MASOMO MSINGI PUBLISHERS

INTERNATIONAL FINANCE REVISION KIT

2015 TO NOVEMBER 2020 PAST PAPERS WITH ANSWERS/SOLUTIONS

2021

UPDATED WITH NOVEMBER 2020 PAST PAPER

KASNEB

PART 3

SECTION 6

INTERNATIONAL FINANCE

REVISION KIT

REVISED ON: FEBRUARY 2021

GENERAL OBJECTIVE

This paper is intended to equip the candidate with knowledge, skills and attitudes that will enable him/her to analyse and manage investments in the international financial market environment.

17.0 LEARNING OUTCOMES

A candidate who passes this paper should be able to:

- Evaluate the operations of international financial markets
- Analyse fixed versus flexible exchange rate regimes
- Apply risk management strategies in international markets
- Justify government intervention in international finance management and international debt crisis
- Assess the role of the multinational corporation in international financial and capital flows
- Analyse the various finance issues related to multinational corporations
- Advise on various ethical dilemmas faced by multinational corporations' managers
- Identify types of country risks and their measurement.

CONTENT

17.1 The environment of international finance

- International finance: Theory of comparative advantage, the theory of factors endowment, product life cycle, globalisation of the world economy, the multinational corporation
- Goals of international finance
- International flow of funds
- The balance of payments: current account, financial account; factors affecting the financial account
- Sources of international finance: rising funds in foreign markets and investments in foreign projects (short term, medium term and long term

sources)
- Terms of payments in international trading

17.2 The foreign exchange market

- Function and structure of the foreign exchange market
- Mechanics of foreign exchange: The market for foreign exchange; exchange rates(direct and indirect quotations, cross-rate calculations, bid-ask quotes and spreads, cross-rate calculations with bid-ask spreads), exchange rate determination
- Parity relationship: interest rate parity, purchasing power parity; international fisher effects
- Forecasting exchange rates
- Indices of currency movements and exchange rate speculation; efficient fundamental and technical approaches to forecasting; forecasting performance and market efficiency; currency betas and consistent forecasts; international arbitrage

17.3 The foreign exchange rates regimes

- Fixed or pegged exchange rate system
- Floating or flexible exchange rate system
- Managed floating exchange rate systems
- Government Intervention in the foreign exchange market
- Deficit finance and exchange rates

17.4 Managing foreign exchange exposure

- Transaction exposure: identification of transaction exposure; hedging (forward, money and options market hedges), limitations of hedging short term exposure, hedging long term exposure, techniques of reducing transaction exposure
- Economic exposure: Measuring economic exposure, managing operating exposures (selecting low cost production sites, flexible sourcing policy,

research and development and product differentiation, financial hedging and diversification of the market)
- Translation exposure: Translation methods, financial accounting standards, hedging translation exposure

17.5 International financial markets

- Motives for world trade and foreign investment
- International financial institutions, the international monetary system, multilateral financial institutions, bilateral financial institution, trade-related investment measures (TRIMS),trading blocks
- International banking and money market: International banking services; capital adequacy standards; banking regulations among countries; international money markets
- International bond and equity markets: Long term financing decisions, foreign bonds, types of instruments, dual currency bonds, bond market credit ratings, market capitalisation (developed and developing countries), market structures, trading practices and costs, equity market benchmarks, trading in international equities

17.6 International financial crisis

- The debt crisis
- Causes and remedies of the international debt crises
- Bank management of loan exposure
- Bank assessment of country risk
- Basel I,II and III requirements

17.7 Foreign direct investments (FDIs)

- Definition of FDI
- Classification of FDI
- Motives for FDI
- Foreign market entry strategies, factors favouring FDI, complexities of FDI, Imperfect markets and foreign direct investments FDI's, benefits of

international diversification, the direct foreign investment decision, political risks and foreign direct investments FDI's

17.8 International capital structures and the cost of capital

- Cost of Capital
- Cost of Capital in segmented versus integrated markets
- Comparisons of capital structure across countries
- Cross-border listings of stocks
- Capital asset pricing model (CAPM) under cross-listings
- The effect of foreign equity ownership restrictions
- The financial structure of subsidiaries

