<u>Examples of the possible structure of examination questions. Please, NOTE that these are NOT examination questions, but rather a guide to how questions could possibly be structured.</u>

SECTION A MULTIPLE CHOICE QUESTIONS(20 MARKS)

Question 1

Which of the following best describes globalisation?

1. A process through which economic and political barriers are removed between nations.
2. A process through which economic and social barriers are removed between nations.
3. A process through which all forms of artificial barriers are removed between nations.
4. A process through which political and social barriers are removed between nations.

Question 2

Which one of the following options is **NOT** a motivation for embracing globalisation?

1. Globalisation enhances the manufacturing capability of developing nations.
2. Globalisation results in the more efficient utilisation of economic resources.
3. Globalisation leads to lower prices for consumer goods and services.
4. Globalisation globally increases per capita income in equal proportion.

Question 3

Which one of the following plays an important role in influencing international business operations?

1. The inequality in the application of global trade regulations by the WTO.
2. The increasing measure of regional integration across the world.
3. The increasing lack of competitiveness of global businesses.
4. The positive impact of trade diversion within the EU.

Question 4

The increasing interdependence of nations has furthered the need for every business to pay adequate attention to the macroeconomic issues around the world. Which of the following is regarded as an external environmental risk?

1. Managers' inability to forestall labour disputes and unrest in the host nation.
2. The abolition of import and export controls by the host government.
3. Stable macroeconomic policies in the host nation.
4. Political interventions such as government takeovers, nationalisation of industries and expropriation of private property in the home country.

Question 5

Which one of the following best describes Tariffs?

1. They are instruments used by governments to generate revenue or to discourage the importation of certain goods.
2. They are administrative bottlenecks established by governments to generate revenue or to discourage the importation of certain goods.
3. They are instruments used by governments to widen the choices of goods available to consumers.
4. They are administrative bottlenecks established by governments to discourage special interest privileges.

Question 6

Religion generally influences the social and business environments in some important ways. Which of the following options best describes the role of religion on global business?

1. In every society, religion generally militates against career opportunity of female workers.
2. Religions generally limit the use of personal inclinations and initiatives at the workplace.
3. Religion places constraints on the roles of individuals, groups and businesses as a member of the society.
4. Major religious holidays generally reduce the productive hours of adherents, thereby resulting in corporate losses.

Question 7

Which of the following measures more accurately describes the cost of living in a country as informed by the country's level of economic development and growth?

1. The Gross National Product (GNP).
2. The Purchasing Power Parity (PPP).
3. The Gross Domestic Product (GDP).
4. The Gross National Income (GNI).

Question 8

Regional trade blocks are associations of nations at a governmental level that promotes trade within the block and defend its members against global competition. Which of the following principles is a criterion for a successful regional trade bloc arrangement?

1. Geographical proximity of member nations.
2. Availability of equal natural resources among member nations.
3. Equal economic growth in member nations.
4. Trade diversion within the trade bloc.

Question 9

In order to achieve economic growth, a country confronted with a balance of payment deficit can adopt one of the following measures:

1. Encourage the inflow of foreign capital.
2. Discourage exports.
3. Discourage foreign direct investment.
4. Encourage the inflow of foreign manufactures.

Question 10

Which one of the following options best describes the concept of purchasing power parity?

1. The relative ability of one currency to buy the same level of goods and services in every country.
2. The relative ability of two currencies to buy the same level of goods and services in the two countries under consideration.
3. The relative ability of two currencies to buy the same level of goods but not services in the two countries under consideration.
4. The relative ability of two currencies to buy the same level of services but not goods in the two countries under consideration.

Question 11

Which of the following is a motivation for a country to move from a command to a market economy?

1. New opportunities to protect the home economy from competitive pressures from foreign investors.
2. New opportunities for the country to achieve information and knowledge transfer.
3. New opportunities for the country to attain cross-cultural literacy
4. New opportunities for foreign investors to exploit the fragility of the economy to their own advantage.

