

The
Management
University
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UNDERGRADUATE UNIVERSITY EXAMINATIONS

SCHOOL OF MANAGEMENT AND LEADERSHIP

DEGREE OF BACHELOR OF COMMERCE

FIN 313: ASSET MANAGEMENT

DATE: 14TH APRIL 2026

DURATION: 2 HOURS

MAXIMUM MARKS: 70

INSTRUCTIONS:

1. Write your registration number on the answer booklet.
2. **DO NOT** write on this question paper.
3. This paper contains **SIX (6)** questions.
4. Question **ONE** is compulsory.
5. Answer any other **THREE** questions.
6. Question **ONE** carries **25 MARKS** and the rest carry **15 MARKS** each.
7. **Write all your answers in the Examination answer booklet provided.**

QUESTION ONE

Read the Case Study below carefully and answer the questions that follow:

MANAGING AGRICULTURAL PRICE RISK USING DERIVATIVES

The derivatives market plays a critical role in managing price volatility for firms dealing in agricultural commodities. Prices of products such as wheat and wheat flour are highly sensitive to weather conditions, changes in farming technology, and supply-chain disruptions. To manage this uncertainty, firms commonly use forward contracts and futures contracts, both of which derive their value from the underlying commodity. Forward contracts are privately negotiated, over-the-counter (OTC) agreements that allow buyers and sellers to customize terms such as quantity, quality, price, and delivery date. While they provide flexibility, they expose parties to counterparty risk since performance depends solely on the contracting parties. Futures contracts, by contrast, are standardized agreements traded on organized commodity exchanges. They are backed by clearinghouses, require margin deposits, and are settled daily through marking-to-market, significantly reducing default risk but limiting customization.

A large wheat processing firm supplies wheat flour to bakeries and food manufacturers. The firm's profitability depends on stable wheat input prices, yet it operates in an environment characterized by unpredictable weather patterns, including droughts and floods. Management is therefore considering whether to hedge its wheat price risk using exchange-traded futures contracts or customized forward contracts with suppliers and buyers. One of the wheat processor's key customers is Jane's Bakery, which purchases flour regularly for its commercial baking operations. At the beginning of the year, the spot price of flour is \$3 per kilogram, supplied by the processor, FlourCorp. Meteorological forecasts warn of a possible drought in major wheat-growing regions, raising concerns that wheat and flour prices may rise sharply over the next six months. To protect herself from escalating input costs and ensure price certainty, Jane's Bakery enters into a 6-month forward contract with FlourCorp to purchase 15,000 kg of flour at \$3 per kg. From FlourCorp's perspective, recent investments in modern irrigation systems and improved farming techniques suggest the possibility of bumper wheat harvests, which could increase supply and push prices down. Nevertheless, FlourCorp agrees

to the forward contract to secure guaranteed sales volumes and stabilize cash flows. Six months later, actual market prices reflect the combined impact of weather outcomes and technological improvements, creating gains for one party and losses for the other, depending on the direction of price movements. The management of the wheat processing firm also reflects on whether the use of futures contracts instead of forwards would have altered the risk exposure and outcomes for both parties.

Required:

- a) Using the above case, advice the wheat processing firm on whether it should use futures contracts or forward contracts to hedge against wheat price volatility. **(5 marks)**
- b) With reference to the forward contract between Jane's Bakery and FlourCorp, explain whether both parties are legally obligated to honor the contract despite unexpected outcomes such as droughts or bumper harvests. **(5 marks)**
- c) Analyze the possible outcomes for both Jane's Bakery and FlourCorp under different post-contract market price scenarios. **(7 marks)**
- d) Explain how the hedging arrangement and outcomes would differ if a futures contract had been used instead of a forward contract. **(8 marks)**

QUESTION TWO

- a) Sarah invests Ksh. 15 million in a fixed deposit. Explain how her bank generates returns by lending to a hotel developer at 16% p.a. interest. **(8 marks)**
- b) Examine the role of three leading pension fund administrators in Kenya. **(3 marks)**
- c) Distinguish between overfunded from underfunded retirement schemes. **(4 marks)**

QUESTION THREE

- a) While unit trusts attract retail investors, describe five key drawbacks before committing funds. **(5 marks)**
- b) Discuss five obstacles hindering pension schemes' performance in Kenya. **(10 marks)**

QUESTION FOUR

- a) Assess five core responsibilities of professional fund managers. **(5 marks)**
- b) Evaluate five policy measures for the Kenyan government to enhance affordable housing finance availability. **(10 marks)**

QUESTION FIVE

- a) Examine five risk factors fund managers must quantify when analyzing money market instruments. **(10 marks)**
- b) Assess five drivers behind asset managers' shift from defined benefit to defined contribution plans. **(5 marks)**

QUESTION SIX

- a) Portfolio Theory Y enables optimal asset combinations maximizing returns at target risk levels.
 - i. Propose an accurate name for Theory Y and justify how it reflects the theory's principles of diversification and risk-return optimization. **(2 marks)**
 - ii. Explain diversification under Theory Y to eliminate firm-specific risk, including the correlation metric used. **(5 marks)**
- b) Positive asset cash flows sustain operations. Describe four managerial strategies to optimize inflows from investments. **(8 marks)**