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University of Windsor Odette School of Business Master of Management 0478-612-01/02 Corporate Finance in a Global Perspective Assignment #1 Dr. Keith C. K. CheungDue: Feb. 26, 2013 Student Name: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ (Print) Student ID Number: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ INSTRUCTIONS 1.

Assignment is collected in class. No late assignment can be accepted. 2. Detailed solution will be found on the CLEW at 5: 00 pm on Feb. 26 3. Part A contains 50 multiple-choice questions.

You have to attempt all questions. Leave your answers in the space provided. . Each correct response is worth one point. Make an educated guess if needed. 5.

Part B contains 4 discussion questions. Again attempt all questions. 6. Each answer has a maximum score of five points. Quality, not quantity, matters. You must clearly support your arguments to earn credits.

7. With a perfect score of 70 points, this assignment is worth 100% of the overall grade. KEEP THE QUESTION PAPER FOR EXAM REVIEW Part A: Multiple-Choice Questions: are designed to test general understanding of a variety of core concepts, and their specific applications . In a given year, Vodafone, a British company from the communication industry has US$247, 850m foreign assets out of total assets of US$258, 626m. Among the total sales of US$62, 494m, the foreign sales (outside United Kingdom) count for US$53, 307m. There are 45, 981 overseas employees working in 70 countries while the company has a total of 198 affiliates with 57, 378 workers.

Find the trans-nationality index (TNI) for this multinational corporation. \_\_\_\_ A) 48. 7 B) 53. 2 C) 79. 0 D) 87. 1 (The following information relates to Questions 2 and 3)

Alternative outputs from one year of labor input are given as below.

| CD Players| Computers| Canada (one person working one year)| 40| 40| Sweden (one person working one year)| 20| 10| 2. Which of the following is true? \_\_\_\_ A) Sweden has an absolute advantage in the production of computer B) Canada should export CD players to Sweden and Sweden should export computers to Canada C) The opportunity cost of a computer in Sweden is two CD players D) The opportunity cost of a CD player in Canada is two computers 3.

If Sweden and Canada decide to specialize according to the law of comparative advantage and trade with each other, then \_\_\_\_ A) The trade agreement will be somewhere between half a computer for one CD player and two computers for one CD player B) Sweden will benefit from trading with Canada, but Canada will not benefit from trading with Sweden C) Sweden will specialize in the production of computers and Canada will specialize in the production of CD players D) None of the above 4. Major differences between international and domestic financial management include \_\_\_\_ A) Corporate governance

B) Foreign exchange risk C) Different business practices D) All of the above 5. When a nation’s products are first introduced into global markets, that particular country has a competitive advantage that is not easily overcome in the short-term.

This expresses the basis of the \_\_\_\_ of international trade. \_\_\_\_ A) Product life cycle theory B) Gravity theory C) Comparative advantage theory D) New trade theory 6. Which of the following is not – by definition – a multinational enterprise? \_\_\_\_ A) A firm that only exports products or import raw material B) A foreign joint venture

C) Acquisition of controlling interest in a foreign company D) None of the above 7. Assume that a bank’s bid rate on Swiss francs is $0. 45 and its ask rate is $0.

47. The bid-ask percentage spread is \_\_\_\_ A) 4. 44% B) 4. 26% C) 4. 17% D) 4. 03% Hint:(Ask price – Bid price)/Ask price 8.

A Japanese yen (Y) is worth $0. 008, and a Fijian dollar (F$) is worth $0. 59. What is the value of the yen in Fijian dollars (i. e. how many Fijian dollars do you need to buy one yen)? \_\_\_\_\_ A) 0.

014 B) 1. 69 C) 73. 75 D) 125 Hint: 9.

If a Japanese firm desires to avoid the risk from exchange rate fluctuations, and it will need C$2 million in 90 days to make payment on imports from Canada, the company \_\_\_\_ A) Should sell Canadian dollars 90 days from now at the spot rate B) Should obtain a 90-day forward sale contract on Canadian dollars C) Should purchase Canadian dollars 90 days from now at the spot rate D) Should obtain a 90-day forward purchase contract on Canadian dollars 10. If the ? /$ bid and ask prices are ? 0.

6623 and ? 0. 6667, respectively, then the corresponding $/? bid and ask prices are \_\_\_\_ A) $1. 50 and $1. 1 B) ? 0. 6667 and ? 0. 6623 C) $1.

51 and $1. 50 D) Undetermined 11.. An decrease in the domestic interest rate shifts the expected return schedule for \_\_\_\_ deposits to the \_\_\_\_ and causes the domestic currency to \_\_\_\_. \_\_\_\_ A) Domestic; right; appreciate B) Domestic; left; depreciate C) Foreign; right; depreciate D) Foreign; left; appreciate 12.