Question 12

Inflation is defined as a sustained increase in the general level of prices for goods and services in an economy over a period of time, usually a year. Which one of the following is NOT an effect of inflation?

1. High inflation rates lead to high interest rates.
2. High inflation rates can reduce domestic demand for goods and services.
3. High inflation rates weaken the purchasing power of the local currency.
4. High inflation rates relatively reduce the pricing of imported goods.

Question 13

High interest rates have been observed to reduce consumer appetite for credit consumption. As a home bond payer, which of the following measures of inflation components should be of peculiar interest to you?

1. The Consumer Price Index (CPI) headline inflation rate.
2. The Production Price Index (PPI).
3. The Consumer Price Index excluding interest rates on mortgage bonds (CPIX).
4. The CPI food and consumables.

Question 14

A balance of payment (BOP) is a financial record of transactions conducted by a country within a period, usually a year. Such transactions include payments for the country's exports and imports of goods, services, and financial capital, as well as financial transfers. Which of the following best describes the use of BOP to a manager in global business?

1. The BOP warns international firms of policy changes in a foreign country that could affect the business climate.
2. The BOP Identifies increased risk of borrowing investment capital from the capital market of specific countries.
3. An increase in BOP indicates that a country's currency will depreciate in the future.
4. A decrease in BOP suggests that the country's foreign reserve is dwindling, thereby requiring foreign aid.

Question 15

A global financial manager is expected to perform one of the following traditional functions:

1. Maintain an optimum capital structure for the firm.
2. Maintain equality of current assets and current liability.
3. Adopt an aggressive capital budgeting approach.
4. Mitigate the effects of inflation on trade creditors.

Question 16

"Although there has been increased interest, on the part of Chinese businessmen in doing business in African countries, they still find it very difficult. One of the reasons why they find it practically difficult to do business in South Africa is that Chinese businesses struggle to understand black economic empowerment policy, which means it must sell equity to a local equity partner who does not have the money to pay for it". This type of constraint typifies the ....risk pertaining to international business.

1 political
2 legal
3 totalitarian
4 technological

Question 17

The following is one of the reasons why multinational enterprises (MNEs) adopt transfer pricing:

1. To reduce tax liabilities payable to the home country.
2. To reduce the effect of inflation on the company's consolidated accounts.
3. To increase the excise duties payable to the host country.
4. To increase intra-subsidiary trading between the subsidiaries of the firm.

Question 18

To achieve shareholder wealth maximisation, an international financial manager is expected to effectively manage the cash flow of the organisation, invest wisely, and minimise foreign exchange risks. Which of the following motives best describes the cash and liquidity levels of an international firm?

1. The need to hold cash at a safety margin to serve as a financial reserve.
2. The need to hold excess cash in order to acquire as much assets as possible.
3. The need to hold marginal cash in order to offset petty cash vouchers.
4. The need to hold cash as a safety net in case of cash scarcity in the country.

Question 19

The growing volatility in the functioning of global financial institutions has further widened the uncertainties that characterises international business operations. Which of the following is **NOT** a strategy and tactic for managing foreign exchange risks?

1. Forward exchange contracts.
2. Currency swaps
3. Backward exchange contracts
4. Currency options

Question 20

The following are all very desirable benefits of the globalisation process, except:

1 Globalisation improves the overall competitiveness of nations.
2 Globalisation results in the more efficient utilisation of regional resources.
3 Globalisation increases the technological and economic development of countries.

4 Globalisation leads to lower prices for goods and services.
5 Globalisation increases consumer income.

SECTION B

- Answer **ANY TWO** of the following three questions in your examination answer book.
- Indicate the numbers of the questions that you answered clearly and correctly in your examination answer book.
- Also indicate the number of questions answered on the **COVER** of the booklet.

