



STRATHMORE UNIVERSITY BUSINESS SCHOOL
BACHELOR OF COMMERCE
BCF 3201: INTERNATIONAL FINANCE
END OF SEMESTER EXAM

Date: 8th September 2022

Time: 2 Hours

INSTRUCTIONS

- 1. Answer Question one (*compulsory*) and any other TWO questions**
- 2. Question One has 30 marks**
- 3. All other questions have 20 marks each**

QUESTION 1

- a. Define International Finance **(2 Marks)**
- b. Explain why international finance is important to a Multinational Corporation **(4 Marks)**
- c. Exchange rates are inevitable when countries participate in trade across the world. The challenge is this exchange rates are not fixed and they keep moving up and down. Discuss any five factors that influence the exchange rates **(5 Marks)**
- d. Enaly Ltd. which is a US company has exported goods to Tel.Code Ltd which is a UK company. Enaly Ltd. has billed Tel.Code £5 million which is payable in one year. The money market interest rates and foreign exchange rates are given as follows:
 - The U.S interest rate: 5% per annum.
 - The U.K interest rate: 7% per annum.
 - The spot exchange rate: \$1.89/£
 - The forward exchange rate: \$1.74/£ (1-year maturity)

Required:

Using money market hedge show how Enaly Ltd. can manage this type of exposure **(5 Marks)**

- e. The Kenyan government has established cotton factories. Being in their initial stages, these cotton factories are prone to competition from foreign cotton companies in developed countries.
 - i. Explain any four measures that the Kenyan government can take to protect these cotton factories. **(3 Marks)**

- ii. Explain **three** problems that can arise as a result of the government taking these measures to protect the infant cotton factories in Kenya (3 Marks)
- f. A financial director of a multinational corporation in Kenya observes that the exchange rate between the Kenyan shilling and the Japanese Yen is: Ksh.1.19: 1Y

Required:

- i. Show the new exchange rate if the value of the Yen increased by 13% (1 Mark)
 - ii. Using the initial exchange rate, show the new exchange rate if the value of the Y was to decrease by 9% (1 Mark)
 - iii. Represent the initial exchange rate as an indirect quote (1 Mark)
 - iv. Using the indirect quote, show the new exchange rate if the value of the Y was to increase by 9% (1 Mark)
 - v. Using the indirect quote, show the new exchange rate if the value of the Y was to decrease by 12% (1 Mark)
- g. The spot exchange rate between the US dollar and the Chinese Yuan is 6.5Yuan: 1\$. Over the next year, price inflation in China is expected to be 6% while inflation in the US is expected to be 9.5%. Assuming US to be the home country, what will be the expected spot exchange rate at the end of the year? (1.5 Marks).
- h. The spot exchange rate between the Kenyan shilling and the British pound is Ksh 131= 1£. The interest rate in Kenya is 14% while the interest rate in the UK is 8%. Assuming that UK is the home country, estimate the forward rate in one year's time. (1.5 Marks)

QUESTION 2

- a. Differentiate between Devaluation and depreciation of a currency (2 marks)
- b. **Show and give a detailed** explanation of what will happen to the exchange rate when the inflation rate in Kenya increases while that one of the US remains constant. (4 Marks)
- c. Differentiate between free floating exchange rate system and the pegged exchange rate system (2 marks)
- d. Discuss the advantages of a fixed exchange rate system rate system. (4 Marks)
- e. If you are trading in the forex market and you notice a quote on the screen of your computer terminal, you notice that Stanbic Bank is quoting €0.9827: \$1.00 and Standard Chartered Bank is offering SF1.2606:\$1.00 (where SF represent Swiss Franc). You learn that DTB bank is making a direct market between the Swiss Franc and the euro, with a current €: SF quote of €0.7495:1SF.
 - i. Using the information provided, show that there is an arbitrage opportunity (3 Marks)
 - ii. Assume you have \$5,000,000 and determine what will be your arbitrage profit (5 Marks)

