

KASNEB

CIFA PART III SECTION 6

INTERNATIONAL FINANCE

FRIDAY: 27 May 2016.

Time Allowed: 3 hours.

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings.

QUESTION ONE

- (a) (i) Illustrate the relationship between the product life cycle theory and both international trade and international investment. (3 marks)
- (ii) Highlight three assumptions of product life cycle theory. (3 marks)
- (b) Evaluate six methods that could be used by multinational corporations (MNCs) to conduct international business. (6 marks)
- (c) Summarise four reasons why a weak domestic currency might not be a perfect solution to correct a balance of trade deficit in international trade. (4 marks)
- (d) Describe four methods of payments that could be used by multinational corporations (MNCs) while conducting international trade. (4 marks)
- (Total: 20 marks)**

QUESTION TWO

- (a) Examine four ethical dilemmas that could be faced by multinational corporations (MNCs) while conducting international business. (8 marks)
- (b) Rhonda Anita has 1 million United States dollars (\$) and specialises in cross-rate arbitrage. She observes the following quotes from the foreign exchange dealer:

Euro (€) /United States Dollar (\$):	0.7000 – 0.7010
United States Dollar (\$) /British Pound (£):	1.7000 – 1.7010
Euro (€) /British Pound (£):	1.2000 – 0.2010

Required:

- The arbitrage profit in United States dollar (\$) assuming that there are no transaction costs. (6 marks)
- (c) Citing three reasons, justify the cause for central banks' intervention to control the foreign exchange rate in their respective countries. (6 marks)
- (Total: 20 marks)**

QUESTION THREE

- (e) (i) Explain the term "Bank Stress Test" in relation to bank management of loan exposure. (2 marks)
- (ii) The recent trends in the banking industry have seen some commercial banks being placed under receivership or even liquidation by the regulator due to poor disclosure policies on non-performing loans.

In light of the above statement, propose six factors that could act as a catalyst for loans default and consequently lead to massive non-performing loans in the banking sector. (6 marks)

- (f) Finix Ventures Limited (FVL) intends to make a \$100 million payment in three months' time. The money is available now. You work as an investment and financial advisor for the company and you are provided with the following information:

- United States dollar (\$) deposit interest rate is 8% per annum.
- Sterling pound (£) deposit interest rate is 10% per annum.
- Spot exchange rate is \$1.40/£.
- Three-month forward rate is \$ 1.38/£.

Required:

- (i) Using suitable computations, advise FVL on the best strategy to invest the \$100 million. (3 marks)
- (ii) Determine the forward rate that would yield an equilibrium situation assuming that the interest rates and the spot exchange rate remain the same in both countries. (3 marks)
- (iii) Using suitable computations, advise the company on the best way of investing the \$100 million assuming the Sterling Pound deposit interest rate was 16% per annum. Assume that the US dollar interest rate, the spot rate and forward rate remain the same. (3 marks)
- (iv) Determine the equilibrium Sterling Pound (£) deposit interest rate assuming that the stated spot rate, the forward rate and the dollar deposit interest rate remain the same. (3 marks)

(Total: 20 marks)**QUESTION FOUR**

- (a) The following cost and revenue information relates to Zobby Limited, a multinational corporation based in the United States (US) which purchases most of its materials from Canada and generates a small portion of its sales from exporting its products to Canada.

	US Business \$"million"	Canadian Business \$"million"
Sales	2,560	32
Cost of materials	400	1,600
Operating expenses	480	-
Interest expenses	24	80
Cash flow	1,656	1,648

Additional information:

- Assume that Zobby Limited expects three possible exchange rate scenarios for the Canadian dollar over the period of concern as follows:
 - \$0.75
 - \$0.80
 - \$0.85
- Assume that U.S. sales will be unaffected by the exchange rates.
- Assume that the Canadian dollars (C\$) earnings will be remitted to the U.S. parent company at the end of the period.
- Ignore possible tax effects.

Required:

- (i) Using relevant computations, assess Zobby Limited's economic exposure under the above three scenarios. (6 marks)
- (ii) Comment on the results obtained in (a)(i) above. (2 marks)
- (b) Tivec Beauties, a multinational company based in Kenya is considering establishing a 4-year venture in Rwanda that would manufacture and sell shoes locally.

Additional information:

- The project would require 20 million Rwanda Francs (RWF) which would include funds to support working capital needs.
- The spot exchange rate is KSh.0.125/RWF which is expected to remain constant for all future periods.
- The estimated price, variable cost and demand schedules during each of the next 4 years are as follows:

Year	1	2	3	4
Unit cost per shoe (RWF)	700	700	760	800
Demand in Rwanda (units)	50,000	50,000	80,000	100,000
Variable cost per shoe (RWF)	500	500	550	580

- The expenses of leasing extra office space is RWF 2 million per annum. Other annual overhead expenses are expected to be RWF 2 million per annum.
- Depreciation on plant and machinery in Rwanda has been fixed at a maximum rate of RWF 4 million per annum.
- The Rwandan government will impose a corporate tax at a rate of 20% on income. In addition, it will impose a 10% withholding tax on any funds remitted by the subsidiary to the parent.

- The Kenyan government will allow a tax credit on taxes paid in Rwanda, therefore, earnings remitted to the Kenyan parent will not be taxed.
7. The subsidiary plans to send all net cash flows received to the parent company at the end of each year.
 8. The Rwandan government will pay the parent company RWF 12 million to take over the ownership of the subsidiary at the end of the four years. Assume that there is no capital gains tax on the sale of the subsidiary.
 9. The required rate of return of the project is 14%.

Required:

Advise Tivec Beauties on whether to undertake the project.

(12 marks)

(Total: 20 marks)

QUESTION FIVE

- (a) (i) Evaluate four techniques that could be adopted by a multinational corporation to optimise its cash flow management. (4 marks)
- (ii) Cider Limited, a large South African based multinational corporation has 1 million South African Rand (ZAR) in excess cash. The corporation wishes to invest this excess cash in South Africa in a 1-year deposit at a rate of 8 per cent per annum but is attracted to higher interest rates in Kenya. It creates a 1-year deposit denominated in Kenya shillings (KES) at an annual interest rate of 12 per cent. The exchange rate of the Kenya shilling at the time of the deposit is KES 7.5/ZAR where the 1-year forward rate is KES 8.0/ZAR.

Required:

The yield on ZAR 1 million investment.

(3 marks)

- (b) Recent trends have seen several multinational corporations and individual countries float eurobonds at the international bond market.

Based on the above statement, summarise five advantages of the eurobond market to borrowers.

(5 marks)

- (c) Discuss four barriers to foreign direct investment (FDI).

(8 marks)

(Total: 20 marks)

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