

## Warwick Summer School 2024- Exam Q&A

**Note: Answer all multiple-choice questions and three questions of your choice from the analytical section. If you answer more than 4 questions, they are not marked.**

### Section of the Multiple Choice Questions (Answer all of them)

- A. What statement is true about the financial institutions working under the title of the *shadow banking system*?**
- a) The central banks fully regulate them and they can accept deposits.
  - b) The central banks do not fully regulate them and they can accept deposits.
  - c) They are partially regulated by the central banks and allowed to accept deposits but can not operate like banks.
  - d) They are partially regulated by the central banks and not allowed to accept deposits or operate like banks.
- B. Which of the following investments will have the highest monetary return at the end of the investment horizon, if the initial investment is £1000? Assume annual compounding.**
- a) 5 years at the interest rate of 5% per year.
  - b) 7 years at the interest rate of 3% per year.
  - c) 2 years at the interest rate of 9% per year.
  - d) 3 years at the interest rate of 6% per year.
- C. The present value of a US treasury bond with a face value of \$1000, a 2% annual return and a maturity date after 5 years of purchasing with the yield to maturity  $r = 2.8\%$  is:**
- a) \$963.14
  - b) \$980.25
  - c) \$1,000.00
  - d) \$1,038.76
- D. Which statement is true?**
- a) Short-term and long-term interest rates always move in parallel.
  - b) If the term structure of interest rates is flat, then the 9-year spot interest rate equals the 10-year spot interest rate.
  - c) Real interest rates and nominal interest rates are always positive values.
  - d) By undertaking an analysis in real terms, the financial manager avoids having to forecast inflation.

**E. Which of these are the benefits of market globalisation?**

- a) Considering the local buyers' needs
- b) Leveling uneven income streams
- c) a) and b)
- d) None of them

**F. The idea that Countries should specialise in the goods they can produce most efficiently and trade for those goods they can't produce,**

- a) is based on the absolute advantage theory
- b) is based on the comparative advantage theory.
- c) is based on the growth theory.
- d) is based on the factor proportions theory.

**G. The risk associated with unanticipated actions by the host country's government or its courts towards a multinational firm is called**

- a) Economic risk
- b) Transaction risk
- c) Political risk
- d) Underestimation risk

**H. All else equal, if an option's exercise price increases, then**

- a) The value of a put option decreases and that of a call option increases.
- b) The value of a put option increases and that of a call option decreases.
- c) The value of both a put option and a call option increases.
- d) The value of both a put option and a call option decreases.

**I. Suppose Carol's stock price is currently £20. In the next six months, it will either fall to £10 or rise to £40. What is the current value of a six-month call option with an exercise price of £12? The six-month risk-free interest rate is 5 percent per six-month period. (Use the risk-neutral valuation method.)**

- a) £13.33
- b) £16.70
- c) £10.28
- d) £9.78

**J. Which statement is not correct?**

- a) WTO tries to strike a balance between national desires for protection and international desires for free trade.
- b) WTO can punish the company that practices a dumping policy against a foreign country.
- c) WTO helps countries to open their markets for trade and serves to settle trade disputes between member countries.

- d) WTO does allow country members to impose anti-dumping duty if they are faced with a dumping policy used by other countries.

**K. What are the instruments of trade promotion?**

- a) **Subsidies, foreign trade zones, and special government agencies.**  
 b) Subsidies, Quotas, and tariffs.  
 c) Tariffs, Quotas, and currency control.  
 d) Currency control, subsidies, and special government agencies.

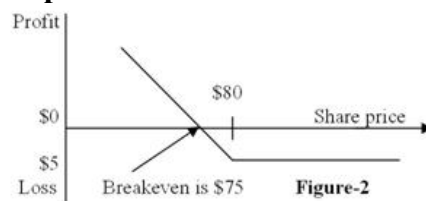
**L. According to the Mercantilist doctrine in international trade, a country can**

- a) Have a permanent positive balance of trade with other countries  
 b) Accumulate wealth through importing precious metals  
 c) Grow by putting restrictions on imports of goods from rival nations.  
 d) **All of the above.**

**M. Which statement is not true?**

- a) The writer of a put option loses if the stock price declines.  
 b) An investor can get downside protection on the purchase of stock by buying a put option.  
 c) **Payoff (position) diagrams and profit diagrams are identical.**  
 d) Buying a stock and a put option and lending the present value of the exercise price provide the same payoff as buying a call option.

