Summer Examinations 2016

ACC301616N

Module Title: International Trade Finance
Level: Six
Time allowed: Two hours plus 15 minutes reading time. Students must not commence answering the questions until the reading time has ended.

Instructions to students:

- Please enter your student number not your name on all answer books.
- During the 15 minutes reading time, students are permitted to make notes on the examination paper but not on the answer book. Students should begin answering the questions after the reading time has ended.
- Answer four out of seven questions.
- All questions are equally weighted. Where a question has more than one part the division of marks is stated.
- Begin each question in a separate answer book; label each answer book clearly with the number of the question you are answering.
- Use of a non-programmable calculator is permitted.

<table>
<thead>
<tr>
<th>No. of Pages</th>
<th>6</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. of Questions</td>
<td>7</td>
</tr>
</tbody>
</table>
Answer four out of seven questions.

**Question 1**

a. Explain the theory of Absolute Purchasing Power Parity and demonstrate how the mechanism works in international markets.  
(13 marks)

b. Evaluate the limitations of Purchasing Power Parity theory.  
(12 marks)

(Total: 25 marks)

**Question 2**

Rodex plc are roofing tile manufacturers located in Liverpool. They have recently entered into the export/import market after solely dealing with UK clients.

They have come to you with some questions that need clarification. They have documentation with regards to export contracts they largely understand but need clarification on the following terms:

a. Terms for shipment:

   i. FAS Hamburg.
   ii. DDP Rotterdam.
   iii. FOB Porto.

You are required to explain these terms and advise what the responsibilities expected of Rodex plc would be under each of these different terms.  
(12 marks)

b. A detailed conversation developed leading you to have a number of questions that need answering. These are:

   i. Who is responsible for insurance and freight charges under the terms CFR?
   ii. At what point does the exporter cease to be responsible for transportation costs under the term FCA (named place)?
   iii. An explanation of INCOTERMS (International Commercial Terms) and how they benefit both exporters and importers.  
(13 marks)

(Total: 25 marks)
Question 3

The development of international trade has been a key feature of economic growth in recent decades.

Required:

a. With reference to comparative advantage, explain why international trade leads to greater economic growth than if there was no international trade.  
   (6 marks)

b. Explain the arguments for trade restrictions and how different types of trade barriers affect international trade.  
   (12 marks)

c. Discuss the role of the General Agreement on Tariffs and Trade (GATT) and the World Trade Organisation (WTO) in the development of international trade and evaluate how it helps support the development of international trade.  
   (7 marks)

(Total: 25 marks)
Question 4

Verina plc, whose home currency is the British pound (GBP), trades with buyers and suppliers across the USA. It is now 1st May 2016 and the senior manager has asked you to review the company’s payables and receivables to decide whether to use forward contracts or money market hedging for the following transactions:

<table>
<thead>
<tr>
<th>Transaction</th>
<th>Currency</th>
<th>Payment Date</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase of goods</td>
<td>USD</td>
<td>cash payment</td>
<td>$135,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>due in 3 months</td>
<td></td>
</tr>
<tr>
<td>Purchase of goods</td>
<td>USD</td>
<td>cash payment</td>
<td>$880,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>due in 6 months</td>
<td></td>
</tr>
<tr>
<td>Purchase of goods</td>
<td>USD</td>
<td>cash payment</td>
<td>$185,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>due in 6 months</td>
<td></td>
</tr>
<tr>
<td>Sale of goods</td>
<td>USD</td>
<td>cash payment</td>
<td>$435,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>due in 3 months</td>
<td></td>
</tr>
<tr>
<td>Sale of goods</td>
<td>USD</td>
<td>cash payment</td>
<td>$375,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>due in 6 months</td>
<td></td>
</tr>
</tbody>
</table>

Exchange rates quotation as at 1st May 2016:

<table>
<thead>
<tr>
<th>Currency</th>
<th>Spot</th>
<th>3 months</th>
<th>6 months</th>
</tr>
</thead>
<tbody>
<tr>
<td>USD</td>
<td>1.5133</td>
<td>0.0025 discount</td>
<td>0.0061 discount</td>
</tr>
<tr>
<td></td>
<td>1.5149</td>
<td>0.0033 discount</td>
<td>0.0069 discount</td>
</tr>
</tbody>
</table>

Interest rates (annualised %):

<table>
<thead>
<tr>
<th>Currency</th>
<th>Loan</th>
<th>Deposit</th>
</tr>
</thead>
<tbody>
<tr>
<td>GBP</td>
<td>3.90%</td>
<td>2.40%</td>
</tr>
<tr>
<td>USD</td>
<td>4.15%</td>
<td>2.80%</td>
</tr>
</tbody>
</table>

Required:

Calculate the net sterling receipts/payments that Verina plc might expect for its 3-month and 6-month transactions if the company hedges its foreign exchange rate risk using:

i. The money market
ii. The forward exchange market

(25 marks)
**Question 5**

Short term finance is generally defined as financing provided by a financial institution to an exporter for up to two years.

**Required:**

a. Outline three different methods of short term finance available to an exporter and evaluate their relative advantages.

(15 marks)

b. What is the purpose of using credit insurance to an exporter? Critically discuss its advantages.

(10 marks)

(Total: 25 marks)

**Question 6**

a. Explain how companies can use foreign currency options to hedge their foreign exchange exposure.

(10 marks)

b. Explain the attractions and limitations of the use of forward contracts and currency futures. Discuss what factors would influence a Finance Director’s decision to use a currency future rather than a forward purchase contract?

(15 marks)

(Total: 25 marks)
Question 7

a. Economic exposure related to exchange rate risk affects the long-term competitiveness of Multinational Companies (MNCs). Discuss the fundamental factors that influence the pricing strategy of MNCs when facing economic risk exposure.

(6 marks)

b. Distinguish economic exposure from transaction exposure. Evaluate the commercial and accounting implications if a company decides not to hedge against these types of risk exposure.

(14 marks)

c. Explain the ways a company can use internal hedging techniques to reduce transaction exposure. Discuss the advantages and disadvantages of using these techniques to hedge exchange rate risk.

(5 marks)

(Total: 25 marks)