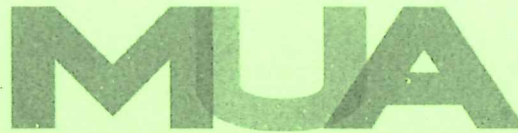


The
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POST GRADUATE UNIVERSITY EXAMINATIONS

SCHOOL OF MANAGEMENT AND LEADERSHIP

DEGREE OF MASTER OF BUSINESS ADMINISTRATION

BFO 507: INTERNATIONAL FINANCIAL MANAGEMENT

DATE: 24TH JULY 2017

DURATION: 3 HOURS

MAXIMUM MARKS: 60

INSTRUCTIONS:

1. Write your registration number on the answer booklet.
2. **DO NOT** write on this question paper.
3. This paper contains **FOUR (4)** questions.
4. Question **ONE** is compulsory.
5. Answer any other **TWO** questions.
6. Question **ONE** carries **30 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:

BLADES, INC.

For the last year, Blades, Inc., has been exporting to Thailand in order to supplement its declining U.S. sales. Under the existing arrangement, Blades sells 180,000 pairs of roller blades annually to Entertainment Products, a Thai retailer, for a fixed price denominated in Thai baht. The agreement will last for another 2 years. Furthermore, to diversify internationally and to take advantage of an attractive offer by Jogs, Ltd., a British retailer, Blades has recently begun exporting to the United Kingdom. Under the resulting agreement, Jogs will purchase 200,000 pairs of Speedos, Blades' primary product, annually at a fixed price of £80 per pair. Blades' suppliers of the needed components for its roller blade production are located primarily in the United States, where Blades incurs the majority of its cost of goods sold. Although prices for inputs needed to manufacture roller blades vary, recent costs have run approximately \$70 per pair.

Blades also imports components from Thailand because of the relatively low price of rubber and plastic components and because of their high quality. These imports are denominated in Thai baht, and the exact price (in baht) depends on prevailing market prices for these components in Thailand. Currently, inputs sufficient to manufacture a pair of roller blades cost approximately 3,000 Thai baht per pair of roller blades. Blades can sell its products at a lower price but generate higher profit margins in Thailand than it can in the United States. This is because the Thai customer has committed itself to purchase a fixed number of Blades' products annually only if it can purchase Speedos at a substantial discount from the U.S. price. Nevertheless, since the cost of goods sold incurred in Thailand is substantially below that incurred in the United States, Blades has managed to generate higher profit margins from its Thai exports and imports than in the United States. Holt has obtained spot rate quotations from two banks in Thailand, Minzu Bank and Sobat Bank, both located in Bangkok. The bid and ask prices of Thai baht for each bank are

displayed in the table below: Minzu Bank Sobat Bank Bid \$0.0224 \$0.0228 Ask \$0.0227 \$0.0229

Required:

- a) Using appropriate example Brief discuss the following terms used in international financial management: An exchange rate ,Cross-Rates ,Changes in Rates,Effective or Trade-Weighted Exchange Rates and The Law of One Price (15Marks)
- b) Discuss the three Exchange rate systems (regimes) used in international financial management (9Marks)
- c) Grecian Tile Manufacturing of Athens, Georgia, borrows \$1,500,000 at LIBOR plus a lending margin of 1.25 percent per annum on a six-month rollover basis from a London bank. If six-month LIBOR is 4 ½ percent over the first six-month interval and 5 3/8 percent over the second six-month interval, how much will Grecian Tile pay in interest over the first year of its Eurodollar loan? (6marks)

QUESTION TWO

Suppose that you hold a piece of land in the City of London that you may want to sell in one year. As a U.S. resident, you are concerned with the dollar value of the land. Assume that, if the British economy booms in the future, the land will be worth £2,000 and one British pound will be worth \$1.40. If the British economy slows down, on the other hand, the land will be worth less, i.e., £1,500, but the pound will be stronger, i.e., \$1.50/£. You feel that the British economy will experience a boom with a 60% probability and a slow-down with a 40% probability.

- a) Estimate your exposure to the exchange risk. (6marks)
- b) Compute the variance of the dollar value of your property that is attributable to the exchange rate uncertainty. (6marks)

- c) Discuss how you can hedge your exchange risk exposure and also examine the consequences of hedging (3Marks)

QUESTION THREE

- a) Ricardo's theory of comparative advantage illustrates some of the advantages of international trade. Briefly describe the model. (7Marks)
- b) Discuss the Best Practices for Exchange Rate Risk Management current examples to illustrate the analysis (8Marks)

QUESTION FOUR

A U.S. firm holds an asset in France and faces the following scenario:

| | State 1 | State 2 | State 3 | State 4 |
|-------------|---------|----------|----------|-----------|
| Probability | 25% | 25% | 25% | 25% |
| Spot rate | \$1.20/ | €\$1.10/ | €\$1.00/ | €\$0.90/€ |
| P* | 1500 € | 1400€ | 1300€ | 1200€ |
| P | \$1,800 | \$1,540 | \$1,300 | \$1,080 |

In the above table, P* is the euro price of the asset held by the U.S. firm and P is the dollar price of the asset.

- a. Compute the exchange exposure faced by the U.S. firm. (6marks)

- b. What is the variance of the dollar price of this asset if the U.S. firm remains unhedged against this exposure? **(6marks)**
- c. If the U.S. firm hedges against this exposure using the forward contract, what is the variance of the dollar value of the hedged position? **(3marks)**

