Tutorial Worksheet: Risk Management

This worksheet is designed to test your understanding Risk Management in a structured format. Answer the following questions based on your study materials. The total marks for this tutorial are 20.

Question	Marks	Answer
1. Define risk management and explain its importance in financial decision-making.	3	Risk management involves identifying, assessing, and mitigating risks to minimize potential negative outcomes in financial decisions. It is crucial as it helps businesses and investors protect against uncertainties, ensuring more stable returns and better long-term financial health.
2. Differentiate between systematic and unsystematic risks with examples.	3	Systematic risk refers to market-wide risks that affect all investments, such as inflation or economic recessions, and cannot be eliminated through diversification. Unsystematic risk is specific to individual companies or industries, such as a company's management failure or product recall, and can be mitigated through diversification.
3. Explain the role of diversification in managing investment risk.	4	Diversification involves spreading investments across different assets or sectors to reduce the impact of any single asset's poor performance on the overall portfolio. By not "putting all eggs in one basket," investors can minimize unsystematic risk and achieve a more balanced risk-return profile.
4. What are the key steps involved in the risk management process?	3	The key steps in the risk management process include: 1. **Risk Identification**: Recognizing potential risks that could affect objectives. 2. **Risk Assessment**: Evaluating the likelihood and impact of the risks. 3. **Risk Mitigation**: Developing strategies to reduce or eliminate identified risks. 4. **Monitoring and Reviewing**: Continuously tracking risks and the effectiveness of mitigation measures.
5. How can financial derivatives be used as tools for risk management?	3	Financial derivatives, such as futures, options, and swaps, can be used to hedge against adverse price movements in assets. For example, an investor can use options to lock in a purchase or sale price, thus managing risk by reducing exposure to volatility in stock, commodity, or currency markets.
6. Explain the concept of risk appetite and how it influences an organization's risk management	4	Risk appetite refers to the amount of risk an organization is willing to accept in pursuit of its goals. It influences risk management strategy by determining which risks to take, avoid, or mitigate based on the company's financial capacity, business objectives, and risk tolerance, shaping decisions around investments, projects, and operations.