QUESTION B1

B1.1 Briefly discuss the main approaches that could be adopted to view globalisation. [10 marks]

Possible approach (NOT A PRESCRIPTION):

Chapter one of the prescribed book contain materials on the various approaches to look at globalisation, namely academic, sociological and economical. 1 identifies the following four main forces that drive globalisation, namely political, economic, social and technological forces. The scholarly approach to understanding the waves of globalisation began with the historical appraisal of its architect, and droves the discourse into the realities of our world today (the contemporary reality). From sociological perspective, globalisation was seen as an increasing attempt to blur global divides on cultural and social-interactive platforms. The author then factored political independence and economic growth into the discussion, within the purview of the effects that cultural integration would have on free flow of goods and services, as well as human capital across global geography. This is covered on pages 5 to 7 of the prescribed book. The discourse also covers the intricacies of foreign expansion of early multinational corporations, especially in Africa.

Question B.1.2: Fully justify the use of non-tariff barriers as an instrument by governments to regulate free trade. [15 marks]

Suggested answer:

Modern economists generally support free trade because it is seen as the best way of ensuring economic growth worldwide. However, there are also opponents of free trade who favour protectionist policies based on trade barriers as the best way of protecting the economic welfare of individual countries. Apart from the argument of protecting infant or growing industries, those who favour protectionist policies often base their arguments on non-economic factors which include political, social, moral and ethical issues.

Non-tariff barriers to trade (NTBs) are trade barriers that restrict imports but are not in the usual form of a tariff. Some common examples of NTBs are anti-dumping measures and countervailing duties. NTBs are usually administrative bureaucracy and red tapes that hinder the free movement of goods across international borders. It is worth noting that the flow of goods which are tariff-free or duty-free may still be restricted by imposing NTBs, and that NTBs are less easy to detect than tariff barriers.

Governments however justify their application of NTBs on various grounds. Prominent among these arguments are protection of domestic job, protection of infant industries, protection of consumers against opportunistic behaviour of importers/foreign manufacturers, to achieve a favourable balance of payment regime, as a mechanism for trade remedy, as a retaliation measure, for the sake of national security, and to achieve domestic food security.

More information can be sourced from pages 196 to 207 of the prescribed book.

Question B2.1 Discuss and evaluate the key issues and environmental forces that have a direct impact on a company's understanding of the international business environment. [8 marks]

Suggested answer:

The international business environment is always very complex and volatile. The increasing global competitiveness of firms as well as the converging tastes of consumers across the globe further exacerbates its relevance and potential impact on any global firm. It is thus suggested that every manager in the global business context must understand the dynamics of the international business environment. Notable among issues and environmental forces that impact on a company's understanding of the international business environment are as follows:

- Political forces.
- Economic forces.
- Social forces.
- Technical/ technological forces.
- Employment practises.
- Human rights issues.
- Environmental pollution/ global warming.
- Prevailing corruption.
- Moral/ ethical issues.

Question B2.2 Discuss and evaluate the various foreign exchange exposures that are peculiar to international business operation. [9 marks]

Suggested answer:

Exposures are generally regarded as measures of foreign exchange risks that managers of multinational organisations have to contend with and manage continuously. Three basic exposures have been identified namely, transaction, translation and economic exposures.

Transaction exposure measures the degree to which the value of anticipated future cash transactions can be affected by exchange rate fluctuations. More specifically, it measures the potential gains or losses on the future settlement of a company's outstanding financial obligations that are denominated in a foreign currency. These financial obligations include account receivables and transactional debts.

Translation exposure measures the degree to which the consolidated financial statement of a multinational enterprise is susceptible to exchange rate fluctuations. This is sometimes referred to as accounting exposure. This kind of exposure arises because the parent company must consolidate the financial statement of all its foreign subsidiaries into a single corporate financial statement. Given that the financial statements of foreign subsidiaries are prepared using the host country currency denominations, the need to 'translate' these financial statements into the home country's currency denomination hereby arises. The process of 'translating' the financial statements from one currency to another brings about losses or gains depending on the effects of fluctuation on either of these currencies.

