

UNIVERSITY OF COLOMBO, SRI LANKA
FACULTY OF MANAGEMENT AND FINANCE

Bachelor of Business Administration (Level I- Semester IV) Examination
January 2017

FIN 1200- Financial Institutions and Markets

Two (02) Hours

Instructions to candidates:

1. Answer all the questions
2. The use of calculators is permitted.

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1. "Well-functioning financial system contributes to the economic prosperity of a country." Elaborate the above statement while drawing attention to major components, functions of a financial system and factors that will contribute to the quality of financial system.

(Total: 12 Marks)

2. Sri Lankan public company is planning to raise new capital, giving its existing shareholders the opportunity to subscribe for new shares. The existing shareholders could purchase two new shares at a price of Rs. 50 per share for every 15 shares held. You are supposed to provide clarifications for following questions raised by the management of the company.

- i. Management wants to avoid any dilution in EPS as result proposed right issue. They have provided you the following information relating to the company.

- Capital employed 900 million.
- Outstanding number of shares 15 million.
- Current rate of return is 16 percent.
- Expected rate of return from new funds raised is 18 percent.

- a) What is your opinion about the present situation and its impact on company EPS?
(04 Marks)

- b) Please suggest any corrective actions to be followed to avoid adverse impact on EPS if any?

(03 Marks)

- ii. A shareholder who hold 15 000 shares of this company thinks that he would suffer a loss in wealth as the company is issuing it shares at a price less than the market price. If the current market price of a share is Rs 70 what would be the impact on his wealth if he;

- a) Exercise the right
b) Sell half of the right and buy half of the right

(Assume that actual market price per share after the right issue would be equal to theoretical ex-right price)

(05 Marks)

(Total: 12 Marks)

3.

- i. Companies can issue shares as private placement or public placement. Briefly explain in what ways do private placements differ from public placement?
(06 Marks)
- ii. List four methods of getting listed in the Colombo Stock Exchange (CSE). Explain two of them.
(06 Marks)
- iii. "Primary markets and secondary markets are not substitute to each other's but they are complementary" Briefly discuss this statement.
(05 Marks)
- iv. "Financial markets are said to be efficient when stock prices reflects all relevant information at any point in time." What are the three forms of efficiency? Compare and contrast each of them

(09 Marks)

(Total: 26 Marks)

4.

- i. List four main roles played by the financial intermediaries
(03 Marks)
- ii. List four types of risks faced by the banks
(03 Marks)
- iii. Briefly explain the Banking Regulatory Environment and key Regulatory areas that should be focused by the relevant authorities while drawing few examples from the real world scenario.

(14 Marks)

(Total: 20 Marks)

5.

i. What are the basic functions of the foreign exchange market? Explain briefly
(05 Marks)

ii. "Arbitrageurs and speculators are guided by different motives when they deal with foreign exchange market" Elaborate the statement with examples.
(05 Marks)

iii. Compare and contrast Fisher Effect and the International Fisher Effect.
(03 Marks)

iv. Suppose that the current spot exchange rate is €0.80/\$ and the three-month forward exchange rate is €0.7813/\$. The three-month interest rate is 5.6 percent per annum in the United States and 5.40 percent per annum in France. Assume that you can borrow up to \$1,000,000 or €800,000.

- a) Determine whether the interest rate parity is currently holding.
 - b) Show how to realize a certain profit via covered interest arbitrage, assuming that you want to realize profit in terms of U.S. dollars.
 - c) Explain how the interest rate parity will be restored as a result of covered arbitrage activities.
- (07 Marks)

v. "The role of derivatives contracts help to hedge the risk in financial transactions." Explain the statement.
(04 Marks)

vi. Suppose the direct quote for the pound sterling in New York (NY) is 2.2220-30.
a) What is the direct quote for dollars in London?
b) Compute the percentage bid-ask spread in NY.
(04 Marks)

vii. NTT Importers has £100,000 in a London bank. Presently the exchange rate is \$1.40 to the British pound. If the British pound were to be devalued by 10%, what would be the currency loss in dollars?

(02 Marks)
(Total: 30 Marks)

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