

UNIVERSITY OF COLOMBO, SRI LANKA
FACULTY OF MANAGEMENT AND FINANCE

Bachelor of Business Administration (Level II-Semester VII) Examination - June / July 2022

FIN 4242 – International Financial Management

Instructions.

- Time allowed Two (02) Hours.
 - Answer all four (04) questions.
 - Number of pages is four (04).
 - This is an online and open book examination.
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01.

i. Forming joint ventures with foreign firms is an effective way of bringing technology in to developing nations. Explain this statement with examples.

(05 marks)

ii. The “Arab Spring” was a series of anti-government protests and uprisings that spread across much of the Arab world in the early 2010s. Multinational companies which had businesses in the Middle East felt the heat of the Arab Spring more than domestic businesses? Do you agree or disagree? Explain your answer.

(05 marks)

iii. Conventional macroeconomic factors are Gross Domestic Product (GDP), industrial production, inflation, interest rates, employment rate etc... Do you think the price of crude oil also should be added to the list of macroeconomic indicators? Justify your answer with an emphasis to multinational companies.

(05 marks)

iv. Country risk can be incorporated into the capital budgeting analysis of a foreign project either by adjusting discount rate or adjusting cash flows. However, it involves subjectivity and depends on the assumptions of the analyst who performs the analysis. Explain the pros and cons of this approach.

(05 marks)

v. Euro was introduced as a common currency for the European Union (EU) in 1999. Now the Euro is a leading currency in the world. Similarly, is it a good step to introduce a common currency among member countries of SAARC (South Asian Association for Regional Cooperation)? Discuss.

(05 marks)

(Total 25 Marks)

02.

i. Explain the role of market participants listed below.

- a. Arbitrageurs
- b. Traders
- c. Hedgers
- d. Speculators

(04 marks)

ii. In January 2022, South Africa changed the value of South African Rand (SAR) from SAR 0.050 per USD to SAR 0.065 per USD.

a. What was the value of USD before and after changing the SAR/USD exchange rate?

(03 marks)

b. What is the percentage of SAR devaluation relative to the USD?

(03 marks)

c. What is the percentage of USD appreciation relative to SAR?

(03 marks)

iii. In early 2021, Malaysia reduced the official value of Malaysian Ringgit (MYR) from USD 0.25 per MYR to USD 0.18 per MYR. The black-market value of MYR is USD 0.14 per MYR.

a. What is the percentage of devaluation of MYR?

(03 marks)

b. After the official devaluation, what is the percentage of devaluation which would be necessary for the MYR to equal its black-market value?

(03 marks)

iv. New Zealand plans to launch its new exchange rate scheme and GBP is trading at USD 2.00 per GBP at that time. Exporters and importers would be able to convert their foreign currencies at an average rate as given below.

$$1 \text{ NZD} = 0.50 \text{ USD} + 0.50 \text{ GBP}$$

a. How many USDs would an importer pay for one NZD under the new system?

(03 marks)

b. How many NZDs would an exporter receive for one USD under the new system?

(03 marks)

(Total 25 Marks)

03.

i. Explain two occasions where purchasing power parity (PPP) may not occur effectively.

(04 marks)

ii. Benwaters PLC is a UK firm which produces educational equipments for school children and university students. Benwaters PLC plans to establish a subsidiary in Sri Lanka. The project requires initial investment of GBP 200,000. Current spot rate is LKR 500 per GBP. Earnings before taxation is forecasted as LKR 50 million and it will increase by 35% each year. Inflation rates of UK and Sri Lanka are given in the table below.

Year	2023	2024	2025	2026	2027
Sri Lankan Inflation Rate	17%	19%	22%	26%	29%
UK inflation Rate	5%	7%	9%	11%	13%

Corporate income tax rate in Sri Lanka is 28% and it will be unchanged during the five-year period. Further Sri Lankan government imposes a 12% withholding tax on remitted funds to the parent company in the UK. Funds remitted to the UK are not taxed by the UK government. The Sri Lankan subsidiary of Benwaters PLC plans to send net cash flows after all taxes to the parent company in the UK each year. It is assumed that the Sri Lankan subsidiary can be sold to a local investor at the end of 2027 for LKR 75 million. Sri Lankan factory worth GBP 200,000 will be fully depreciated over five years. Required rate of return for similar projects is 15% and weighted average cost of capital for Benwaters PLC is 12.50%.

Calculate requirements below for all five years.

a. Profit after tax in LKR

(05 marks)

b. Remittances to UK after all taxes in LKR

(05 marks)

c. LKR/GBP exchange rate

(05 marks)

d. Present values in GBP

(05 marks)

e. Net Present Value in GBP

(01 marks)

(Total 25 Marks)

04.

i. Explain the difference between the interest rate parity (IRP) and purchasing power parity (PPP).
(02 marks)

ii. Ashford PLC needs to borrow USD 500,000 for one year. Quoted interest rates are 9% in the USA, 4% in Hong Kong and 3% in Singapore. Possible percentage changes for Hong Kong Dollar (HKD) and Singapore Dollar (SGD) are in the table below.

Currency	Possible % change in spot rate for 1 year	Probability
HKD	2%	25%
HKD	4%	50%
HKD	6%	25%
SGD	1%	30%
SGD	3%	40%
SGD	5%	30%

a. Calculate the effective finance rates for HKD and SGD.
(08 marks)

b. Assume Ashford PLC borrows 30% in HKD and 70% in SGD. Calculate the effective finance rate for foreign currency portfolio.
(10 marks)

iii. Kelum Perera started a new business to produce sports shoes. He plans to start two factories in Bangladesh and Vietnam. The Bangladesh factory constitutes 45% of the total capital of Kelum Perera's business while the rest of the capital is allocated for the Vietnam factory. Other details of the two factories are given below.

	Bangladesh	Vietnam
Standard deviation of returns	14%	21%
Correlation of returns between Bangladesh and Vietnam	0.03	

a. Calculate the overall return of Kelum Perera's business.
(01 marks)

b. Calculate the standard deviation of the entire business of Kelum Perera.
(04 marks)

(Total 25 Marks)
