Strathmore
UNIVERSITY

STRATHMORE BUSINESS SCHOOL

MASTER OF SCIENCE IN DEVELOPMENT FINANCE

END OF SEMESTER EXAMINATION

MDF 8302: FOREIGN DIRECT INVESTMENT

Date: Monday 1st August 2022 **Time: 3** Hours

Instructions

1. This examination consists of **FIVE** questions.
2. Answer **QUESTION ONE** and **ANY OTHER TWO** questions.

Question 1 (30 Marks) (Compulsory)

You are required to answer questions based on the following two case studies:

Case: *Foreign direct investment in china (Enright, 2004)*

a. China is the top foreign direct investment [FDI] destination in the world. The country has a comprehensive policy framework on FDI "the Guiding Directory" that is cleverly designed to yield the greatest impact on the economy. You are required to explain the specific type of FDI that China encourages in order to achieve this objective **[12 Marks]**

b. Explain three reasons why China sought predominantly export-oriented FDI **[6 Marks]**

Case: *Sonata Software Ltd., India: Building Global Competitive Advantage through an International Joint Venture (Hurt and Narapareddy, 2015)*

c. The Sonata-TUI AG joint venture (JV) was a huge success unlike the previous failed attempts at JV with other firms by Sonata. What was unique about this JV that made it a success? **[8 Marks]**

d. "By the late 1990s, clients were shifting to offshoring IT services to companies in other countries such as India". Explain factors that contributed to this **[4 Marks]**

Question 2 (20 Marks)

a. Trade deficit is not necessarily a bad thing for a country if it is analysed from the perspective of foreign direct investment. Explain **[6 Marks]**

   Hint: Capital account

b. The following transactions relates to country X for a given fiscal year

Merchandise exports	$ 470 million
Merchandise imports	$ 330 million
Export of services	$ 265 million
Import of services	$ 310 million
Private transfers to other countries	$ 19 million
Private transfers from other countries	$ 24 million
Official transfers from other countries	$ 10 million

   Required: Prepare current account for Country X **[6 Marks]**

c. From numerous empirical studies, stylized facts have identified the key determinants of FDI. Identify and explain four key determinants of FDI **[8 Marks]**

Question 3 (20 Marks)

a. Explain any three reasons that have impeded the participation of East African countries in the global value chains **[6 Marks]**

b. Cost leadership is one of the strategies a multinational corporation might use to enhance its competitiveness. Identify any eight tactics that might be employed to operationalize this strategy **[8 Marks]**

c. Characteristics of FDI Projects can affect productivity spillovers. Explain **[6 Marks]**

Question 4 (20 Marks)

a. Offshore investing is not something that you hear about in the evening news. However it is a multi-billion dollar industry that has forced most of the world financial institutions to locate offices to off shore jurisdiction such as Isle of Man, Switzerland and the channel / Islands. Explain five reasons that makes offshore investment attractive **[10 Marks]**

b. Foreign multinational corporations have been accused of profit shifting practices hence denying African countries the much-needed tax revenue. With examples explain how this happens **[10 Marks]**

Question 5 (20 Marks)

a. Jambo Ltd a Kenyan firm currently has no existing business in South Africa but is considering establishing a subsidiary there. The following information has been gathered to assess this project:

1. The initial investment required is R50 million in South African Rands for plant and equipment. Given the existing spot rate of Ksh 5 per South African Rand, the initial investment in Kenya shillings is Ksh 250 million.
2. The project will be terminated at the end of Year 3, when the subsidiary will be sold
3. The price, demand, and variable cost of the product in South Africa are as follows:

Year	Price	Demand	Variable cost
1	R 500	40 000 units	R 30
2	R 511	50 000 units	R 35
3	R 530	60 000 units	R 40

4. The fixed costs, such as overhead expenses, are estimated to be R 6 million per year
5. The exchange rate of the South African rand is expected to be R1 = Ksh 5.20 at the end of year 1, R1=Ksh 5.40 at the end of Year 2, and R1=Ksh 5.60 at the end of Year 3.
6. South African government will impose an income tax of 30 percent on income. The Kenyan government will allow a tax credit on the remitted earnings and will not impose any additional taxes
7. All cash flows received by the subsidiary are to be sent to the parent at the end of each year
8. The plant and equipment are depreciated over 10 years using the straight line depreciation method. This means that the annual depreciation will be R5million.
9. In 3 years, the subsidiary is to be sold. ABC Ltd expects to receive R 32 million from the sale. This amount will not be subject to any taxes
10. ABC Ltd requires a 20 percent rate of return on this project.

Required: Using the NPV approach advice if Jambo should undertake this investment

[12 Marks]

b. The most severe country risk is a host government takeover. Explain any four strategies that a multinational may use to manage this risk **[8 Marks]**