JARAMOGI OGINGA ODINGA UNIVERSITY OF SCIENCE AND TECHNOLOGY

(KLC)

MAY – AUGUST 2014 EXAMINATIONS

BACHELOR OF BUSINESS ADMINISTRATION WITH INFORMATION TECHNOLOGY

(FINANCE OPTION)

COURSE NAME: INTERNATIONAL FINANCE

COURSE CODE: ABA 419

INSTRUCTIONS

Answer question one **(compulsory)** and any other two questions

Question one carries 30 marks and all other questions carry 20 marks each

QUESTION ONE (COMPULSORY)

a) The government of Kenya through its Cabinet secretary was planning to raise Sh174 billion through floating of a sovereign bond from Euro currency market. Despite the unfavorable political climate in the country and risks associated with terrorist attacks, the bond was oversubscribed by four times to the tune of Sh700 billion setting the country on a historic feat in the whole of Africa. The government however faces different risks given that different investors have bought the bond from different countries. The government expects the economic multiplier factor created by factors like infrastructure Development, discovery of oil among others will comfortably cover the repayment upon maturity and earn the economy revenue long after the repayment.

Required

i. Discuss any **four** ways in which the government can hedge against currency exchange rate fluctuations since the bond is denominated in Euros**8Mks**

ii. Highlight on any **four**factors which may have led the cabinet secretary to borrow from the foreign currency market rather than within the country**8 Mks**

iii. Discuss any four risks that may be associated with the euro bond **8 Mks**

b) With examples, explain any **two** techniques through which firms attempt to forecast exchange rates **6 Mks**

TOTAL: 30 MARKS

QUESTION TWO

a) Highlight on any four factors to consider before choosing the best investment vehicle for your company **8 Mks**

b) The finance director of Kencom Ltd, a Kenyan based company is thinking of opening a plant in Germany. After thorough analysisof the project by the finance officer, the cost of the project is settled at 10 million DM. after the analysis, the expected inflows are expected as follows.

Year	1	2	3
Cash flows(DM)	10,000,000	9,000,000	9,000,000

Assuming that the current spot rate at the time of evaluation is DM 1= Ksh 50 and the current risk free rate in Kenya is 10 % compared to that in Germany of 6 %. Consider a tax deduction of rate of 2% for every year in Kenya.

The appropriate discount rate for the project is estimated to be 10% which is Kenyan cost of capital for the Germany project.

Required:

c) Advice the finance director on whether to undertake the project or not. (Explain on your decision) **12 Mks**

TOTAL: 20 MARKS

QUESTION THREE

a) "Like the traffic lights in the city, the international monetary system is taken for granted until it begins to malfunction and to disrupt people's daily lives". Robert Solomon.

Required:

Explain the relevance of the quotation and use fundamental exchange rate relationships to demonstrate the efficiency in working of international financial markets **12 Mks**

b) Outline any four factors to be considered by a multinational corporation before deciding on whether to use debt finance or equity finance **8 Mks**

TOTAL: 20 MARKS

QUESTION FOUR

a) Consider that the UK£ spot rate is Ksh 160 and that the British and Kenyan inflation rates are the same. However due to some effects unfavourable economic factors Britain experiences 10% inflation, while Kenya experiences 6% inflation.

Required

Using the theory on purchasing power parity:

i. Determine the percentage change of the exchange rate **4 Mks**

ii. Determine the new direct quoteafter it adjusts to the inflationary changes **4 Mks**

b) Apart from the inflation rates, describe any four economic factors that could have affected the equilibrium exchange rate of the UK£ value with respect to the Kenyan shilling and explain how they affect the exchange rate **12 Mks**

TOTAL: 20 MARKS

QUESTION FIVE

a) Safaricom ltd, a kenya based company has bought cables from Interconnect, a US firm which cost safaricom ltd $ 20 million. The company is supposed to pay for the cables after 6 months' time.Due to the prevailing risks and political instability in Kenya currently which may affect the exchange rates in future. The company finance director wishes to hedge against such risk and is considering using either a forward exchange contract or money market hedge

Annual interest rate and foreign exchange rate are given below:

COUNTRY	BORROWING RATE **1 month**	BORROWING RATE **6 months**	DEPOSIT RATE **1 month**	DEPOSIT RATE **6 months**
KENYA (Ksh)	12.0%	2.25%	8.75%	2.0%
US ($)	8.75%	8.75%	5.0%	5.0%

Spot rate Ksh1: $1.8625 – 1.8635

1 month forward 0.30 – 0.38 cents -discount

3 months forward 1.60 – 1.60 cents -discount

Required

Advise the company on the best method to use and comment briefly **12 Mks**

b) Discuss any four implications of International Capital Asset Pricing Model (ICAPM) **8 Mks**

TOTAL: 20 MARKS