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*(Knowledge for Development)*

**KIBABII UNIVERSITY**

**UNIVERSITY EXAMINATIONS**

**2020/2021 ACADEMIC YEAR**

**FOURTH YEAR SECOND SEMESTER**

**MAIN EXAMINATION**

**FOR THE DEGREE OF BACHELOR OF COMMERCE**

**COURSE CODE: BCF 430**

**COURSE TITLE: INTERNATIONAL FINANCE**

**DATE: 12<sup>TH</sup> OCTOBER, 2021      TIME: 9.00AM - 11.00AM**

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**INSTRUCTIONS TO CANDIDATES**

Answer Question One in Section A and Any other TWO (2) Questions in Section B

**TIME: 2 Hours**

## SECTION A

### QUESTION ONE (Compulsory)

- a) Your company, a large global mining enclave, is considering extracting mineral deposits which it owns at the Giant Tapir River in Malaysia. It contains one of the world's largest oil deposits of cobalt and chrome outside the Old Soviet Union. The cost of developing the mine is estimated to be US\$500million.

Required:

- i) Examine what you would consider to be the major source of risk in undertaking the project (8 marks)
  - ii) Indicate how your company would structure its financing in order to reduce such risk (6 marks)
  - iii) Briefly, show how financing would add value to the project (6 marks)
- b) You are a corporate treasurer of a medium sized manufacturing company which trades throughout Europe. At a recent meeting to discuss the company's policy on foreign exchange management, the managing director, a non-accountant made the following statements:
- Statement 1. Translation risk is concerned with the effect of exchange rate changes on financial statements and is mainly an accounting issue. There is no need to hedge this risk unless we are close to our foreign currency borrowing limits.
- Statement 2. Transaction risk can easily be hedged using the forward market although I am inclined either not to hedge at all or to use internal hedging methods as they are cheaper.
- Required:
- i) In respect of statement 1, explain what the managing director means when he says that there is no need to hedge unless the company is close to its foreign borrowing limits. (4 marks)
  - ii) In respect of statement 2, comment on whether the managing director is right to consider not hedging as an appropriate strategy and discuss briefly three internal hedging techniques which the company could consider (6 marks)

**SECTION B**  
**ANSWER ANY TWO QUESTIONS**

**QUESTION TWO**

- a) "Both the forward and future markets serve the same objective of covering the foreign exchange risk."

Required:

To provide what you consider to be the main differences between forward and future markets

(10 marks)

- b) An Indian subsidiary of a UK multinational has a translation exposure of Rs 10 million. The rates are as follows:

Spot: Rs 55.0000/£

One-year forward: 56.3200/ £

A 4 percent depreciation of the rupee is expected.

Required :

Demonstrate how the exchange rate risk can be hedged

(10 marks)

**QUESTION THREE**

- a) XYZ Ltd a global company, wishes to determine the cost of capital it can be use to appraise its foreign investments . The company has provided the following information:

- Risk free rate of returns is 12%
- Systematic risk of foreign project is 1.2
- Required rate of return on market portfolio, consisting of all risky assets is 20%

Required

To estimate the cost of equity capital to be earned on a foreign investment project (8 marks)

- b) What are the factors to consider when choosing between Euromarkets or Domestic markets?

Discuss this from the perspective of a trader

(12 marks)

**QUESTION FOUR**

- a) Discuss the methods available to the company to reduce the effects of restrictions on remittances from a foreign investment centre

(10 marks)

- b) MK Ltd is evaluating an investment in Kwetuland whose currency is kwetu (kw). The spot rate is 15kw/£ and this exchange rate is to apply for the duration of the project. The finance director is convinced that the government of Kwetuland will impose limits on the amount of funds to be permitted for transfer out of the country. The limit the government imposes is a maximum of 30% of the initial cost of the project each year. Any blocked fund will be placed on a deposit account to earn 6% per annum.

The company director has estimated that the cost of capital will be 18% and the expected cash inflow for the period is as shown below :

Year	Cash inflow (kw 000)
1	250
2	200
3	200

If the initial cost of the investment is kw 400,000.

Required

Compute the net present value of the project:

- i) With no remittance restriction (4 marks)
- ii) With restriction (6 marks)

#### QUESTION FIVE

- a) Examine the methods a company would employ in order to achieve international status (8 marks)
- b) Smith, a UK exporter has invoiced a customer in the USA the sum of \$300,000 receivable in one year's time.

He has under consideration two methods of hedging his exchange risk:

- i) By borrowing an appropriate amount now for a year, converting the amount into sterling and repaying the loan out of the eventual receipts.
  - ii) By entering into a 12-month forward exchange contract to sell the \$300,000.
- The sterling-US dollar spot rate is 1.8190-1.8402  
The 12-months forward rate of dollars against the sterling is 1.7703-1.7915  
Interest rates for 12 months are USA 6.5%, UK 9.25%

Required:

To determine the net proceeds in sterling under each alternative and suggest which is the better alternative (12 marks)