If the Bank of China issues a bond in Canada denominated in Canadian dollar, the bond will be considered to be \_\_\_\_ A) A global bond B) A foreign bond C) A Euro bond D) A Samurai bond 13. A 5-year floating-rate note (FRN) has coupons referenced to LIBOR.

It pays coupon interest semi-annually although interest on Eurobonds is usually paid annually. Assume that the current LIBOR is 6%. If the risk premium above LIBOR that the issuer must pay is 0. 125%, the next period’s coupon interest on a $1, 000 par value FRN will be \_\_\_\_ A) $30.

625 B) $61. 250 C) $30. 000 D) $29. 375 14. ABC Inc. can borrow $4 million at LIBOR plus a lending margin of 0.

65% per annum on a 3-month rollover basis from the Standard Charter Bank in Britain. The 3-month LIBOR is currently 5. 5%. Suppose that over the second 3-month interval LIBOR falls to 5%.

How much will ABC pay in interest to the Standard Charter Bank over the entire six-month period for this Eurodollar loan? \_\_\_\_ A) $50, 000 B) $100, 000 C) $118, 000 D) $120, 000 15. The principal feature of Eurocurrency markets is \_\_\_\_ A) Lack of regulation B) High interest rates that are available C) Lower risks than are present in other markets D) Lower rate on borrowed funds 16.

The S$/$ spot exchange rate is 1. 60, the C$/$ spot rate is 1. 33, and the S$/C$ cross rate is 1. 15. Determine the triangular profit that is possible if you have $1, 000, 000.

\_\_\_\_ A) $44, 063 profit B) $46, 093 loss

C) No profit is possible D) $46, 093 profit 17. When a foreign interest rate is higher than a domestic interest rate, the foreign currency’s forward rate will be less than its spot rate using indirect quotes. This means \_\_\_\_ A) The value of the foreign currency is expected to increase in the future B) The value of the foreign currency is expected to decline in the future C) The foreign interest rate is expected to increase in the future D) The foreign interest rate is expected to decline in the future 18. Uncovered interest rate parity \_\_\_\_ A) Is an arbitrage condition

B) Holds most of the time C) Is based on expectations D) Will provide guaranteed but small profits 19. A country’s capital controls can affect interest rate parity (IRP) by \_\_\_\_ A) Causing interest rates to be higher independent of the forward premium of the country’s currency B) Limiting foreign investment in the country so that interest rates are artificially reduced C) Limiting foreign investment in the country so that interest rates are artificially increased D) Causing the forward premium of the country’s currency to be increased without regard to the real value of the currency 0. Purchasing power parity (PPP) theory implies that \_\_\_\_ A) Exchange rates should equalize prices of standard commodity baskets in two countries B) As the purchasing power of a currency sharply declines (due to hyper-inflation), that currency will depreciate against stable currencies C) Both (A) and (B) D) Neither (A) nor (B) 21.

In the short term, \_\_\_\_

A) Purchasing power parity is not reached and currency values do not tend to converge because of other factors affecting B) Purchasing power parity is not reached but currency values do tend to converge anyway C) Purchasing power parity can be accomplished, but only with government intervention to control prices D) Purchasing power parity will be accomplished if markets are allowed to operate freely 22. Assume the following information: You have $1, 000, 000 to invest Current spot rate of pound= $1. 30 90-day forward rate of pound= $1. 8 3-month deposit rate in Canada= 3% 3-month deposit rate in Britain = 4% If you use covered interest arbitrage for a 90-day investment, what will be the amount of Canadian dollars you will have after 90 days? \_\_\_\_ A) $1, 040, 000 B) $1, 034, 000 C) $1, 030, 000 D) $1, 024, 000 23. Assume that the Canadian investors are benefiting from covered interest arbitrage due to high interest rates on euros.

Which of the following forces should result from the act of this covered interest arbitrage? \_\_\_\_ A) Downward pressure on the euro’s spot rate

B) Downward pressure on the euro’s forward rate C) Downward pressure on the Canadian interest rate D) Upward pressure on the euro’s interest rate 24. Technical forecasting relies completely on \_\_\_\_ A) Computer models that consider every factor that could affect the value of a currency B) New information that can change the value of a currency C) All information, old and new, that can change the value of a currency D) An analysis of currency values over time rather than on a consideration of economic factors and their effects on the currency value 5. Based on international Fisher effect, if U. S. investors expect a 5% rate of domestic inflation over one year, and a 2% rate of inflation in European countries that use the euro, and require a 3% real return on investments over one year, the nominal interest rate on 1-year U.

