UNIVERSITY OF SWAZILAND

DEPARTMENT OF ACCOUNTING AND FINANCE

MAIN EXAMINATION QUESTION PAPER

APRIL 2014

DEGREE	:	**BACHELOR OF COMMERCE**
TITLE OF PAPER	:	**BUSINESS FINANCE II**
COURSE CODE	:	**IDE AC 503**
TIME ALLOWED	:	**THREE (3) HOURS**
TOTAL MARKS	:	**100**
INSTRUCTIONS	1.	**TOTAL NUMBER OF QUESTIONS ON THIS PAPER: FIVE (5)**
	2.	**ANSWER ALL QUESTIONS**
	3.	**WHERE APPLICABLE ALL WORKINGS SHOULD BE SHOWN**
	4.	**ALL CALCULATIONS ARE TO BE MADE TO TWO DECIMAL PLACES**

NOTE: **YOU ARE REMINDED THAT IN ASSESSING YOUR WORK, ACCOUNT WILL BE TAKEN OF ACCURACY, LANGUAGE, THE GENERAL QUALITY OF EXPRESSION, TOGETHER WITH THE LAYOUT AND PRESENTATION OF YOUR FINAL ANSWER.**

SPECIAL REQUIREMENT: **FINANCIAL CALCULATOR**

THIS PAPER IS NOT TO BE OPENED UNTIL PERMISSION HAS BEEN GRANTED BY THE INVIGILATOR.

QUESTION 1

(a) Describe business risk and political risk in the context of managing multinational operations. **(4 marks)**

(b) Gcinwayinkhosi Corporation is a Swazi firm processing dried fruits. Its export business has risen to the point that it is considering establishing a small processing operation in Zambia.

Suppose Gcinwayinkhosi's Zambian facility is expected to generate the following cash flows in Zambian kwachas (K):

Year:	0	1	2	3	4	5
Cash flows (millions of kwachas)	-15.2	4.0	5.0	6.0	7.0	8.0

The interest rate in Swaziland is 6 percent. Gcinwayinkhosi's financial manager estimates that the company requires an additional expected return of 12 percent to compensate for the risk of the project.

The financial manager looks in the newspaper and finds that the current exchange rate is 0.75 kwacha to the lilangeni ($S_{K/L}$ = 0.75), while the interest rate is 6 percent in Swaziland (r_L = 0.06) and 4 percent in Zambia (r_K = 0.04).

(i) Calculate the NPV of Gcinwayinkhosi Corporation's project. **(7 marks)**

(ii) Should they pursue the project? **(1 mark)**

(iii) Would you be able to buy more or less kwachas in the forward market than in the spot market? **(1 mark)**

(c) Anti-corporate advocates criticize multinational corporations for entering countries that have low human rights or environmental standards. Explain **four** of these criticisms/claims. **(4 marks)**

(d) COMESA as a regional economic grouping achieved an FTA on 31 October 2000. In accordance with the tariff reduction schedule which was adopted for the gradual removal of tariffs on intra-COMESA trade in an effort to move towards customs union, this has faced challenges. Explain **three** harmonisation problems in COMESA. **(3 marks)**

(Question 1 – Total marks : 20)

QUESTION 2

(a) Use the information below to execute covered interest arbitrage (CIA). Assume that you are the arbitrageur, you could borrow SZL1 million in Swaziland or $100,000 in the United States of America.

Spot = SZL10.00/\$
F_{60} = SZL10.30/\$
R_{SD} = 16%
R_{US} = 10%

(i) State which currency will be borrowed and the reason. **(2 marks)**

(ii) Compute the profits from arbitrage explaining the different stages. **(6 marks)**

(iii) Compute the rate of return on the investment. **(2 marks)**

(b) (i) If the current price of a Big Mac hamburger in the United States is \$3.80, and the current price of the same burger in Germany is €2.75, what is the implied exchange rate of dollars per euro? **(2 marks)**

(ii) If the price of a Big Mac burger in the United States is \$4.25 and the current €/\$ exchange rate is €0.7506/\$, what is the implied price of a Big Mac in France? **(2 marks)**

(c) Suppose the exchange rates for the British pound and Swiss franc are:

£/\$ = £0.60/\$
SF/\$ = SF2.00/\$
The cross-rate is SF3/£. Is this consistent? Assuming you have \$100,000, explain how to go about making some money. **(6 marks)**

(Question 2 – Total marks : 20)

QUESTION 3

(a) A Swaziland subsidiary in the UK will receive £100,000 cashflow per annum for five years.

A UK subsidiary in Swaziland will receive E1,500,000 cashflow per annum for five years. The parent companies agree to exchange these cashflows at an exchange rate of 15/£.
Explain gains and losses to be made by the parties in this currency swap if after one year the exchange rate turns out to be E12.75/£. **(4 marks)**

(b) (i) Explain how hedging transaction exposure is achieved by using a forward contract vis-a-viz a money market hedge. **(3 marks)**