

# Recommendation to corvette case study examples

[Business](#), [Company](#)



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## **Abstract**

International financial decisions are never easy to make. This is majorly because of the various that bring a lot of uncertain elements in the decision making process. In most case, the issue of contention in international finance is majorly uncertainties in future exchange differences. This is explained in the case study that follows. In this example, the company is torn between accepting a sure amount of money from a bank, and awaiting the outcome of a risky and unsure income.

This paper seeks to unravel the element of uncertainty in this decision. This will be done by an analysis of the risks involved in the contract, by the use of standard deviation and probability analysis.

## **Introduction**

This case study underlines the contract of Corvette to sell its automobiles to its major clients in the UK, Japan, France and South Africa. Corvette has been in the business of manufacture and sale of sports cars for many years now

and this has meant business all around the globe. The company has entered into binding contracts with these clients to deliver the cars at future predetermined prices. The challenge that corvette is facing is the determination of the amounts receivable, given the fluctuation of the various currencies involved in these overseas clients. One of the major challenges is of course the fact that since the prices are based on the local currencies, Corvette has to fully understand the implication of forex movements and the risks that this poses to the returns expected after the sale. The company is also torn between waiting for the terminal returns and accepting an offer from HSBC in lieu of the sales revenues.

In order to fully understand the financial implication of the forex sensitivity, the company has obtained assistance from the Bank of America with the various risks involved with the various currencies. The bank has provided the various currencies and their standard and mean deviations and this is helpful in ensuring that the company makes an informed choice in their decision to invest. An analysis of this would therefore be important in helping the company to fully understand this issue and at the same time make a decision on what is the best option to take, given various competing alternatives.

Corvette has to content with uncertainty of its future revenue, as a result of the various orders made by these clients in which the UK has ordered 12 cars, Japan 8, France 5 and then south Africa 2 cars. The process are also different but depended on the exchange rate fixed during the contracts, the challenge is however to ensure that the company does not incur a loss, given the various standard deviations for the exchange rates.

In international finance, a multinational has to play its cards very right; otherwise, many losses could be occasioned, especially as a result of forex differences. The problem that majorly arises is that when making a contract, the parties are always unsure of the future exchange rates and therefore the amounts of money payable or receivable are rather uncertain. It's with this understanding that companies fix the exchange rates that they would like to transact with so as to weed out the anticipated foreign exchange movements.

In this case, HSBC has offered some sure amounts to the company and now the challenge that the company faces is whether to accept the offer, or to reject it, a decision that will be informed by a critical analysis of the currencies standard deviations. The company has however to decide on its preferred risk profile in its decision on whether to accept any offers on the same. This is in agreement with the fact that accepting the offers will of course bring the risk to a zero level, but at the same time the returns would be low as compared to the company deciding to wait for the outcome of the contracts (Hermes, 2010).

The core of this paper is therefore to assist the company in deciding what the best option is, given the prevailing circumstances.

The offer by HSBC amounting to \$ 2150, 000 is therefore not a very good offer and should be rejected. Looking at our calculations above, whichever way the deal goes, the company is still better off since the worst case scenario still has better returns than the HSBC's sure offer.

A quick calculation reveals that at the worst case scenario, the company would have returns amounting to 2131052. 05 which is arrived at by taking

the mean return less the standard deviation. This is just a few dollars shy of the HBSC offer which is the maximum that the bank would offer. On a more optimistic note however, the company stands a very great position to net in very high returns but of course with a higher level of risk. If Corvette therefore decides to take the risk, then the likely returns are expected to be high, given the statistics.

In my view, therefore, the company needs to reject this offer, since even though the risk is reduced, the offer by HSBC is not sufficient. It's therefore recommended that the company rejects the offer and await the funds from the customers as earlier agreed as there is a very high likelihood that the returns would be very favorable.

