

CHUKA



UNIVERSITY

UNIVERSITY EXAMINATIONS

EXAMINATION FOR THE AWARD OF MASTER OF BUSINESS
ADMINISTRATION

MBAD 835: INTERNATIONAL FINANCE

STREAMS: MBAD

TIME: 3 HOURS

DAY/DATE: THURSDAY 05/12/2019

2.30 P.M. – 5.30 P.M.

INSTRUCTIONS: ANSWER ALL QUESTIONS

QUESTION ONE

(a) Explain any four dimensions that distinguish international finance from domestic finance [6 marks]

(b) Explain any four benefits of borrowing from the Euro bond market [6 marks]

(c) You have been provided with the following series of exchange rates

$$\text{\$1} = \text{SwFr } 1.6639 - 1.6646$$

$$\text{\text{€}1} = \text{\$0.9682} - 0.9686$$

$$\text{\text{€}1} = \text{SwFr } 1.6410 - 1.6423$$

Assume that you have

\\$1,000,000 in cash

Required:

Describe how you could take advantage of these exchanges rates to obtain arbitrage gain

[6 marks]

(d) Excel limited expects to receive \\$1,200,000 in the next three months to 30th April 2019.

The current spot rate is \\$/\text{£} 1.5020 – 1.5110

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The current futures price on a contract size of £62,500 is \$/£ 1.5035. The forward rate is stated as \$/£ 1.5080-1.5160.

The spot exchange rate in April is forecast at \$/£ 1.5100-1.5190 while the April futures is selling at \$/£ 1.5120

Required:

Advise on the appropriate hedging strategy [7 marks]

QUESTION TWO

- (a) A current spot exchange rate is \$1.50/£ and the three month forward exchange rate is \$1.52/£. The three month interest rate is 8.0 percent per annum in the U.S and 5.8 percent per annum in the U.K. Assume that you can borrow as much as \$1,500,000 or £1,000,000.

Required:

- (i) Determine whether interest rate parity is currently holding [4 marks]
(ii) If IRP is not holding, determine the arbitrage profit [7 marks]
- (b) Describe transaction exposure and explain how it can be measured [4 marks]
- (c) A company whose home currency is the dollar (\$) expects to receive 500,000 pesos in six months' time from a customer in a foreign country

The following interest rates and exchange rates are available to the company:

Spot rate quote (Pesos/\$) 15.10 – 15.40

Six month forward rate (Pesos/\$) 1.50 – 1.35

	Home country	Foreign country
Borrowing interest rate	4% per year	8% per year
Lending interest rate	3% per year	6% per year

Advise on the appropriate hedging strategy [10 marks]

QUESTION THREE

- (a) Describe the following international financial markets
- (i) International money market [5 marks]
(ii) International equity market [4 marks]

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- (b) Briefly but clearly explain any three constraints that interferes with a multinational corporation goal of maximizing shareholders wealth [6 marks]
- (c) ABC PLC is a UK firm considering investing in a new projecting Canada which will have a life of four years. The initial investment is C\$150,000 including working capital. The net after tax cash flows generated are C\$60,000 per annum for years 1, 2 and 3 C\$45,000 in year 4. The net after tax terminal value of the project is estimated at C\$50,000.
- The current spot rate for C\$/£1.7 and according to the economic forecast, sterling is expected to strengthen against the Canadian Dollar by 2% per annum over the four years. The company evaluates UK projects of similar nature at 14 per cent.

Required:

Advise if the project should be accepted [10 marks]

QUESTION FOUR

- (a) With relevant illustrations, explain four internal hedging techniques [8 marks]
- (b) Bright PLC is a large multinational company based in the UK with a number of subsidiary companies around the world. Currently, foreign exchange exposure as a result of transactions between Bright PLC and its subsidiary companies is managed by each company individually. Bright PLC is considering whether or not to manage the foreign exchange exposure using multilateral netting from the UK, with the Sterling Pound (£) as the base currency. The following cash flows are due in three months between Bright PLC and one of its subsidiary SGL ltd, based in the United States (currency US\$)

Owed by	Owed to	Amount
Bright PLC	SGL Ltd	US\$4.5 million
SGL Ltd	Bright PLC	US\$2.1 million

Exchange rates available to Bright PLC:

	US\$/£1
Spot	1.5938 – 1.5962
3 month forward	1.5996 – 1.6037

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Currency options available to Bright PLC:

Contract size £62,500, Exercise price quotation: US\$/£1, Premium: cents per £1

Exercise price	Call options		Put options	
	3-month	6-month	3-month	6-month
1.60	1.55	2.25	2.08	2.23
1.62	0.98	1.58	3.42	3.73

Required:

Advice Bright PLC on, and recommend, an appropriate hedging strategy for the cash flows it is due to receive or pay in three months from the subsidiary [17 marks]
