Examination Period 3: 2016/7

**ACC301617N**

<table>
<thead>
<tr>
<th>Module Title</th>
<th>International Trade Finance</th>
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</thead>
<tbody>
<tr>
<td>Level</td>
<td>Six</td>
</tr>
<tr>
<td>Time allowed</td>
<td>Two hours plus 15 minutes reading time. Students must not commence answering the questions until the reading time has ended.</td>
</tr>
</tbody>
</table>

**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 **three** 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>
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</thead>
<tbody>
<tr>
<td>No. of Questions</td>
<td>7</td>
</tr>
</tbody>
</table>

Page 1 of 6
Answer **three** out of **seven** questions.

**Question 1**

Mambo Limited is a manufacturing company that is based in the UK (GBP is the home currency). It trades internationally with both buyers and suppliers in USA, Japan and China. Assume that it’s the 1st of May 2017 today, and that the finance director of Mambo Limited has asked you to review that company’s payables and receivables arising from its transactions with suppliers and customers based in the USA. The finance director wants you to identify and recommend which transactions to hedge or not to hedge, and whether to use forward contracts or money market hedges. Mambo Limited has the following outstanding transactions:

- **Purchase of goods**
  - Cash payment due in 3 months: $200,000
  - Cash payment due in 3 months: $100,000
  - Cash payment due in 3 months: $150,000
  - Cash payment due in 6 months: $600,000
  - Cash payment due in 6 months: $500,000
  - Cash payment due in 6 months: $300,000

- **Sale of goods**
  - Cash receipt due in 3 months: $300,000
  - Cash receipt due in 3 months: $400,000
  - Cash receipt due in 3 months: $200,000
  - Cash receipt due in 6 months: $300,000
  - Cash receipt due in 6 months: $100,000
  - Cash receipt due in 6 months: $150,000
  - Cash receipt due in 6 months: $110,000

Exchange rates quotation as at 1st May 2017:

<table>
<thead>
<tr>
<th>Spot (USD$/£)</th>
<th>Bid</th>
<th>Ask</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.5384</td>
<td>1.5426</td>
<td></td>
</tr>
<tr>
<td>0.0020 discount</td>
<td>0.0035 discount</td>
<td></td>
</tr>
<tr>
<td>0.0010 premium</td>
<td>0.0015 premium</td>
<td></td>
</tr>
</tbody>
</table>

Interest rates (annualised %):

- **GBP (£)**: 3.6% 4.0%
- **USD ($)**: 5.0 6.5%

__Question 1 continues overleaf__
Required:

Calculate the net sterling (£) receipts/payments that Mambo Limited might expect for its 3-month and 6-month transactions if the company hedges its foreign exchange rate risk using:

a. The money market.  
   (10 marks)

b. The forward exchange market.  
   (10 marks)

c. Recommend the best hedging technique for the 3-month and 6-month transactions.  
   (5 marks)

Total: 25 marks

Question 2

Trade liberalisation is one key driver of economic growth, but the challenges associated with free international trade cannot be ignored.

Required:

a. Explain how international trade leads to greater economic growth than if there was no international trade.  
   (10 marks)

b. Discuss the reasons for imposing trade restrictions, and how different types of trade barriers affect international trade.  
   (15 marks)

Total: 25 marks

Question 3

a. Discuss the responsibilities of the seller and buyer under the following Incoterms 2010:
   i. FOB (Free on Board)
   ii. EXW (Ex works)
   iii. FAS (Free alongside ship)
   iv. DDP (Delivery duty paid)
   v. CIF (Cost Insurance & Freight)  
   (15 marks)

Question 3 continues overleaf
b. What are INCOTERMS (International Commercial Terms)? Explain how INCOTERMS benefit both exporters and importers.

(10 marks)

Total: 25 marks

Question 4

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

Required:

a. Discuss the following forms of short term finance available to an exporter. Outline and evaluate their relative advantages and disadvantages.
   i. Trade credit
   ii. Factoring
   iii. Forfaiting

(15 marks)

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

(10 marks)

Total: 25 marks

Question 5

SevenTen plc is a UK manufacturing company selling steel and aluminium products mainly in the USA, China and Europe. It is now 1 June 2017 and the treasury department of SevenTen plc faces the following situation.

Towards the end of December 2017, the treasury department of SevenTen plc may need to advance to $15,000,000 to one of the US subsidiaries. The advancement of the amount depends on whether the subsidiary is successful at winning a new franchise. The department’s view is that the US dollar will strengthen over the next few months, and it believes that a currency hedge would be sensible.

The following data is relevant:

<table>
<thead>
<tr>
<th></th>
<th>US Dollar</th>
<th>Euro</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spot</td>
<td>1.8920</td>
<td>1.4845</td>
</tr>
<tr>
<td></td>
<td>1.8965</td>
<td>1.4902</td>
</tr>
</tbody>
</table>

Question 5 continues overleaf
Currency options
Sterling £31,250 contracts (cents per £)

<table>
<thead>
<tr>
<th></th>
<th>Calls</th>
<th>Puts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exercise price</td>
<td>June</td>
<td>June</td>
</tr>
<tr>
<td>$1.9000/£</td>
<td>0.40</td>
<td>2.38</td>
</tr>
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</table>

Required:

a. Assuming the franchise is won, illustrate the results of using option currency hedges if the US$/£ spot exchange rate and options price at the mid of June is:
   i. $1.80 (scenario A)
   ii. $2.00 (scenario B)  

   (15 marks)

b. Using examples explain the difference between plain vanilla options and exotic options.  

   (3 marks)

c. Distinguish between the time value and the intrinsic value of an option.  

   (7 marks)

   Total: 25 marks

Question 6

a. Why do central banks manage exchange rates?  

   (9 marks)

b. Discuss the two methods used by central banks when intervening in the foreign exchange markets.  

   (6 marks)

c. What are the effects of central bank interventions in the foreign exchange markets?  

   (10 marks)

   Total: 25 marks
Question 7

a. Explain the law of one price and the theory of purchasing power parity.  
   (4 marks)

b. Why doesn’t the purchasing power parity explain all exchange rate movements? What factors determine long-run exchange rates?  
   (6 marks)

c. Critically discuss the advantages and disadvantages of the following exchange rate systems:
   
i. exchange rate band
ii. adjustable peg
iii. crawling peg
   
   (15 marks)

Total: 25 marks