Economic exposure measures the degree to which a firm's present value of future cash flows can be influenced by exchange rate fluctuations. In essence, the present value of a firm's cash flows can be affected by an unexpected change in exchange rates. It is noteworthy that economic exposures could delve a devastating blow to a firm's operational success; far more compared to either transaction or translation exposures. This is because it is more long-term orientated and any meaningful swing in exchange rates could adversely affect the firm's cash flows. A major problem that is unique to economic exposure is that the cause or potential causes of either beneficial or adverse future trends are normally not/ rarely readily apparent before the event unfolds.

More information can be found on pages 174 to 175 of the prescribed book.

Question B2.3 Explain what transfer pricing is and discuss its advantages? [8 marks]

Suggested answer:

Transfer pricing refers to the pricing of contributions (assets: tangible and intangible, services, and funds) transferred within the foreign subsidiaries of an organisation. For example, goods from the production division may be sold to the marketing division, or goods from a parent company may be sold to a foreign subsidiary. Since the prices are set within an organisation (i.e. internally controlled), the typical market mechanisms that establish prices for such transactions between third parties may not apply. As a result, the choice of the transfer price does affect the allocation of the total profit among the parts/ subsidiaries of the company. This is a major concern for fiscal authorities who worry that multinational entities may set transfer prices on cross-border transactions to reduce taxable profits in their jurisdiction. This has led to the rise of transfer pricing regulations and enforcement, making transfer pricing a major tax compliance issue for multinational companies.

Its main advantages for companies include:

1. Reducing the firm's tax liability by moving profits/funds away from a country with a high tax rate to one with a low tax rate
2. Moving funds away from a country where a currency devaluation is expected, to a more stable economy in order to reduce the firm's foreign exchange exposure
3. Moving funds from subsidiaries to a parent company or to a tax haven to increase corporate profits
4. To reduce the import and excise duties to be paid especially ad valorem taxes/duties.

Further information can be found on pages 164 to 166 of the prescribed book.

Question B3.1 In detail, comment on the importance of purchasing power parity (PPP) in measuring the economic growth of a country. [10 marks]

Suggested answer:

Purchasing power parity (PPP) is a theory which states that exchange rates between currencies are in equilibrium when their purchasing power is the same in each of the two countries. This means that the exchange rate between two countries should equal the ratio of the two countries' price level of a fixed basket of goods and services. When a country's domestic price level is increasing (i.e., a country experiences inflation), that country's exchange rate must depreciated in order to return to PPP. The basis for PPP is the "law of one price". In the absence of transportation and other transaction costs, competitive markets will equalise the price of an identical good in two countries when the prices are expressed in the same currency.

For example, a particular TV set that sells for US $500 in South Africa should cost US $500 in Namibia when the exchange rate between South Africa and

Namibia is 1.00 ZAR/NAD. If the price of the TV in South Africa was only US $450, consumers in Namibia would prefer buying the TV set in South Africa. If this process (called "arbitrage") is carried out at a large scale, the Namibian consumers buying South African goods will bid up the value of the ZAR, thus making South African goods costlier to them. This process continues until the goods have again the same price. There are three caveats with this law of one price:

(1) As mentioned above, transportation costs, barriers to trade, and other transaction costs, can be significant.

(2) There must be competitive markets for the goods and services in both countries.

(3) The law of one price only applies to tradable goods; immobile goods such as houses, and many services that are local, are of course not traded between countries.

More information can be found on pages 134 to 135 of the prescribed book.

B3.2 Indicate, as the Europe-Regional financial manager of BMW, what the applicable strategies are to manage the foreign exchange risks that currently threaten the European Union? [10 marks]

Exposures are generally regarded as measures of foreign exchange risks that managers of multinational organisations have to contend with and manage continuously. Three basic exposures have been identified namely, transaction, translation and economic exposures.

