EASTERN UNIVERSITY, SRI LANKA

Faculty of Commerce and Management

Third Year Second Semester Examination in BBA/B.com / B.Econ

2004/2005 (Nov./Dec.2006)

OCM – 3032 Risk Management

Answer All Questions. **Time: Two Hours**

Q1. **The Sydney Opera House**

The Sydney Opera House (SOH) is a top tourist attraction and landmark for Sydney and all of Australia. It has become a major arts center (although, owing to the design, it is not necessarily the best place to hear opera). The SOH is visually spectacular and a magnificent structure, but designing and building it was somewhat frightening.

The original concept for the SOH was a sketch submitted by a Danish architect. Judges selected it from an open competition that ended with 233 entries from 11 countries. Though happy to win the competition, Danish architect was mildly shocked. Although his concept had caught the attention of the judges, it consisted only of simple sketches with no plans or even perspective drawings. The architect faced the task of converting the concept into a design from which a structure could be built, but he had no prior experience in the design and construction of such a large building. Because of his lack of plans, detailed design drawings, and estimates of materials, little existed from which the cost could be determined. Interestingly, because the design was so unique, some people presumed it would also be inexpensive to build. No one knew how it would be build, and some experts questioned whether it could be built at all. Despite all the uncertainty, the initial project cost estimate was put at $7 million. The government would use profits from series of state- run lotteries to pay for the project.

Engineers who reviewed the concept noted that the roof shells were much larger and wider than any shells seen so far. Further, because they stuck up so high, they would act like sails in the strong winds blowing up the harbour. Thus, the roof would have to be carefully designed and constructed to prevent the building from blowing away.

The government was worried that people scrutinizing the design might raise questions about potential problems that would stall the project. They thus quickly moved ahead and divided the work into three main contracts: the foundation and building except the roof, the roof and the interior & equipment.

As feared by many experts, the SOH project became an engineering and financial debacle, lasting 15 years and costing $ 107 million ($100 million over the initial estimate). Infact from the beginning this should have been viewed as a very risky project. Nonetheless, risks were either down -played or ignored, and not much was done to mitigate or keep them under control.

a. **Differentiate risk and uncertainty**

(09 marks)

b. **Identify the obvious risks associated with SOH.**

(09 marks)

c. **Discuss the Risk Management Process, and explain why early actions have been taken to reduce the risks.**

(10 marks)

Q2. a. **Risks are categorized in differentiate ways. What are the categories commonly discussed? Support your answer with suitable examples.**

(07 marks)

b. **What do you understand by sources of risk? Illustrate it with suitable examples.**

(08 marks)

c. **"Risk Taking is a capital investment" Discuss.**

(09 marks)

Q3. a. **State four major categories of managing risk.**

(08 marks)

b. **Risk can be managed by implementing pro-active strategies". Elaborate on this statement, supported by examples.**

(08 marks)

c. **Exchange rate fluctuations have much influence on the currency. What are the causes of currency risk?**

(08 marks)

Q4. a. Define *unsystematic risk*. Can you eliminate unsystematic risk? Support your case with logic and evidence.

(06 marks)

b. "Companies and employees are abided by the enforcement of legal risk". Critically comment on it.

(08 marks)

c. Portfolio management is a way of managing risk. What is portfolio management? What do you mean by the term *Value at Risk*?

(10 marks)