There is a probability of 0.0465 that the company's revenues, given the information from the Bank of America, would exceed \$2,250,000. Evidently also, the probability that the revenue would be lower than the offered \$2,150,000 is much less, at 0.2843. Our calculations also reveal that there is no way that the revenues will be below the \$2,000,000 mark. It's however not probable that the revenues will be more than \$2,500,000. This therefore informs us that the company is still better off without accepting the bank's offer as there is still a very high probability that the returns from the contracts far much exceed the amount offered by the HSBC banking corporation (Morris, et al 2001). It's therefore reiterated that the offer of \$2,150,000 by the bank should be rejected at the earliest instance as the company is in a great position to net even better returns.

In deciding in who is more risk averse between the sales manager and the CEO, we conclude that the sales manager is more risk averse, considering

that he pessimistically decides that the HBSC's deal is ok, when actually it's not, this means that he does not want to bear the risk of losing any moneys should the fluctuations negatively impact on the company's contract. This obviously blinds him from seeing the huge opportunity that awaits the company's decision to hold on and wait for the contracts to mature.

## **Recommendation to HSBC**

HSBC in its capacity as a banking institution is out to ensure maximum returns for its shareholders and therefore by getting into the agreement to give Corvette moneys to the tune of over \$2. 15million, the bank is putting itself into a considerable amount of risk.

It must be noted that the bank shall give the money to corvette, early in advance, even before the completion of the contract of sale; the bank is putting itself into a considerable amount of risk.

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It must be noted that the bank shall give the money to corvette, early in advance, when before the expiry of the contract period. This means that the company will give the money in anticipation of the successful completion of the sale. The bank needs to appreciate that there are a number of risks that abide in this nature of transaction.

First and foremost, there is the ever present risk that the exchange rates

rate movements would be unfavorable to the bank, therefore making it to incur a loss in the event that that really happens. Exchange rate fluctuations have been known to occasion huge losses to businesses. In fact, given the magnitude of the transaction, even the slightest movement, say 5% fluctuation would have devastating effects on the returns to the bank.

In the second instance, there is a possibility that the buyers could find reasons to rescind their contracts of purchase of the cars. While this may be a remote possibility, it cannot be wished away or even ignored. For instance, the buyers could become insolvent, or even decide to buy from other suppliers. This would mean that the contract would not be realized and the bank would not be able to recover its moneys. This therefore should inform the bank that they should not rush into the transaction with corvette as it may not be as good as it appears.

One last reason why the bank should reject this transaction is that there is a very high likelihood that the opportunity cost of investing this money in the corvette deal may be much higher, and therefore much more beneficial to the banks shareholders. Opportunity cost is that cost that one forgoes in the next best alternative. I would therefore recommend that the bank evaluates the many available investment avenues before settling on the corvettes deal, given the above reasons (David, 1997)

## **Overall recommendation**

We have analyzed the case study, with emphasis on the risks involved in the contract between Corvette and her international customers as well as the offer by the international bank, HSBC. We have noted, and appreciated the issues that have to be considered in determining whether the company

accepts the offer of \$2, 150, 000 or not. In making our decision as to whether the company needs to accept or reject this offer, we analyzed the standard deviation, which informed us of the risks involved and the likely returns from the contracts. We concluded that the company should not accept the deal since there is a very high probability that the company would reap higher returns as compared to accepting the offer from HSBC.

In the same vein, we have noted that a risk still abides in the deal, prompting us to recommend that HSBC should also be wary of their investment in the company. The reasons that we have found are that there is a probability that there may be forex fluctuations that would be out of favor with the bank, thus leading to huge losses to the bank (David, 1997)

At the same time, the buyers could rescind their contracts with corvette and therefore the revenues would not be forthcoming. It's therefore advisable that the company evaluates its investment decisions and find out whether the corvette deal is the best one available. If that is not the case, then the company would benefit by using its funds to lend its customers or even invest in other opportunities that would bear more returns for the shareholders.

## **Conclusion**

Probability theory and statistics are important tools that help the management of a company to make critical decisions as the one above. We have used the above tools to be able to analyze the aforementioned data and come up with an objective decision that the offer by HSBC should not be accepted on the basis of the recommendations.

On the basis of our computations, it's recommended that the offer is rejected



and the bank puts its money in more beneficial use while corvette awaits the completion of the sales deal as the returns are likely to be quite favorable

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