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**W1-2-60-1-6**

JOMO KENYATTA UNIVERSITY OF AGRICULTURE AND TECHNOLOGY

# **UNIVERSITY EXAMINATIONS 2014/2015**

FOURTH YEAR FIRSST SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR OF COMMERCE

**HBF 2401 : INTERNATIONAL FINANCE**

**DATE: APRIL 2015 TIME: 2 HOURS**

**INSTRUCTIONS:**

**ANSWER QUESTION ONE AND ANY OTHER TWO QUESTIONS**

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**QUESTION ONE**

1. The law of comparative advantage apply in practice. However there are certain limitations on how it operates. State these two limitations. [2 marks]
2. State any two advantages of international trade [2 marks]
3. Highlight some of the protectionist measure implemented by a government. [3 marks]
4. What do you understand by a Euro currency deposit. [2 marks]
5. Under the exchange rate system, what is an exchange rate. [2 marks]
6. What are the determinants of exchange rate? [3 marks]
7. What do you understand by international fisher effect? [2 marks]
8. What happens to a country’s cash flow that sets up a subsidiary in a country where it exports? State the net present value formula. [3 marks]
9. Explain the impact of a growing international firm on dividend levels. [5 marks]
10. Highlight factors that affect dividend representation [6 marks]

[total 30 MARKS]

**QUESTION TWO**

1. What are the merits of using a fixed exchange rate. [5 marks]
2. Discuss the factors affecting exchange rate [12 marks]
3. If the direct quote in Deutmark is DM 1=$0.5 while the general rate of interest in kshs. is 6% and the general rate in Germany is 3%.

Required:

Compute percentage change in direct quote and the new exchange rate. [3 marks]

[total 20 marks]

**QUESTION THREE**

ABC Ltd, a UK firm has bought goods from a supplier and must pay $4million

in 3 months. The company’s finance direct wishes to hedge against the foreign

exchange risk and it considering three methods

1. Using foreign exchange contact
2. Using money hedge
3. Using lead payments

Annual interest rates and foreign exchange are give below

US $ UK $

Deposit rate Borrowing rate Deposit rate Borrowing rate

1 Month 7% 10.25% 10.75% 14%

2 months 7% 10.75% 4.0% 14.25%

Spot Rate £1: $1.8625 - $1.8635

One month forward 0.6 – 0.58 cents premium

3 months forward 1.8 – 1.75 cents premium

Advice the company on the best method to use [10 marks]

(b) In what ways are currency options useful to a company [10 marks]

[total 20 marks]

**QUESTION FOUR**

1. Describe the types of Euro currency loans [8 marks]
2. State the ways in which international banks assist multinational corporation. [6 marks]
3. Flagwaver plc is considering whether to establish subsidiary in Slovenia of a cost of ₤20 000 000. The subsidiary will run for four years and the net cash flows from the project are shown below:

Year Net cash flow (€)

1 3 600 000

2 4560 000

3 8 400 000

4 8 480 000

There is a cash holding tax of 10% on remitted profits and the exchange

rate is expected to remain constant at € 1.50/t. at the end of the four year

period the Slovenian government will buy the plant for € 12 000 000.

The latter amount can be repatriated free of withholding taxes. If

discount rate is 15% what is the present value of the project . [6 marks]

**QUESTION FIVE**

1. **ABC**  Ltd, a US firm has been invited to tender for a contract in Blue band with a local currency of Blues (B) The company thinks that the contract should cost ₤1850 000 and it prepared to price the contract at ₤2 million. The exchange rate for the Blue and £ is £1: B2.8The company therefore bids for B 5.6 million. The contract will not be considered until six months. A six month currency option to sell B 5.6 million at an exchange rate of £1:B28 is currently costing £40 000

ABC Ltd can either buy the option or enter into a forward contract of £1:B2.8

Assume that the company fails to win the contract and the spot rate in six

months time is £1:2.5

Advice the company on which alternative is better. [7 marks]

1. The WTO an organization dealing with rates of trade between Nations. What are the aims of this organization [6 marks]
2. Briefly discuss the arguments against protectionism in the international market. [6 marks]

[total 20 marks]