Mid Exams Spring 2020

**(Subject Name=financial Management)**



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**Q-1:-**

**If the expected return is 9% and the standard deviation is 8.38%, what is the probability that return will be more than 10 percent? Also find the probability for return to be less than 40 percent.**

**Solution:-**

**Formula z= **

R = 9%, S = 8.38%

For Probability that return will be 10% or more:

Z = $\frac{10\% - 9\%}{8.38\%}$ = $\frac{.1 - 0.09}{0.0838}$ = 0.1193 (value from Z table = 0.4602)

This means there is a probability of 46.02% that the return will 9% or more

R = 9%, S = 8.38%

For Probability that return will be less then40%

Z = $\frac{40\% - 9\%}{8.38\%}$ = $\frac{.40 - 0.09}{0.0838}$ = 3.699 (value from Z table =??)

This means there is a probability of???? That the return will Or LESS

The value in the table can’t be shown.

**Q-B:-**

  **Keeping the current pandemic in mind, which type of risk i.e. systematic or unsystematic risk is faced by stocks traded on Pakistan Stock Exchange and why?**

**Ans:-**

 **SYSTEMATIC RISK:-**

Systematic risk is the probability of a loss associated with the entire market means a country’s whole economy due to some disasters.

So systematic risk is faced by stocks traded on Pakistan stock exchange because due to current pandemic condition fluctuation occur in currencies no business run in the country like before currency was already down as compare dollars now due to pandemic condition currency down more and investor’s confidence down and has big risk for investing. So Pakistan stock exchange completely disturb due to this pandemic condition.

 **Unsystematic risk:-**

 Loss associated with a specific company or industry. So this pandemic condition is not come in an unsystematic risk.

**Q-2:-**

 **Consider two investment opportunities, A and B, whose normal probability distributions of one-year returns have the following characteristics:**

|  |  |  |
| --- | --- | --- |
|  | **Investment A** | **Investment B** |
| **Expected Return** | **0.09** | **0.20** |
| **Standard deviation** | **0.05** | **0.10** |

**A part:**

 **Calculate coefficient of variation for both investment A and B. Identify which of the two investments is more risky and why?**

**Solution part A:-**

|  |  |  |
| --- | --- | --- |
| Investment | A | B |
| Expected Return | **0.09** | **0.20** |
| Standard Deviation  | **0.05** | **0.10** |
| CV=SD/R | **0.05/0.09=0.555** | **0.10/0.20=0.5** |

Investment **A** is more risky then B as the CV value for a is **greater** than that of B

**Part-B:-**

  **Briefly explain the difference between the characteristic line and security line?**

**Ans:-**

 **Characteristic line:-**

Characteristic Line: A characteristic line is a straight line formed using regression analysis that summarizes a particular security's systematic risk and rate of return. And is also called security characteristics line (SCL). The characteristic line created by plotting a security return at various points in time. The measurement of the y-axis shows the excess return of the security. Excess return is measure for the purpose against the risk free of return.

 **Security market line:-**

The security market line is a line drawn on a chart that serves as a graphical representation of the capital asset pricing model. For the purpose it shows different levels of systematic market risk of various marketable securities, Plotted against the expected return of the entire market at any given time. It is used by money managers and investors for the purpose to evaluate an investment product and thinking about the products including in a portfolio.

**Q-3:-**

 **Part A-**

 **Keeping the pros and cons of different goals in mind, what should be the ultimate goal of a firm? Give reasons for your answer.**

**Ans- (a):-**

 Every firm has different goal and objective it’s depend that which kind of business they operate. But the main goal that every firm has that the creation of market value of the firm. Because if a firm has higher the market value it’s means more people want to do business with it and in it. Creating good market value means that the company is the good books of the investors of that specific industry. And also means company produces or generating more profits. It avoid risky adventures and shareholder gets more benefits.

**B-part:-**

**Why do agency problems arise? How can they be avoided?**

**Ans:-**

 The agency problem is a conflict of interest inherent in any relationship. The agency problem is the conflict of interest between company’s management and the company’s stockholders. The manager act as the agent for the shareholder it’s mean that manager supposed to make decisions which help to maximize shareholder wealth although manager has best interest to maximize his own wealth also.

**Avoided:-**

 This type of problem can be avoided having good interpersonal relationships between the management and shareholder providing extra incentives to the company’s management and also can be avoided through giving limited decision power to firm’s management and strict policy behind the management activity means financial reports.