**N. Figure below depicts the**



- a) position diagram for the buyer of a call option.  
 b) profit diagram for the buyer of a call option.  
 c) position diagram for the buyer of a put option.  
 d) **profit diagram for the buyer of a put option.**

**O. Suppose an investor sells (writes) a put option. What will happen if the stock price on the exercise date exceeds the exercise price?**

- a) The seller will need to deliver stock to the owner of the option.  
 b) The seller will be obliged to buy stock from the owner of the option.  
 c) **The owner will not exercise the option.**  
 d) The option will extend for nine more months.

P. Which of the following is not one of Hofstede's four dimensions of culture? Choose all that apply.

- a) Individualism vs. collectivism
- b) Masculinity vs. femininity
- c) Uncertainty avoidance
- d) Neutral culture vs. emotional culture

Q. Which ones are Firm-specific assets/ownership advantages? Choose all that apply.

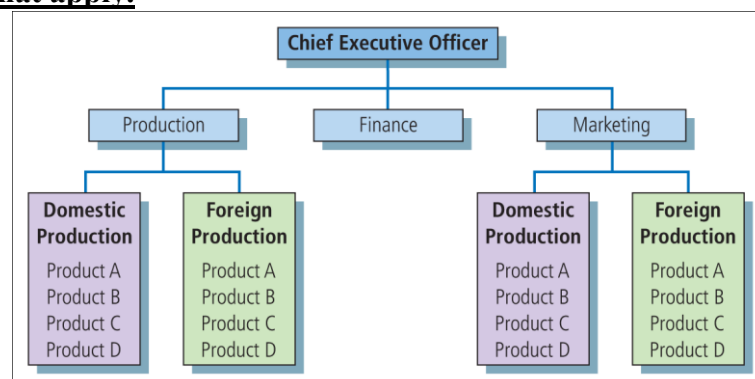
- a) Asset-type
- b) Transaction-type
- c) Recombinant-type
- d) All of the above

R. In the figure, firms A and B must decide their advertising expenditures simultaneously. They have a choice between three levels of expenditure: low, medium or high. Both firms' payoffs from the advertising campaign depend on their expenditure and the expenditure of the other firm. Find the NASH Equilibrium. Choose all that apply.

	Y: Low (L)	Y: Medium (M)	Y: High (H)
X: Low (L)	(50, 50)	(40, 55)	(20, 35)
X: Medium (M)	(55, 40)	(60, 60)	(25, 45)
X: High (H)	(35, 20)	(45, 25)	(30, 30)

- a) Medium-Low
- b) Low-Medium
- c) Low-Low
- d) Medium-Medium
- e) High-High

S. What type of an example of organisational structure is the following figure? Choose all that apply.



- a) Global product structure
- b) Global area structure
- c) **Global functional structure**
- d) Matrix structure
- e) Mixed structure

**T. Firms often charge new customers a lower price than existing customers for the same product or service as an ‘introductory offer’ What type of price discrimination is this?**

- a) First-degree price discrimination
- b) Second-degree price discrimination
- c) **Third-degree price discrimination**
- d) There is no price discrimination in the example since it only refers to an ‘introductory offer’.

## Section of Analytical Questions

**1. Explain the following terms. In your explanation compare each term with its previous term, except the first term:**

- i. Real Assets**
- ii. Financial Assets**
- iii. Securities**

**Answer:**

- i. Real assets are physical or tangible economic resources such as commodities, machinery, buildings, precious metals/stones, arts, equipment, etc. that can produce future returns.
- ii. Financial assets are non-physical or intangible assets such as bank accounts, bonds, shares, etc. but they can also produce future returns and they are more liquid than real assets, meaning they can be converted to money much quicker than the real assets.
- iii. Securities are specific types of financial assets that can be traded in the financial markets such as bonds, and shares. For example, savings accounts or current accounts are financial assets, but they are not usually tradable or transferable, but Shares, bonds, and asset-backed securities (ABS) are tradable in the market.

**2. It is possible to buy a three-month call and three-month put options on stock Q. Both options have an exercise price of £60 and both are worth £10. If the interest rate is 5% a year, will you buy the stock at the offered price of £55?**

**Answers:**

Let  $P$  = the value of the three-month put,  $C$  = the value of the three-month call,  $S$  = the market value of a share of stock, and  $K$  = the exercise price of the options.

Then, from put-call parity:

$$C + \frac{K}{(1+r)^t} = P + S$$

As  $P=C$ , then:

$$S = \frac{60}{(1+0.05)^{1/4}} = \text{£}59.27$$

The offered price is much lower than the theoretical price, so buying the stock is profitable.

### 3. Answer the following questions:

- i. What is an option?
- ii. How many options are there in the financial markets? Explain them.
- iii. Why do we need options in the financial market? Explain your answer.