QUESTION 3

- (a) After listening to a press briefing by the Governor of the central bank, you are saddened that the Kenyan government has always suffered a deficit in the current account of the balance of payment.
- (i) Explain three problems that can arise when the current account is in a deficit position **(3 Marks)**
 - (ii) Explain three problems that can arise when the current account is in a surplus position **(3 Marks)**
- (b) Explain the following terms as used in international finance:
- (i) Purchasing power parity theory **(2 Marks)**
 - (ii) Interest rate parity **(2 Marks)**
- (c) MC Ltd. which is a Kenya company has bought goods on credit from a US company and it will be required to pay \$540,000 in 180 days. Since the payment is denoted in a foreign currency, the company want to hedge the transactional exposure that it is exposed to by either using: a forward hedge, a money market hedge or an option hedge. The following information is available to enable in assessing the three alternatives:
- Spot rate of the dollar as of today = Ksh 115 for \$1
 - 180-day forward rate of pound as of today= Ksh 118 for \$1

Interest rates are as follows:

	Kenya	USA
180-day deposit rate	10%	5%
180-day borrowing rate	12%	6.6%

- A call option on pounds that expires in 180 days has an exercise price of Ksh 118 and a premium of Ksh 1.18.
- A put option on pounds that expires in 180 days has an exercise price of Ksh 114 and a premium of Ksh 1.2.

Required:

- i. Assess the amount of money that MC Ltd will pay in Ksh if it uses a forward hedge. **(3 Marks)**
- ii. Assess the amount of money that MC Ltd. will incur in KSh if it uses a money market hedge. **(4 Marks)**
- iii. Assess the maximum amount of money that MC Ltd. will pay in Ksh if it uses an option hedge. **(3 Marks)**

QUESTION 4

- (a) HH LTD (a UK company) will receive \$650,000 in 180 days. It considers using either an option hedge or a swap contract. Its analysts develop the following information, which can be used to assess the alternative hedging techniques.
- Spot rate of the dollar as of today = £0.657 for \$1
 - 180-day forward rate of pound as of today= £0.689 for \$1

Interest rates are as follows:

	UK	USA
180-day deposit rate	6.5%	5%
180-day borrowing rate	7.5%	6%

- A call option on pounds that expires in 180 days has an exercise price of £0.657 and a premium of £0.024.
- A put option on pounds that expires in 180 days has an exercise price of £0.59 and a premium of £0.004.

Required:

- i. If the future exchange rate turns out to be £0.69 for \$1, advise the company on how to go with the option hedge **(3 Marks)**
 - ii. Explain to the company how it can hedge this type of risk using Swap contract hedge. **(3 Marks)**
- (d) Explain what economic exposure in international business management **(2 Marks)**
- (e) Explain two techniques that can be used to manage economic exposure **(3 Marks)**
- (f) A South African company named Madjozi ltd, is considering undertaking a new project in Kenya. This project will require an initial cash outlay of Ksh. 150 million and has no scrap value at the end of the five-year life span of the project. The project will also require an initial working capital of Ksh. 50 million, which will be recovered at the end of the project. The total initial capital will therefore be Ksh. 200 million. The project is expected to generate pre-tax cash inflows of Ksh. 90 million for each of the five years.
- The company will be charged corporate tax in Kenya at a rate of 30%, with depreciation on a straight-line basis being an allowable deduction for tax purposes. Kenyan tax is paid at the **end of each** year in which the taxable profit arise. There is a double taxation agreement between South Africa and Kenya, which means that no South African tax will be payable on the project profits.
- The current R/Ksh spot rate (**direct quote**) is **R 0.145 = 1 Ksh**. Inflation rates are 4% in South Africa and 6% in Kenya. A project of similar risk recently undertaken by Madjozi ltd in South Africa had a required post-tax rate of return of 10%.

Required:

- i. Using the Home currency approach determine the NPV of the Project
(9 Marks)

QUESTION 5

- a. Other than the exchange rate movement, explain two other factors that a company should take into consideration when it is doing international capital budgeting
(4 Marks)
- b. The term Balance of Payment is a popular term and is often mentioned in the news media. The term is however not well understood and is sometime misused. Taking this into consideration explain what the balance of payment and the importance Balance of payment
(7 Marks)
- c. A successful company in Kenya and it therefore wish to establish a subsidiary in a foreign country as part of its expansion plan. As the financial director of the company, you are required to:
 - i. Explain to the management some of the unique agency problems that are likely to arise from the establishment of the subsidiary. (3 Marks)
 - ii. Explain to the management the solution to these agency problems(3 Marks)
- d. One of the theories that explain the reason for international trade is imperfect market theory. Explain the imperfect market theory
(3 Marks)