



## SECTION – II

### **Q .4. Case Study**

**(15)**

Blades, Inc., is currently exporting roller blades to Thailand and importing certain components needed to manufacture roller blades from that country. Under a fixed contractual agreement, Blades' primary customer in Thailand has committed itself to purchase 180,000 pairs of roller blades annually at a fixed price of 4,594 Thai baht (THB) per pair. Blades is importing rubber and plastic components from various suppliers in Thailand at a cost of approximately THB2,871 per pair, although the exact price (in baht) depends on current market prices. Blades imports materials sufficient to manufacture 72,000 pairs of roller blades from Thailand each year. The decision to import materials from Thailand was reached because rubber and plastic components needed to manufacture Blades' products are inexpensive, yet of high quality, in Thailand. Blades has also conducted business with a Japanese supplier in the past. Although Blades' analysis indicates that the Japanese components are of a lower quality than the Thai components, Blades has occasionally imported components from Japan when the prices were low enough. Currently, Ben Holt, Blades' chief financial officer (CFO), is considering importing components from Japan more frequently. Specifically, he would like to reduce Blades' baht exposure by taking advantage of the recently high correlation between the baht and the yen. If Blades decides to import components from Japan, it would probably import materials sufficient to manufacture 1,700 pairs of roller blades annually at a price of ¥7,440 per pair. Holt is also contemplating further expansion into foreign countries to ensure that the profit margin from import and export exceeds 25% which is below 15% at present. He believes that further foreign expansion will be beneficial to the company's future. Though Blades' current exporting and importing practices have been profitable, Ben Holt is contemplating extending Blades' trade relationships to countries in different regions of the world. One reason for this decision is that various Thai roller blade manufacturers have recently established subsidiaries in the United States. Furthermore, various Thai roller blade manufacturers have recently targeted the U.S. market by advertising their products over the Internet. As a result of this increased competition from Thailand, Blades is uncertain whether its primary customer in Thailand will renew the current commitment to purchase a fixed number of roller blades annually. The current agreement will terminate in 2 years. Another reason for engaging in transactions with other, non-Asian, countries is that the Thai baht has depreciated substantially recently, which has somewhat reduced Blades' profit margins. The sale of roller blades to other countries with more stable currencies may increase Blades' profit margins. While Blades will continue exporting to Thailand under the current agreement for the next 2 years, it may also export roller blades to Jogs, Ltd., a British retailer. Preliminary negotiations indicate that Jogs BLADES, INC. CASE Assessment of Exchange Rate Exposure Chapter 10: Measuring Exposure to Exchange Rate Fluctuations 305 would be willing to commit itself to purchase 200,000 pairs of "Speedos," Blades' primary product, for a fixed price of £80 per pair. Holt is aware that further expansion would increase Blades' exposure to exchange rate fluctuations, but he believes that Blades can supplement its profit margins by expanding. He is vaguely familiar with the different types of exchange rate exposure but has asked you, a financial analyst at Blades, Inc., to help him assess how the contemplated changes would affect Blades' financial position. Among other concerns, Holt is aware that recent economic problems in Thailand have had an effect on Thailand and other Asian countries. Whereas the correlation between Asian currencies such as the Japanese yen and the Thai baht is generally not very high and very unstable, these recent problems have increased the correlation among most Asian currencies. Conversely, the correlation between the British pound and the Asian currencies is quite low. To aid you in your analysis, Holt has provided you with the following data:

Currency	Expected Exchange Rate	Possible Exchange Rate
British Pound	\$ 1.50	\$1.47 - \$1.53
Japanese Yen	\$ .0083	\$.0079 - \$ .0087
Thai Baht	\$ .024	\$ .020 - \$ .028

Holt has asked you to answer the following questions:

1. What type(s) of exposure (i.e., transaction, economic, or translation exposure) is Blades subject to? Why?
2. If Blades does not enter into the agreement with the British firm and continues to export to Thailand and import from Thailand and Japan, do you think the increased correlations between the Japanese yen and the Thai baht will increase or reduce Blades' transaction exposure?
3. Do you think Blades should import components from Japan to reduce its net transaction exposure in the long run? Why or why not?
4. Assuming Blades enters into the agreement with Jogs, Ltd., how will its overall transaction exposure be affected?
5. Given that Thai roller blade manufacturers located in Thailand have begun targeting the U.S. roller blade market, how do you think Blades' U.S. sales were affected by the depreciation of the Thai baht? How do you think its exports to Thailand and its imports from Thailand and Japan were affected by the depreciation?

**Q .5. Answer the following.**

**(10)**

1. Write characteristics of 'financial Engineering'.

**OR**

2. An Indian Firm exports jeans to America. Currently, it sells 20000 pieces at \$30 per piece. Its cost per jean is Rs.300. In addition, it needs to import certain raw materials which costs \$10 per piece. The fixed costs of the company is Rs.20,00,000. The current spot rate is Rs.44/\$. Suppose that the rupee appreciates to Rs.40/\$ by how many units the company's sales should increase for its profits to remain unchanged?