S. treasury securities would be \_\_\_\_ A) 2% B) 3% C) 5% D) 8% 26. Which of the following does not characterize net present value (NPV)? \_\_\_\_\_ A) NPV discounts all future cash flows B) NPV incorporates all relevant information C) NPV is the simplest of all investment rules

D) NPV uses all of the project’s cash flows 27. A corporation has the following opportunity to invest in a project with a cash flow of $46, 900 in one period. The current investment is $42, 000. The financial market rate is 14%.

What is the NPV and the decision to invest? \_\_\_\_ A) -$859. 65; do not invest B) $859. 65; invest C) $4, 900; invest D) -$10, 058; do not invest Hint: 28. What does it mean that international projects are often “ strategic” in nature? \_\_\_\_ A) Firms who do not have a strategy before undertaking a project in a oreign market cannot be successful B) Firms often undertake a small project in a foreign country to learn about the foreign country and market before making a larger commitment to that country and market C) Firms often consider projects in other countries from a strategic or broad view rather than concentrating on the tactical or detailed aspects of the project D) A foreign investment has to be part of a firm’s larger business strategy 29. A project has the following information: operating cash flow (OCF) = $5, 700, sales (S) = $40, 000, cash expenses (E) = $34, 000, tax rate (T) = 30%.

Find depreciation (D). \_\_\_\_ A) $5, 000 B) $4, 500 C) $4, 000 D) $3, 500 Hint: NOPAT = (S – E – D)? (1 – T) (The following information relates to Questions 30 to 34) A Canadian based MNC is considering a capital investment in Germany. The expected cash flows of the project are given below. Year| 0| 1| 2| 3| Cash Flows (billion)| -€44. 44| €21. 67| €22.

80| €23. 99| The current spot rate is $1. 3214/€. While the Canadian nominal interest rate is 6%, it is 7% in Europe. Real rate of interest is 3% in both countries. Canadian required rate of return is 12%.

30.

How much does this project cost now? \_\_\_\_ A) $33. 631 billion B) $44. 440 billion C) $51. 945 billion D) $58. 723 billion 31.

Using PPP, what is the expected spot rate (€/$) for year 3? \_\_\_\_ A) 0. 77903 B) 0. 77154 C) 0. 76412 D) 0. 75677 Hint: 32. What is the cash flow of this project in year 2? \_\_\_\_ A) $17.

591 billion B) $29. 551 billion C) $22. 581 billion D) $25. 521 billion 33. Should the project be undertaken? Why? \_\_\_\_\_ A) No; NPV = -$12. 075 billion B) No; NPV = $12.

075 billion C) Yes; NPV = $12. 075 billion D) Yes; NPV = -$12. 075 billion 34.

Using IFE, what is the compatible required rate of return on the euro cash flows? \_\_\_\_ A) 10. 923% B) 12.

000% C) 13. 087% D) 15. 381% Hint: 35. What effect does the NPV of a project have on the value of the firm undertaking the project? \_\_\_\_ A) The firm’s value increases or decreases by the NPV of the project B) The value of the firm is not affected by the NPV of the projects being undertaken C) The firm’s value cannot decrease because of the NPV of a project D) The firm’s value increases by an amount equal to the NPV of a project multiplied by the firm’s effective tax rate 6. Sensitivity analysis considers how NPV responds to \_\_\_\_ A) Increased country risk B) Changes in input values C) Changes in output values D) Increased competition 37. How can firms incorporate country risk into their NPV calculations? \_\_\_\_ A) Country risk can be addressed by adjustments to discount rates or adjustments to cash flow assumptions B) Country risk is not considered in NPV calculations C) The discount rate used in NPV calculations automatically incorporates country risk D) Country risk can be incorporated by increasing the operating cost of the project 8.

A decision tree shows a 30% probability of $2 million in returns and a 70% chance of $1 million in returns. What is the maximum you would invest today in this project if the cash inflow occurs one year in the future and the discount rate is 10%? \_\_\_\_ A)$818, 182 B)$1, 181, 818 C)$1, 300, 000 D)$1, 363, 636 39. Break-even analysis identifies the minimum inputs into a project that are necessary to produce positive NPV. What are the NPV break-even sales for a project costing $4 million and generating annual cash flows according to (0. ? sales – $450, 000)? Assume this project lasts for ten years and requires a discount rate of 12%. \_\_\_\_ A)$2, 093, 654 B)$2, 359, 047 C)$3, 859, 798 D)$13, 783, 333 Hint: NPV= (0.

3S – $450, 000)\*PVIFA (12%, 10) – $4, 000, 000 where PVIFA (12%, 10) = 5. 65 40. Which of the following is not a real option? \_\_\_\_ A) The option to expand production if the product is successful B) The option to buy shares of stock if its price goes up C) The option to expand into a new geographic region

D) The option to switch the type of fuel used in an industrial furnace E) None of the above 41. Which of the following is true regarding real options? \_\_\_\_ A) Real options affect the size, but not the risk, of a project’s expected cash flows B) Real options are most valuable when the underlying source of risk is very low C) Real options are rights to buy real assets such as stocks, rather than interest-bearing assets such as bonds. D) All of the above E) None of the above 42.

