SCHOOL OF BUSINESS AND ECONOMICS
DEPARTMENT OF COMMERCE
FINAL EXAM: JANUARY 2019 SEMESTER
CODE: BUS 421 A/T   UNIT: RISK MANAGEMENT

TIME: 2 HOURS

INSTRUCTIONS

Answer Question ONE (Compulsory) and any other TWO

QUESTION ONE

Read the following cases and answer questions that follow;

FUDDRUCKERS

Romano, founder of Fuddruckers, a nationwide gourmet hamburger chain, truly is a restaurant entrepreneur. Romano has experienced the taste of failure on more than one occasion. Yet he realizes that success in the volatile restaurant business requires trying creative new concepts that may fail. Failure is common in the restaurant industry; eating and drinking establishments top the list of businesses with the greatest failure rates.

Much of Romano's success is attributable to his ability to anticipate dining trends and to develop effective restaurant promotions. He caught on to the salad-bar trend early in his first restaurant, the Nag's Head Bar in West Palm Beach. He captured customers' interest with another venture after his grand-opening; he padlocked the door and sent keys to select customers. The gimmick created an informal cadre of salespeople touting the restaurant by word of mouth. When meat prices pushed up prices 30 percent at his Friends of Edinburgh Scottish Pub, Romano had new menus printed. Nevertheless, he issued the old menus to regular customers, who continued to pay the old prices as long as they brought their old menus. The gimmick at his lunch- oriented First National Bar & Grill was for customers to punch time clocks and pay by the minute.

The gimmicks didn't always work, and Romano's instincts about diners' preferences weren't always correct. His Pasta Palace, a combination art-deco movie house and pasta restaurant opened well before art deco or pasta became chic in Florida. It closed quickly thereafter. Romano thought he was catching the wave for lighter fare with his health-oriented Stix Eating Spa in San Antonio. However, the upscale restaurant appealed to only a very small customer base, and sales fell well below expectations. "It was the right restaurant in the wrong place," he claimed after the restaurant closed.

Even Fuddruckers, which for a time was one of the hottest food chains around, began to slide. Romano overestimated the public's willingness to pay $5 for a burger. The restaurant failed to adapt its menu and its prices in time and incurred a huge loss. Romano sold Fuddruckers the next year. His current venture, Romano's Macaroni Grill, is highly successful. Modeled after his memories of his grandfather's warm Italian kitchen, the

restaurant draws crowds on traditionally slow nights. Romano offers free meals on Monday or Tuesday each month. The catch: customers never know which Monday or Tuesday!

Romano's newest restaurant idea presents yet another challenge for him: convincing New Yorkers to indulge their palates with hearty Tex-Mex fare. The competition will be stiff; there are some twelve thousand competing restaurants in Manhattan, and overhead expenses are outrageously high. The real test of success or failure will be told on the tables of the Texas Tortilla Bakery.

Questions

a) Much of Romano's success is attributable to his ability to anticipate dining trends and to develop effective restaurant promotions whereas his failure can be attributed to his inability to manage risk. Discuss   (8 Marks)

b) How would you describe Romano's appetite for risk?   (2 Marks)

c) Explain FIVE methods that you can used to identify risk exposures for Romano's restaurant business   (10 Marks)

d) Explain FIVE types of risks Romano is exposed to as an entrepreneur   (10 Marks)

QUESTION TWO

a) In approximating the probability distribution for the amount of damage to your car next year, five possible levels of damage and the corresponding probabilities are assumed as follows: Ksh. 0 (0.50), Ksh. 100,000(0.30) Kshs. 150,000 (0.10) Ksh. 200,000 (0.06) and Ksh. 250,000 (0.04). What is the expected value of damage to your car?   (10 Marks)

b) Petero and Maria are in a car pooling arrangement. Each is exposed to a 20 % chance of an accident and an 80 % chance of no accident next year. The accident will cause a loss of Kshs.100, 000. Prepare a probability distribution for accident losses and comment on the probabilities and their implications.   (10 Marks)

QUESTION THREE

a) i. What is a physical hazard?   (2 Marks)

ii. Give examples of physical hazards   (8 Marks)

b) Differentiate between pure and speculative risks and give THREE examples for each
                                                                            (10 Marks)

QUESTION FOUR

a) For each scenario below, explain whether the correlation between random variable 1 and random variable 2 is likely to be uncorrelated, positive or negative.   (8 Marks)

i.   Random variable 1: Your automobile accident costs for the coming year.
       Random variable 2: The automobile accident costs of a student in another country or the coming year

Random variable 1: the property damage due to hurricanes in Miami, Florida in September.

Random variable 2: the property damage due to hurricanes in Ft. Lauderdale, Florida in September

ii.   Random variable 1: the property damage due to hurricanes in Miami, Florida in September 2016.

Random variable 2: the property damage due to hurricanes in Miami, Florida in September, 2018

iii.   Random variable 1: The number of people in New York who die from HIV/AIDS in the year 2017.

Random variable 2: the number of people in London who die from HIV/AIDS in the year 2017.

b) Based on the severity and frequency of losses, determine the appropriate technique(s) to employ to handle risk in a manufacturing setting. Illustrate your answers by using risk treatment matrix.   (12 Marks)