TECHNICAL UNIVERSITY OF MOMBASA

Faculty of Business & Social Studies

DEPARTMENT OF BUSINESS STUDIES

UNIVERSITY EXAMINATIONS FOR

MASTERS OF BUSINESS ADMINISTRATION

BFI 5203: FINANCIAL INSTITUTIONS AND MARKETS

END OF SEMESTER EXAMINATIONS

SERIES: APRIL 2015

TIME: 3 HOURS

INSTRUCTIONS:

- Answer question **ONE (Compulsory)** and any other **THREE** questions
- Do not write on the question paper.

This paper consists of Three printed pages

QUESTION 1 (Compulsory)

a) Explain the negative effects of financial liberalization. **(10 marks)**

b) Explain the measures a country can undertake to ensure a strong regulatory framework. **(10 marks)**

c) Johnes is a speculator who buys a British call option with a strike price of $1.51 and a December settlement date. The current spot price as of that date is about $1.49. Johnes pays a premium of $0.012 per year for the call option. Assume there are no brokerage fees. Just before the expiration date, the spot rate of the British pound reaches $1.52. At this time, Johnes exercises the call option and immediately sells the pounds at the spot rate to a bank. One option contract is equivalent to 42,240 units.

Required:

Determine Johne's profit or loss. **(5 marks)**

QUESTION 2

a) Discuss the main forms of hedging foreign exchange risk. **(10 marks)**

b) Explain the risks of financial intermediation. **(10 marks)**

c) Calculate the price of a zero coupon bond with a $24,000 face value and 10 year maturity assuming semi-annual compounding. The market interest rate is 12%. **(5 marks)**

QUESTION 3

a) Evaluate the main objectives of regulating financial institutions. **(10 marks)**

b) Explain the benefits of agency banking to a financial institutions. **(10 marks)**

c) On April 20th, a future contract specifying 500,000 Mexican pesos and a June settlement date is priced at $0.08. On April 20th, speculators who expect the Peso will decline sell futures contracts on Pesos. Assume that on June 20th, (the settlement date), the sport rate of the Peso is $0.07. Calculate the gain or loss on the future contract.

QUESTION 4

a) Explain the rationale for government intervention in financial markets. **(10 marks)**

b) Explain factors that influence a multinational company's degree of translation exposure. **(10 marks)**

c) Slate Ltd, a U. S based company has one subsidiary in the United Kingdom. The subsidiary forecasts that its earnings next year will be £50 Million. To hedge its translation exposure, slate can implement a forward hedge on the expected earnings by selling £50Million at the sport rate to fulfill its forward contract obligation to sell £50million. If the pound depreciates over the year such that the average weighted exchange rate is $1.5 over the year.

Required:

i) Calculate the translated subsidiary earnings. **(3 marks)**

ii) Calculate the gain or loss on forward contract assuming the spot rate is $1.70 at the end of the year. **(2 marks)**

QUESTION 5

a) Describe factors that influence exchange rates in a country. **(10 marks)**

b) Explain the benefits of financial innovation. **(10 marks)**

c) Calculate the price of a three year bond with a face value of $8,000 and a coupon rate of 9%. Coupon payments are made annually and market rate of interest of similar bonds is 10%. **(5 marks)**