17.9 International capital budgeting

- Subsidiary versus parent perspective: translation
- Foreign investment decision process
- Factors to consider in multinational capital budgeting
- The adjusted present value model
- Risk adjustment in capital budgeting analysis
- Divesture analysis; international acquisitions, reducing exposure to host government takeovers

17.10 Multinational cash management

- The size of cash balances, choice of currency
- Cash management systems in practice: bilateral and multilateral netting of internal and external net cash flow
- Transfer pricing and related issues
- Blocked funds, methods used in moving blocked funds
- Factors influencing financing in foreign currencies
- Cash flow analysis for parent/subsidiary, optimisation of cash flows and distortion of subsidiary performance, reduction in precautionary cash balances, financing with a portfolio of currencies

17.11 The international tax environment

- The objectives of taxation: tax neutrality, tax equity
- Types of taxation: income tax, withholding tax, value-added tax
- National tax environment: worldwide taxation, territorial taxation, foreign tax credit
- Organisational structures for reducing tax liabilities: branch and subsidiary income, tax havens, controlled foreign corporation
- Use of transfer pricing to reduce taxes
- Corporate behaviour and international tax laws
- Multinational corporate policy

17.12 Ethics in the international financial environment

- Ethical dilemmas for multinational corporations (MNC) and its manager
- The Green movement

17.13 Country risk analysis

17.13.1 Country risk characteristics

- Political risk characteristics
- Economic risk characteristics
- Financial risk characteristics

17.13.2 Measuring country risk/ country risk profiling

- Methods or techniques of measuring country risk
- Derivation of country risk rating
- Comparison of country risk rating among different countries
- Decision making process from country risk rating

17.14 Emerging issues and trends

PAST PAPERS WITH SUGGESTED ANSWERS

TOPIC **PAGE NUMBER**

CHAPTER ONE

THE ENVIRONMENT OF INTERNATIONAL FINANCE

DEC 2012 Q1c

The following information relates to the republic of Zengaland for the year ended 31st December 2011:

	Sh. 'billions'
Export of goods	5,000
Import of goods	3,000
Receipts from interest and dividends	1,500
Payments of interest and dividends	1,000
Gifts received from abroad	800
Gifts to foreign countries	1,200

Required;

A current account for the year ended 31 December 2011

<u>**Solution**</u>

REPUBLIC OF ZENGALAND

CURRENT A/C AS AT 31ST DEC 2011

	Billions		Billions
Exports	5000	Imports	3000
Receipts from interest and dividend	1500	Payments of interest and dividend	1000
Gifts received	800	Gift to foreign currency	1200
		Bal c/d surplus	2100
	7300		7300

MONDAY: 30 November 2020.

QUESTION FOUR

(c) Explain five points of considerations when selecting an international payment method.
(5 marks)

Solution

1. **Dynamic language conversion.** Most shoppers will naturally abandon their purchases if they can't understand the checkout page, so your provider must have the ability to detect the shopper's location and automatically display the page in their language.
2. **Dynamic currency conversion**. Your payment provider should be able to automatically display the purchase price in the shopper's local currency. Asking your customers to do currency calculations themselves adds friction to the process.
3. **Support for local currency.** Shoppers should be able to pay in their own currency, so they know the exact purchase price. Otherwise, the issuing bank will have to convert the purchase to the local currency, and customers won't know what the exchange rate will be at the time of purchase.
4. **Support for international payment methods**. A small percentage of shoppers will abandon a purchase if they don't see a local payment option they prefer (or, at the very least, they'll be less satisfied with the experience!). It's not enough to simply offer the major credit cards; outside the U.S., the vast majority of sales are done using other payment methods, anything from cash vouchers to bank transfers to online banking options.
5. **Partnerships with numerous banks around the globe**. Cross-border transactions sent only to U.S. banks have a higher probability of being flagged for fraud. So look for a payment processor that partners with many acquiring banks around the globe, and will send every transaction to the bank most likely to approve it.
6. **Cross-border fraud protection**. Global e-Commerce payments open up undeniable opportunities for merchants. But cross-border e-Commerce, compared to pure domestic e-Commerce is inherently riskier. There are a