First, transaction exposure measures the potential gains or losses on the future settlement of a company's outstanding financial obligations that are denominated in a foreign currency. These financial obligations include account receivables and transactional debts. Second, translation exposure measures the degree to which the consolidated financial statement of a multinational enterprise is susceptible to exchange rate fluctuations. This is sometimes referred to as accounting exposure. This kind of exposure arises because the parent company must consolidate the financial statement of all its foreign subsidiaries into a single corporate financial statement. The third kind of financial exposure is the economic exposure. It measures the degree to which a firm's present value of future cash flows can be influenced by exchange rate fluctuations. It is noteworthy that economic exposures could delve a devastating blow to a firm's operational success; far more compared to either transaction or translation exposures. A major problem that is unique to economic exposure is that the cause or potential causes of either beneficial or adverse future trends are normally not/ rarely readily apparent before the event unfolds.

Evidence suggests that the European Union has been affected in recent years, by all the forms of financial exposures. Transaction and translation exposures can be managed as follows:

1 Operating financial strategies – this is intended to minimise the effects of changing exchange rates on the local firm's profitability. In economies with high inflation, subsidiaries in such economies are expected to adopt a set of approaches. The first set of such approaches are as follows:

   a. Collect their debts as quickly as possible

   b. Concentrate and encourage cash sales relative to credit sales

   c. Delay as far as possible, paying obligations denominated in local currency

   d. Pay all debts that are denominated in foreign (strong) currencies as quickly as possible

   e. Buy fixed assets that could appreciate in value to take advantage of the inflationary period.

2 Other approaches are:

   a. lead strategy, which involves collecting debts denominated in foreign currencies before they are due. This is done to forestall an envisaged depreciation of foreign currency; and lag strategies involve delaying the collection of foreign currency denominated debt if that foreign currency is expected to appreciate further in future.

3 Hedging (forward exchange contracts, currency swaps, and currency options) can as well be used.

To reduce economic exposures, some strategic choices will have to be made. These choices largely lie outside the domain of the organisation. Some of the possible strategies that could be applied to reduce economic exposures include: taking location specific advantages by dispersing the operational facilities of the business across geophysics. Close monitoring of interest and inflation rates, monitoring of the trend in the purchasing power parity of the host countries, the performance of balance of payment, the changes in cost structure of the firm as well as the labour productivity index of the economies in which the firm invests.

Further material on this question can be found on pages 136 to 140 of the prescribed book.

B3.3 Explain what transfer pricing is, and discuss its advantages? [5 marks]

In every international business setting, the goal of multinational financial manager is the maximisation of the MNE's wealth. As such, the objectives of multinational financial management include the effective management of the firm's global cash flows, its foreign exchange risk, its investments by means of fundamental capital budgeting approaches, its capital structure and leveraging of efficient financing fostered by financial information disclosure. Although the responsibility for these activities derives from the parent company in the home country, the implications of such activities and responsibilities permeate the entire MNE, including foreign subsidiaries in remote locations. There is documented evidence to suggest that MNEs transfer goods and services between the parent company and foreign subsidiaries, as well as between foreign subsidiaries individually. By so doing, the price at which these input materials are moved (transfer price) could be manipulated to evade tax. The practical application of this process is well documented in the prescribed book.

Further material can be found on pages 164 to 166 of the prescribed book.

In addition: (Not part of examination structure – simply a possible way to construct a question):

While it is generally acknowledged that the most suitable way of ensuring worldwide economic growth in the long term is through free international trade, there may be certain arguments in favour of government intervention in free trade.

Required:

Briefly discuss three arguments in favour of government intervention in this regard. [5 marks]

The main antagonism of governments to free trade appears to stem from political, economic and social considerations. Governments often argue in favour of trade restriction from the perspectives of job/infant industry protection, protection of consumers, protection of foreign exchange reserves as well as food and national securities.

More information can be found on pages 206-207 of the prescribed book.