UNIVERSITY EXAMINATIONS: 2013/2014

EXAMINATION FOR THE MASTERS OF SCIENCE (MSC) IN COMMERCE

MSF 509 MULTINATIONAL FINANCE (EVENING)

DATE: APRIL, 2014 **TIME: 3 HOURS**

INSTRUCTIONS: Answer Question One and Any Other Three Questions

QUESTION ONE (31 MARKS)

Nike a company headquartered in Beaverton, Oregon is a major force in the sports footwear and fashion industry with annual sales exceeding dollars 12 billion more than half of which now come from outside the United States.

The company has no production facilities in the United States. Rather the company manufactures athletic shoes and garments in such Asian countries as China, Indonesia and Vietnam using subcontractors and sells the products in the US and international markets. In each of those Asian countries where Nike has production facilities the rates of unemployment and underemployment are high. The wage rate is very low compared to the US standards. In addition workers in those countries operate in poor and unhealthy environments and their rights are not well protected. Recently however Nike came under worldwide criticism for its practice of hiring workers for such a low rate of pay and for condoning poor working conditions in host countries.

Initially the company denied the charges and lashed out at critics. But later the company began monitoring the labor practices at its overseas factories and grading the factories in order to improve labor standards.

Required;

a) Do you think the criticism of Nike is fair considering the host countries are in dire need of creating jobs? (4 Marks)

b) Do firms need to consider the so called social corporate responsibility in making multinational investment decisions? (5 Marks)

c) It is argued that strategic motives drive firms to invest abroad and become multinationals. From this case state and explain the reasons that lead to such decisions. (5 Marks)

d) Explain how Nike can manage its foreign currency risk given its diverse operations in many countries. (5 Marks)

e) The capital structure debate was pioneered by the famous greats Franco Modigliani and Merton Miller. Some scholars have referred to their work as the greatest finance article ever written. Moffet, Stonehill and Eiteman in their textbook 'fundamentals of multinational finance' argue that the optimal financial structure needs to be modified by four more variables in order to accommodate the case of the Multinational firm. From the above case and personal experience state and explain the four variables. (12 Marks)

QUESTION TWO

Total Limited a multinational company needs to borrow funds for one year to finance expenditure in Kenya. The following interest rates are available.

	Borrowing rate
Kenya	12%
Tanzania	8%
Uganda	7%

The percentage change in the spot rates of the Tanzanian shilling and the Ugandan shilling over the next year are as follows.

Tanzanian shilling		Ugandan shilling	
Probability	% change in spot rate	Probability	% change in spot rate
10%	5%	20%	6%
90%	2%	80%	1%

a) If Total limited borrows 50% of the funds from the Tanzanian shilling and 50% from the Uganda shilling determine the probability distribution of the effective financing rate of the portfolio. (18 Marks)

b) What is the probability that the company will incur a higher effective financing rate from borrowing this portfolio than from borrowing the Kenya shillings? (5 Marks)

QUESTION THREE

Laingu limited a multinational company with operations in Kenya, Uganda and Tanzania is considering issuing Uganda shillings dominated bond at its present coupon rate of 7%, even though it has no incoming Ugandan shilling cashflows to cover the bond bond payments. It is attracted to the low financing rate since Kenya shilling denominated bonds issued in Kenya would have would have a coupon rate of 12%. Assume that either type of bond would have a four year maturity and could be issued at par value. The company needs to borrow Kenya shillings 20 million or bonds denominated in Uganda shillings with a par value of Uganda shillings 400 million. The spot rate of the Uganda shilling is ksh 0.05. The Company has forecasted the Uganda shillings value at the end of each of the next four years, when coupon payments are to be made.

End of year	Exchange rate of Uganda shilling
1	0.052
2	0.056
3	0.058
4	0.053

Required:

a) Determine the expected annual cost of financing with Ugandan shillings. (15 Marks)

b) Giving concrete reasons state whether the company should issue bonds denominated in Kenya shillings or Ugandan shillings? (8 Marks)

QUESTION FOUR

Marcus limited is based in France has recently imported raw materials from the USA and has been invoiced for US Dollars 240,000 payable in 3 months time.

In addition it has also exported finished goods to Japan and Australia. The Japanese customer has been invoiced for US Dollars 69,000 payable in 3 months time and the Australian customer has been invoiced for Australian Dollars (ASD) 295,000 payable in four months time.

Current spot and forward rates are as follows;

US Dollars / Euro

Spot	0.9830 – 0.9850
3 moths forward	0.9520 – 0.9525

Euro / ASD

Spot	1.8890 – 1.8920
4 moths forward	1.9510 – 1.9540

Current money market rates (pa) are as follows;

USD	10.0% - 12.0%
ASD	14.0% - 16.0%
EURO	11.5% - 13.0%

Show how the company can hedge its exposure to FX risk using :

- The forward markets
- The money markets
- Make a lead payment

And in each case determine which the best hedging technique is. (23 Marks)

QUESTION FIVE

a) Assume that the Tsh exhibits a 6 month interest rate of 20 % per annum while the Ksh exhibits a 6 month interest rate of 15% per annum.

Required;

i) Compute the forward rate premium of the Tsh with respect to the Ksh according to interest rate parity. (3 Marks)

ii) If the current spot rate of the Tsh is Ksh 0.06 compute the six month forward rate of the Tsh with respect to the Ksh. (3 Marks)

iii) Compute the gain from covered interest arbitrage to a Multinational firm with headquarters in Nairobi with ksh 20 million to invest for the six month period. (7 Marks)

b) Explain how a multinational firm manages its tax problem. (3 Marks)

c) Suppose the pound sterling is bid at dollars 1.9724 in New York and the euro is offered at dollars 1.3450 in Frankfurt. At the same time London banks are offering the pound sterling at euros 1.4655.

Required;

Show the steps a Multinational firm would exploit to earn a risk-less profit through a triangular arbitrage. Assume that the firm begins in New York with dollars 3,000,000. (7 Marks)

QUESTION SIX

a) Using a multinational company of your choice review the goals of multinational corporations (MNCs) and conflicts that arise from those goals. (10 Marks)

b) Describe and briefly explain the key theories that justify international business. (8 Marks)

c) Explain the common methods used by multinational corporations to conduct international business. (5 Marks)