Generally, the existence of a(n) \_\_\_\_ option reduces the downside risk of a project and should be considered in project analysis.

\_\_\_\_ A) Abandonment B) Flexibility C) Timing D) Growth 43. A project has an expected NPV of -$25 based on the traditional DCF analysis. However, the real option valuation shows the expected NPV is $75. What is the value of the option? \_\_\_\_ A) $25 B) $50 C) $75 D) $100 Hint: OV = NPV with option – NPV without option 44. Parent-subsidiary asymmetry can arise from the forecasting difference between the two parties because \_\_\_\_

A) The subsidiaries may be estimating cash flow in one currency while the parent may be estimating cash flow in another currency B) The parents often do not inform subsidiaries of all of the information used in their forecasts C) The subsidiaries can have a positive bias causing them to over-estimate positive cash flow in order to make projects they want to pursue more attractive D) The parents often encourage subsidiaries to be aggressive in their estimations of positive future cash flow 45.

Whitewater Co. s a U. S. company with sales to Canada amounting to C$8 million. Its cost of materials attributable to the purchase of Canadian goods is C$6 million. Its interest expense on Canadian loans is C$4 million.

Given these exact figures above, the dollar value of Whitewater’s “ earnings before interest and taxes” would \_\_\_\_ if the Canadian dollar appreciates; the dollar value of Whitewater’s cash flows would \_\_\_\_ if the Canadian dollar appreciates. \_\_\_\_ A) Increase; increase B) Decrease; increase C) Decrease; decrease

D) Increase; decrease E) Increase; be unaffected (The following information relates to Questions 46 and 47) Oklahoma Instruments (OI) is considering a project called F-200 that has an up-front cost of $250, 000. The project’s subsequent cash flows are critically dependent on whether another of its products, F-100, becomes an industry standard. There is a 50% chance that the F-100 will become the industry standard, in which case the F-200’s expected cash flows will be $110, 000 at the end of each of the next 5 years.

There is a 50% chance that the F-100 will not become the industry standard, in which case the F-200’s expected cash flows will be $25, 000 at the end of each of the next 5 years. Assume that the cost of capital is 12%.

46. Based on the above information, what is the F-200’s expected net present value? \_\_\_\_\_ A) -$6, 678 B) -$3, 251 C) $15, 303 D) $20, 004 47. Now assume that one year from now OI will know if the F-100 has become the industry standard.

Also assume that after receiving the cash flows at t = 1, OI has the option to abandon the project, in which case it will receive an additional $100, 000 at t = 1 but no cash flows after t = 1. Assuming that the cost of capital remains at 12%, what is the estimated value of the abandonment option? \_\_\_\_ A) $2, 075 B) $4, 067 C) $8, 945 D) $10, 745 48.

While the ability to modify a project as it develops may be viewed as a positive attribute of the project, it also means that \_\_\_\_ A) The project is not very well planned B) The project will always be in danger of failing

C) The project will cost more than originally forecasted D) More decisions will potentially have to be made about the project 49. A Canadian MNC is considering establishing a two-year project in New Zealand with a C$30 million initial investment. The firm’s cost of capital is 12%. The required rate of return on this project is 18%. The project is expected to generate cash flows of NZ$12 million in year 1 and NZ$30 million in year 2, excluding the salvage value. Assume no taxes, and a stable exchange rate ($/NZ$) of 0.

6 over the next two years.

All cash flows are remitted to the parent. What is the break-even salvage value? \_\_\_\_ A) About NZ$15 million B) About NZ$25 million C) About NZ$31 million D) About NZ$37 million Hint: The breakeven salvage of a particular project is the salvage value necessary to make the project’s return equal the required rate of return. 50. If the parent’s government imposes a \_\_\_\_ tax rate on funds remitted from a foreign subsidiary, a project is \_\_\_\_ likely to be feasible from the \_\_\_\_ point of view. \_\_\_\_ A) High; less; subsidiary’s

B) High; less; parent’s C) High; more; parent’s D) Low; more; subsidiary’s PART B: DISCUSSION QUESTIONS are designed to encourage critical thinking for real-world issues.

1. How does the “ agency problem” affect the governance of MNCs? 2. Why is the shareholder-wealth maximization rule a better one for corporate managers to follow than the profit-maximization rule? 3. Should an MNC reduce its ethical standards to compete internationally? 4. How should project managers respond to value differences between parents and subsidiaries?