Answers:

- i. An option is a contract giving its owner the right (but not the obligation) to buy or sell an asset at its strike (exercise) price on (or before) a specified maturity (expiration) date.
- ii. Based on the nature of the contract:
  - 1) **call option:** gives its owner the right to buy an asset at an exercise (strike) price before (or on) the maturity date.
  - 2) **put option:** gives its owner the right to sell an asset at an exercise (strike) price before (or on) the maturity date.and based on the exercising right before or on the maturity date we have:
  - 1) **European:** It can be exercised only at its maturity (expiration) date
  - 2) **American:** It can be exercised on any date up to and including the maturity (expiration) date.
- iii. In a world, full of unpredicted events people try to reduce risk by making advance contracts which secure some aspects of the risky events. Options can be seen in this context. For example, if someone buys shares of a company, to protect the value of his/her investment from declining the price of the shares, a put option on the same asset can be bought. The same with the call option if the price of the underlying asset is going up against our wish.

### 4. Explain

- i. In what way do ethnocentrism and misconceptions about other cultures inhibit those doing business internationally?
- ii. Why are cultural differences an important factor when adapting products for new overseas markets? Give examples to illustrate your answer.

Answers:

- i. Ethnocentrism is the belief that one's own way of doing things is superior to that of others. This inhibits doing business internationally because it prevents the manager from being flexible and open-minded when dealing with people from

other cultures. The manager is convinced that the way things are done in the home country is better.

- ii. Cultural differences are important because they define the preferences of individuals. The more obvious example is language. For example, computer software sold in Latin America must give instructions in Spanish or Portuguese, not in English. A more subtle difference would include a preference for quieter air conditioners in Japan, where silence and calm are highly praised. In terms of marketing, the labels and instructions should be in the language of the targeted market. More importantly, advertisements should give due consideration to the values and morals of the targeted market.

**5. Explain:**

- i. **How will an MNE carry out an external environmental assessment? Identify and describe some steps involved in this process.**
- ii. **There are five key variables that MNEs examine in choosing from among alternative organization structures. What are these five? Identify and briefly describe 3 of them.**

**Answers:**

- i. In an external environmental assessment, an MNE gathers information and then assesses these data.  
Information gathering focuses on answering the question: What is going on in the external environment? There are a number of ways that MNEs go about conducting an environmental scan and then forecasting the future, including (a) asking experts in the industry to discuss industry trends and make projections about the future; (b) using historical industry trends to forecast future (c) asking knowledgeable managers to write scenarios describing what they foresee for the industry over the next two to three years; and (d) using computers to simulate the industry environment and generate likely future developments. Of these, expert opinion is the most commonly used.  
Information assessment is often based on an evaluation of the five forces that determine industry competitiveness—buyers, suppliers, potential new entrants to the industry, the availability of substitute goods and services, and also rivalry among the competitors. As an MNE examines each of these five forces, it evaluates the attractiveness and unattractiveness of each.
- ii. The first key variable the MNE evaluates is the relative importance of international operations at the present time, projecting what the situation might be within three to five years. Second, the company considers its past history and experience in the international arena. Third, it reviews its business and product strategy. Fourth, it considers its philosophy of operating. Fifth, it examines its ability to adjust to organizational changes.

**6. Answer the following questions:**

- i. How many types of market structures there are? Explain the differences between each.
- ii. What are Sequential games? Suppose two breakfast cereal producers are both considering a new product launch. They each have a choice of launching one of two products: one product's appeal is 'crunchiness' and the other's appeal is 'fruitiness'. Assume the crunchy cereal is more popular with consumers than the fruity cereal. In the breakfast cereals game with A as the first mover, build the game tree and find the Subgame Perfect Equilibrium (SPE).

		Firm B's strategies	
		<i>Crunchy</i>	<i>Fruity</i>
Firm A's strategies	<b>Crunchy</b>	3 3	5 4
	<b>Fruity</b>	4 5	2 2

Answers:

- i.
- |                          | No. of firms | Entry conditions  | Product differentiation  |
|--------------------------|--------------|-------------------|--------------------------|
| Perfect competition      | Many         | Free entry        | Identical products       |
| Imperfect competition    |              |                   |                          |
| Monopolistic competition | Many         | Free entry        | Some differentiation     |
| Oligopoly                | Few          | Barriers to entry | Some differentiation     |
| Monopoly                 | One          | No entry          | Complete differentiation |
- ii. In many sequential games, the player who moves first gains an advantage, by influencing the shape of the game and forcing the other player to react to the first-mover's decision, rather than act in a way that is independent of the first-mover's presence. In the breakfast cereals game with A as a first mover, (Crunchy, Fruity) is a Subgame of Perfect Equilibrium (SPE).