

[Frequently Asked Questions]

Conventional Tools to Handle Risk

Subject:

Business Economics

Course:

Paper No. & Title:

B. A. (Hons.), 5th Semester, Undergraduate

Paper – 551 Elective PaperP1 – Project Management

Unit No. & Title:

Unit – 3 Incorporating Risk in Projects

Lecture No. & Title:

Lecture – 1 Conventional Tools to Handle Risk

Frequently Asked Questions

Q1. What is RISK?

A1. Risk can be understood as an exposure to potential danger or loss. When investment in unplanned, dubious projects in order to derive higher returns is a form of financial risk.

Q2. Which are different types of risk?

A2. The risks taken into account in modeling are typically grouped into credit risk, liquidity risk, market risk, and operational risk categories.

Q3. Which are basic characteristics of risk?

A3. Uncertainty – the risk may or may not happen, that is, there are no 100% risks (those, instead, are called constraints) Loss – the risk becomes a reality and unwanted consequences or losses occur.

Q4. Define certainty equivalent.

A4. Certainty equivalent is a guaranteed return that someone would accept, rather than taking a chance on a higher, but indecisive, return.

Q5. What is sensitivity analysis?

A5. A technique of risk analysis that can be used to study the responsiveness of a criterion of merit like NPV or IRR to variation in underlying factors such as selling price, quantity sold etc.

Q6. Explain project risk

A6. It threatens the operation of a specific project, thereby affecting the repayment of the lender's loan.

Q7. Do you know which types of risks are associated to a project?

A7. Risks associated to a project are:

Project risk Debtor's credit risk Sovereign credit risk Commercial risk Political risk

Force majeure

Q8. Elaborate advantages and limitation of risk adjusted rate.

A8. Advantages of this method are:

It is very popular and is commonly applied

(ii) It is easier to manage the discount rate that considers both risk and time.

Limitations of this method is :

It is difficult to estimate the risk adjusted discount rate for a project consistently.

This method wrongly assumes that risk increases at a constant rate with time.

Q9. Why sensitivity analysis is needed to evaluated risk in any project?

A9. A sensitivity analysis is a technique used to determine how different values of an independent variable will impact a particular dependent variable under a given set of assumptions.

Q10. Which are drawbacks of sensitivity analysis?

A10. Drawbacks of this method are:

(i)The absence of any formal assignment of probabilities to the variation of crucial parameters is a potential limitation of sensitivity analysis.

The concept may be best understood in relation to the case under review.