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KIRIRI WOMENS' UNIVERSITY OF SCIENCE AND TECHNOLOGY
UNIVERSITY EXAMINATION, 2023/2024 ACADEMIC YEAR
THIRD YEAR, FIRST SEMESTER EXAMINATION
FOR THE DEGREE OF BACHELOR OF BUSINESS AND INFORMATION
TECHNOLOGY

Date: 8th December, 2023
Time: 11.30am –1.30pm

KBA 2307 - INTERNATIONAL PAYMENTS

INSTRUCTIONS TO CANDIDATES

ANSWER QUESTION ONE (COMPULSORY) AND ANY OTHER TWO QUESTIONS

QUESTION ONE (30 MARKS)

CASE STUDY

Randy Bozarth loosened his grip on the tiller of his sail boat and let the bow turn slowly into the breeze. Soon the craft nosed into the wind and was virtually dead in the water giving Randy time to think about what had been troubling him for days now. If only he had taken an international finance course rather than wasting his time on “fun” electives when in college. But that was in the past and if he had learned anything so far in life it was you cannot change the past. Randy had relocated from the Chesapeake Bay area to the west coast of Mexico a couple of years earlier to be able to sail more and also to experience a different culture. So far, he was quite happy with his decision although life ‘south of the border’ did present some unique challenges. Most of the challenges came from his housing arrangements. Upon moving south, he decided he would forgo living in a single-family dwelling and instead opt for a condominium. There were several condo complexes to choose from and most were owned predominately by Canadians, U.S. citizens, and Europeans. Randy chose Bahia Mar Condominiums as his home and in general was very satisfied with his choice.

Given Randy’s educational background (B.S. in accounting) and years spent as a hospital controller it was no surprise that he was called upon by his neighbours to assist in the governance of the homeowner’s association (HOA). With some reluctance he had allowed himself to be elected treasurer of the Bahia Mar HOA’s Board of Directors last year. This means that he is obligated to review the quarterly financial statements prepared by the management of the HOA. Additionally, he is responsible for presenting the proposed budget for the upcoming year to the annual meeting of all 150 condo owners. It is the budget that is troubling him. The HOA is responsible for building and grounds maintenance, security, maid service (if desired), as well as general administration of the HOA which includes paying taxes, utilities, billing owners, etc. Virtually all costs incurred are denominated in pesos. The current year’s budgeted expenditures are 5,250,000 pesos. Approximately two-thirds of the budget is comprised of salaries for various HOA employees.

The budgeting process is largely driven by the expenditures requested by management. Once those have been justified and agreed upon by the Board of Directors of the HOA, management converts the budget into U.S. dollars. The budgeted expenditures amount is then divided by 150, the number of condominiums, to determine the annual condominium fees. The resulting annual fee is then divided by four as homeowner fees are paid quarterly on the first day of each quarter. Since most condo owners' primary residences are in the U.S. it was decided that condo fees would be denominated in U.S. dollars rather than the local currency. During the last few years management used an exchange rate of 10.5 pesos to the U.S. dollar to convert the peso denominated budget into dollars. Actual exchange rates fluctuated between 9.9 and 13.9 pesos per U.S. dollar during that period. The manager of the HOA is insisting on utilizing the same conversion factor as in the past years. His arguments range from "consistency" to "no one can predict the future". Randy is uncomfortable with this approach. He takes his fiduciary responsibilities seriously and while on his watch as treasurer he wants the budgeting process accomplished in a professional manner. As the budgeting process moves forward Randy knows he must decide how he wants the currency translation to be handled. He will also need to provide a coherent argument for his position and draft a memo for the HOA's Board and manager. As Randy contemplates these exchange rate issues, he notices a squall building rapidly a few miles to the west and moving his way. Apparently, it's time to make some decisions both financial and navigational.

Having read the case study above, you are required to:

- a) Assuming Mr. Bozarth would prefer to use external sources for an exchange rate, how would you suggest a rate for converting next year's budget from pesos to U.S. dollars be determined? (6 marks)
- b) What alternate strategies might Mr. Bozarth propose to the Board for managing foreign exchange risk? (10 marks)
- c) What are the advantages for the owners and the HOA manager of using the advantages of fixed exchange rate as compared to the 10.5 pesos per U.S. dollar rate used in prior years' budgeting process? (6 marks)
- d) How might this influence the owners' and managers preferences regarding the choice of exchange rate for next year's budget? (4 marks)
- e) How will foreign exchange transactions be settled between international banks settled in Mexico and U.S.? (4 marks)

QUESTION TWO (20 MARKS)

- a) Advance payment is the most secure method of trading for exporters and, consequently the least attractive for importers. Discuss the reasons regarding the utilization of advance payment. (10 marks)
- b) To a large extent, payment methods in international trade are similar to those in domestic business. However, due to the added risks and complexities involved in cross-boarder transactions, certain terms are more often seen in international trade. Discuss the commonly used terms of payment. (10 marks)

QUESTION THREE (20 MARKS)

- a) Discuss the key issues in international payments. (10 marks)
- b) Explain the issues and concerns of both the buyer and seller in the international trade. (10 marks)

QUESTION FOUR (20 MARKS)

- a) There are arguments for and against the alternative exchange rate regimes.
- i) List the advantages of the flexible exchange rate regime. (4 marks)
 - ii) Criticize the flexible exchange rate regime from the viewpoint of the proponents of the fixed exchange rate regime. (4 marks)
 - iii) Rebut the above criticism from the viewpoint of the proponents of the flexible exchange rate regime. (4 marks)
- b) Where payment under a letter of credit is arranged, four stages can be distinguished. Explain. (8 marks)

QUESTION FIVE(20 MARKS)

- a) ‘Your primary objective will be to create a written agreement that clearly states the rights and responsibilities of both parties to the transaction’. Discuss the basic contract provisions. (10 marks)
- b) There are a number of ways in which the exporter can manage the financial pressures inherent in export sales. Explain. (10 marks)