office decides to buy a Euro call option for \$ 300,000 at a premium of Rs. 0.05 per USD. If the exercise price is Rs. 142 and the spot price of the USD at date of expiration is Rs. 145, what is the profit or loss on the call option for the Sri Lankan company? Illustrate your answer using profit/loss table and graphs.

(16 marks)

(Total 30 marks)