



**FACULTY OF COMMERCE
DEPARTMENT OF FINANCE
BACHELOR OF COMMERCE HONOURS DEGREE IN FINANCE
PART IV – 2ND SEMESTER SUPPLEMENTARY EXAMINATION - AUGUST 2011
INTERNATIONAL FINANCE II [CFI 4202]
TIME ALLOWED: 3 HOURS**

Instructions

1. Attempt any **FOUR** questions
2. Each Question carries a total of **25 marks**.
3. Write neatly and legibly

Question One

- (a) Discuss the internationalization process according to the following theories:
- | | |
|----------------------------------|-----------|
| (i) Life Cycle Theory | [3 marks] |
| (ii) Incremental Theory | [4 marks] |
| (iii) Transaction Cost Theory | [3 marks] |
| (iv) Market Imperfections Theory | [3 marks] |
- (b) Identify and explain **FOUR** strategies for managing country risk for an MNC.
[12 marks]

Total [25 marks]

Question Two

- (a) Identify and explain **THREE** benefits of the Eurocurrency markets from the perspective of a multinational corporation. [8 marks]
- (b) Discuss the circumstances under which the capital expenditure of a foreign subsidiary might have a positive net present value in local currency terms but be unprofitable from the parent firm perspective. [8 marks]

- (c) Discuss the concept of real options in international capital budgeting. In your answer, highlight two such real options. [9 marks]

Total [25 marks]

Question Three

- (a) Discuss the difference between performing the capital budgeting analysis from the parent firm's perspective as opposed to the project perspective. [6 marks]
- (b) Discuss the effect of market segmentation on the capital structure of foreign subsidiaries of an MNC. [8 marks]
- (c) Explain how an MNC may use its financing decisions to manage the following risks:
- (i) Confiscation risk [4 marks]
 - (ii) Foreign exchange risk [3 marks]
 - (iii) Currency Inconvertibility risk [4 marks]

Total [25 marks]

Question Four

- (a) Salt Lakes, a US-based MNC, owns Cashel Orchard plantations in Zimbabwe and it is worried that the Zimbabwean government will expropriate its plantations in the next 12 months. The Zimbabwean government has however promised to compensate Salt lakes to the tune of US\$10m in the event of expropriation paid at the end of the year. If expropriation fails to occur within the 12 months, it will not occur in the foreseeable future. At the end of the year, the plantation will be worth US\$30m. Mr.Gambaguru, a Zimbabwean businessman, has offered Salt Lakes \$12,8m for the plantation now.

Required

- (i) Using a discount rate of 22%, calculate the probability of expropriation at which Salt Lakes is indifferent between selling now and holding onto its plantation. [6 marks]
- (ii) Interpret the results in (i) above. [3 marks]

(b) Consider an MNC in the US that is appraising a project in South Africa. The South African Treasury can borrow USD in the Eurobond market at a sovereign spread of 2%. The US Treasury can borrow at 5% p.a. The credit spread for the MNC is 3%. Assuming that the risk on the South African project is the same as the average investment undertaken by the MNC, calculate the risk-adjusted cost of debt for the South African project. [4 marks]

(c) You are further given that the equity beta of the MNC in (b) above is 0.9, the South Africa-to-US country beta is 0.6, and the equity risk premium required by a US investor on South African investments is 6%.

Calculate:

- (i) The offshore beta for the MNC [3 marks]
- (ii) The adjusted cost of equity for the MNC [5 marks]
- (iii) The adjusted weighted average cost of capital assuming a target debt ratio of 40% and a marginal tax rate of 30%. [4 marks]

Total [25 marks]

Question Five

(a) Outline the fundamental steps in international cash management. [8 marks]

(b) Discuss the benefit of the following international working capital management strategies:

- (i) Cash pooling [3 marks]
- (ii) Payment netting [3 marks]

(c) Explain **THREE** potential problems in funds repositioning. [6 marks]

(d) A US-based MNC is considering whether to borrow USD in the local market or to borrow ZAR in the South African market. The USD borrowing rate is 8% p.a while the ZAR rate is 12% p.a. The South African rand is expected to depreciate by 3.5% against the USD in a year. Recommend the best borrowing option for the MNC. [5 marks]

Total [25 marks]