

# Chapter 18

## Derivatives and Risk Management

### LEARNING OBJECTIVES

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After reading this chapter, students should be able to:

- Identify several good reasons for companies to manage risk.
- Define the term “natural hedge” and give some examples.
- List three reasons why the derivatives markets have grown more rapidly than any other major market in recent years.
- Explain what an option is, identify some factors that affect the value of a call option, and calculate the exercise value and premium of an option.
- Explain the term riskless hedge and then go through an example to create one.
- Use the Black-Scholes Option Pricing Model to calculate the value of a call option.
- Distinguish between forward and futures contracts and define the following terms: swaps, structured notes, and inverse floaters.
- Briefly explain what risk management involves and identify the steps in the three-step approach to risk management.
- Explain how financial futures can be used to hedge against security price exposure and how commodity futures can be used to hedge against commodity price exposure.