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**Question 1:**

**(A)**

**Answer:**

**Expected Return = Ŕ = 9% = 0.09**

**Standard Deviation = 𝛔 = 8.38% = 0.0838**

**What is the probability that the return will be more than 10 percent?**

**Z =**

**Z =**

**Z =**

**Z = 0.1193**

**Z = 0.4602**

**Z = 46.02%**

**There is 46.02% probability that the return will be more than 10%**

**Probability for return to be less than 40 percent?**

**Z =**

**Z =**

**Z =**

**Z = 3.6992**

**Z = 0.0013**

**Z =0.13%**

**There is 0.13% probability for the return to be less than 40%.**

**Question 1:**

**(B)**

Nowadays the pandemic situation (Crona Virus), it not only affected the Pakistan Stock Exchange, it affected the stock exchanges of all over the world.

Every stock exchange is going down.

This pandemic situation affected the economic condition of all countries.

This pandemic situation started first in China, so it affected China Stock exchange first and later this situation spread in all over the world and all stock exchanges affected from it.

Pakistan Stock Exchange is in bad condition nowadays. Before Pakistan Stock Exchange were traded on 43000 but after this pandemic situation it trading on 34000.

Pakistan stock exchange decreased 900 points in 100 index in few days.

The share prices are also going down. And investors don’t invest their money.

This situation is going worst day by day.

The investors lost millions rupees.

The investors have to wait and divestment, because Pakistan has a strong relationship with China and the stock exchange of China is going down, so it can affect Pakistan Stock Exchange also.

It is the ***systematic risk,*** because it affects the overall market. It changes the economic condition. It can’t be diversified.

**Question 2:**

**(A)**

**Answer:**

**Investment A investment B**

**Expected return 0.09 0.20**

**Standard deviation 0.05 0.10**

**Coefficient of Variation 0.55 0.5**

**Investment A**

**CV =**

**CV = = 0.55**

**Investment B**

**CV =**

**CV = = 0.5**

**Investment A is more risky as it has greater variation relative to the size of expected return.**

**Question 2:**

**(B)**

**Answer:**

**Security Market Line (SML):**

When as per CAPM, the expected rate of return is presented graphically:

SML will be a ***sloping upward*** straight line.

This line is called ***Security Market Line***.

Y

E(R)

SML

Rf

0

β X

SML sloping upward indicates that:

The higher the β the higher will be E(R).

The more the **Risk**, the more should be the **Return**.

**Characteristic Line:**

A line that describes the relationship between an individual security’s return and returns on the market portfolio. Beta is the slope of this line.

Excess Return on stock

+ The narrower the spread, the higher the correlation

Characteristics line

Beta = slope (rise over run)

- + Excess return on market portfolio

-

**Difference between Security Market Line and Characteristic Line:**

**Security Market Line:**

* It represent the relationship between return and risk (measured in term of systematic risk) of security or portfolio.
* The graph nature is cross sectional (at a single point in time, from different individuals or groups observations coming).
* SML graphs beta versus expected return.
* It is used for estimating the expected return for security relative to its beta risk.

**Characteristic Line:**

* It represents the relationship between the return of 2 securities or a security and the market return, over a period of time.
* Security characteristic line is a time series graph (observations collected and equally spaced time intervals)
* SCL graphs time series of security return versus index return.
* It determines that how a security return correlates to a market index return and also helps to estimate beta.

**Question 3:**

**(A)**

**Answer:**

**Goals of a Firm:**

Every firm has various goals which are below:

**Profit Maximization:**

Profit maximization is an objective of the firm which is supposed to be have traditional rules, means in traditional era it is supposed that a firm or organization is only and only established for the profit objective.

Means, a firm which is engaged in a business activity is supposed to have the profit maximization objective nothing else is the objective of a firm rather than earning economic value than can increase the profit of the entrepreneur.

**Value Maximization:**

Value maximization is upgraded version of profit maximization.

Profit maximization is supposed to have short term goal but value maximization is a process which have further steps and one of the steps is profit maximization.

Value maximization is a long term object for the firm.

Here value means the market value of the shares of a concern or the market value for the capital which is employed by the entrepreneur in the business.

**Sale/Revenue Maximization:**

The sale or revenue maximization is a goal of the firm where the firm only concentrate at increasing the sales and revenue in the market.

Here the only motive of the firm is to achieve a high standard sales and cop up the market by increasing the sales of a firm.

Here only and only motive is sales maximization.

It sometimes exploit the customers also.

**Stability:**

Stability object means that the firm need to be in a stable base, means firm wants to go for a number of year.

Under the stability approach or stability object the firm only be consistent in the activities.

**Question 3:**

**(B)**

**Answer:**

**Agency:**

It is an organization which is providing a particular services or producing a particular products.

**Agency relationship:**

The relationship between shareholders and management is called Agency relationship.

**Agency Problems:**

Shareholders want to maximize profit. Because they want to maximize the return from their investment both in term of the share price and also the dividend that they will receive.

Managers who face day to day business decisions making on price, marketing, research and products. They may have different motivations and different objectives.

The management may act in its own best interest rather than those of the shareholders, because shareholders of the firm can’t observe directly what the management is doing.

Agency problem arise when there is a conflict of interest between shareholders and management.

When the shareholder’s objectives and manager’s objectives are not in same alignment that is called agency problems.

**How to avoid Agency Problems?**

Jensen and Meckling developed a theory of a firm under the agency arrangement. They defined that the shareholders can assure themselves that the management will make good decisions only if the managers are monitored and only if appropriate incentives are given.

There are some ways from which can avoid agency problems:

* If owner provides fixed salary to manager and also reward for his/her better performance, then the manager will motivate to work more and taking rewards because if the salary is fixed he will not bother about his salary he will motivate to work more and take rewards and benefits.
* Provide him bonus share or give him options to purchase shares of a company. So then manager will also act as an owner. He will motivate to work for the benefit of the shareholders.
* Provide him bonus, if he increase sale, increase profit and increase the revenue of a company.
* Give him target, for example if you achieve that target so then I will provide you a ticket of a foreign country to visit.

**The end.**