Aston Business School
Birmingham

# BSM939 UNCERTAINTY AND RISK IN BUSINESS

**Academic Year 2012/13**

Number of Aston Credits: 15

Number of ECTS Credits: 7.5

## Staff Member Responsible for the Module:

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Availability: Walk in during designated weekly office hours
TBA, or by prior appointment
Or contact the Economics and Strategy Group Administrator
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## Pre-requisites for the module:

BSM940 Economic Environment of Business

## Mode of Attendance:

On Campus

## Information for Distance Learning Students:

All information regarding this module is available/can be found on the Blackboard. In some cases, links to external web sites will be provided.

## Module Objectives and Learning Outcomes:

The aim of this module is to provide students with an understanding (a) of the differences between risk and uncertainty, and reaction of economic agents to risk and uncertainty; and (b) the nature of the different types of risk that are routinely experienced in business; and (c) tools with which these risks can be managed.

By the end of this module, students should be able to:

- identify the risks associated with strategic business decisions, and
- develop strategies and business plans that incorporate within them ways to mitigate the risks.

## Module Content:

To begin with, students will be introduced to the differences between risk and uncertainty, and the reaction of economic agents to risk and uncertainty. The discussion will use as its basis the *Knight*ian distinction between risk and uncertainty, as well as the non-neoclassical views about agents' response to risk and uncertainty included in decision and prospect theories.

**Week 1:** Risk and uncertainty

Arguably, price risk is the most fundamental risk that is experienced by a business. On the one hand, a fall in output price may affect revenues adversely, and, on the other hand, a rise in prices of inputs such as energy might raise cost of operations substantially. Hence, to begin with, we shall discuss price risk and ways to hedge this risk using tools such as futures contracts and vertical integration.

**Week 2:** Price risk

Next, we shall discuss two different sources of financial risk, which are related. First, we shall discuss exchange rate risk which has taken centre stage in an era of globalised supply chains and globalised markets for outputs. Next, we shall discuss interest rate risks that are experienced by all businesses that borrow working and project capital. We shall discuss briefly associated theories such as the one involving uncovered interest parity, but much of the discussion will focus on risk management tools such as options contracts and swaps.

**Week 3:** Exchange rate and interest rate risk I

**Week 4:** Exchange rate and interest rate risk II

In the following two weeks, we shall discuss the related issues of operational risk and governance risk experienced by businesses and their stakeholders. The discussion would include cases such as Barings where absence of an efficient operational risk management system led to bankruptcy, and Enron where weak corporate governance led to the same outcome. In the context of these risks, we shall also discuss holistic risk management practices such as enterprise risk management.

**Week 5:** Operational risk and governance risk I

**Week 6:** Operational risk and governance risk II

During weeks 7 and 8, we shall bring politics and the government into the ambit of the discussion. First, we shall discuss political risk, and the related issue of macroeconomic risk. The discussion about political risk would include both political economy issues such as policy paralysis and risks associated with conflict that can arise from policies related to income distribution etc. Next, we shall discuss the role of the government and policymakers in creating regulatory infrastructure to minimize the risk (including systemic risk) in the business environment. This discussion will draw significantly on the regulatory changes in the banking-financial sector.

**Week 7:** Political risk and macroeconomic risk

**Week 8:** Impact of regulations and government policy on risk

Finally, Week 9 will be devoted to a review of the eight previous lectures, and the examination will take place in Week 10.

**Week 9:** Revision

**Week 10**: **Examination**

## Corporate Connections:

The lectures will draw on cases reported in academic literature, and experiences of financial and non-financial companies, as well as organizations such as Orange Country in California to discuss the nature of the risks and ways to manage them. In addition, as part of their assessment, students would be expected to undertake risk analyses of firms or industries or countries.

## International Dimension:

The lectures will use examples from both developed countries, particularly those from Europe and North America, and emerging market economies, with emphasis on the BRICS economies.

## Contribution of Research:

The module content will draw significantly on the lecturer's past and present research in the areas of risks and their management, especially those undertaken as a corporate economist working at a credit rating agency.

## Method of Teaching:

The module will use a number of non-technical research papers (some of which are included in the recommended text book) on each of the key issues. The recommended book and lecture notes would be required reading, and students might be asked to read some of the papers or reports as well. The lectures would provide the analytical framework, and integrate the required reading would be integrated into this framework. The lectures would also draw on experiences of business and others such as Orange Country, as appropriate. Each 2.5-hour lecture would be followed by a 1-hour tutorial in which student contribution to the discussion would be encouraged and facilitated. Assimilation of different viewpoints and critical analysis would be encouraged during the course of the lectures and the tutorials. Finally, students will be encouraged to use free online tutorials offered by organizations such as the Chicago Board Options Exchange.

## Ethical Approval:

This module does not require any primary research and no ethical approval will be necessary.

## Method of Assessment and Feedback:

The assessment strategy for this module involves one 2-hour exam, and a written coursework:

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|---|---|
| Courswork (research) | 40% |
| Closed book exam (essay questions) | 60% |

The 1200 word essay (supplemented by a maximum of 3 tables and 3 charts/graphs) would require students to do research during the first eight weeks of the term, and submit the essay during the ninth week of the term, by the stipulated deadline. The essay would require application of theories and concepts discussed in class, and will involve critical analysis of available qualitative and quantitative evidence about the research question. The research question itself would be uploaded to Blackboard during Week 1, and further guidance and formative feedback would be provided throughout the term.

The rest of the final exam would involve essay questions, and would be closed book in nature. The essay questions would require students to demonstrate understanding of the theories and principles, and risk management tools and practices that would be discussed during the lectures and the tutorials.

The feedback on the students' performance on the module would be given using a variety of methods such as via Blackboard, or to individuals on request.

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## Learning Hours:

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|---|---|
| Contact hours total | 31.5 |
| Lectures | 22.5 |
| Tutorials | 9 |
| Research | 50 |
| Private study | 66.5 |
| Final Assessment | 2 |
| **Total** | **150** |

**The following essential and recommended readings are subject to change. Students should not therefore purchase textbooks prior to commencing their course. If students wish to undertake background reading before starting the course, many of the chapters/readings are available in electronic form via on-line library catalogues and other resources**

## Recommended Reading:

The lectures will draw on a number of sources, and hence the reading list is likely to include cases and non-technical journal papers. Students may be required to use two sources of information in particular:

1) Corporate Risk Management, (Ed.) Donald H. Chew, ISBN: 978-0-231-14363-9

2) Notes prepared by the lecturer, drawing on multiple journal articles etc, and made available through Blackboard.

In addition, students would be referred to a text book and available online information (including tutorials) about hedging tools such as options and futures.

## Useful Reference;

CME Group, http://www.cmegroup.com/education/index.html

Chicago Board Options Exchange, http://www.cboe.com/learncenter/tutorials.aspx