Roll No. ____________ Enrollment No. ____________

KADI SARVA VISHWAVIDYALAYA, GANDHINAGAR

MBA, Semester - III Examination, December 2013

International Financial Management (FS 301)

Date: 30/12/2013 Total Marks: 40% Duration: 2 Hours 30 Minutes

Instructions:

1. Write precise answer with suitable examples.
2. Make assumptions wherever necessary in your paper and state clearly
3. Figure to the right indicates weightage.

Q1	A	Which are the paths accessible for a company to enter in the international business.	4%
	B	Discuss in brief the factors affecting international trade.	4%
		OR	
	B	Today you notice the following exchange rate quotations: (a) 1$ = 3.00 Argentine Pesos and (b) 1 Argentine Peso = 0.50 CAD. You need to purchase 100,000 CAD with U.S. Dollars. How many U.S. Dollars will you need for your purchase?	4%
Q2	A	If the Asian countries experience a decline in economic growth (and experience a decline in inflation and in interest rate as a result), how will their currency values, with respect to US dollar, be affected?	4%
	B	Mike Suerth sold a call option on Canadian dollars for $.01 per unit. The strike price was $.76, and the spot rate at the time the option was exercised was $.82. Assume Mike did not obtain Canadian dollars until the option was exercised. Also assume that there are 50,000 units in a Canadian dollar option. What was Mike's net profit on the call option?	4%
		OR	
Q2	A	Government can use direct and indirect intervention to control the currency exchange rate. Which method do you suggest to the Reserve Bank of India to control the currency exchange rate? Why?	4%
	B	You go to a bank and are given these quotes: You can buy a euro for 14 pesos. The bank will pay you 13 pesos for a euro. You can buy a U.S. dollar for .9 euros. The bank will pay you .8 Euros for a U.S. dollar. You can buy a U.S. dollar for 10 pesos. The bank will pay you 9 pesos for a U.S. dollar. You have $1,000. Can you use triangular arbitrage to generate a profit? If so, explain the order of the transactions that you would execute, and the profit that you would earn. If you cannot earn a profit from triangular arbitrage, explain why?	4%
Q3	A	You, being CFO of a U.S. based MNC, need to forecast the cash-flow for the next six months. The cash in-flow and out-flow of your Indian subsidiary always change due to regular fluctuations in the exchange rates. By keeping this in mind, discuss the tools that are available with you to forecast the foreign exchange rate.	4%

B As of today, assume the following information is available: 4%

	U.S.	Mexico
Real rate of interest required by investors	2%	2%
Nominal interest rate	11%	15%
Spot rate	—	\$0.20
One year forward rate	—	\$0.19

a. Use the forward rate to forecast the percentage change in the Mexican peso over the next year.

b. Use the differential in expected inflation to forecast the percentage change in the Mexican peso over the next year.

c. Use the spot rate to forecast the percentage change in the Mexican peso over the next year.

OR

Q3 A Compare and contrast transaction exposure and economic exposure. Why would an MNC consider examining only its "net" cash flows in each currency when assessing its transaction exposure? 4%

B Assume that Suffolk Co. negotiated a forward contract to purchase 200,000 British pounds in 90 days. The 90-day forward rate was \$1.40 per British pound. The pounds to be purchased were to be used to purchase British supplies. On the day the pounds were delivered in accordance with the forward contract, the spot rate of the British pound was \$1.44. What was the real cost of hedging the payables for this U.S. firm? 4%

Q4 A Which are the reasons that motivate the MNCs for direct foreign investment? 4%

B What is letter of credit? Explain the documentary credit procedure for letter of credit in detail. 4%

OR

Q4 A Being a CEO of an Indian company, you are looking for new markets for the expansion of your firm. Which techniques you will use to assess the risk of the country that you selected to enter? Discuss in detail. 4%

B Mr. Black, CFO of an U.S. based MNC is accessing the long term financing options for its subsidiary in Egypt. How can Mr. black will be able to reduce the exchange rate risk involve in the long term financing options. 4%

Q5 Read the case given in the next page and answer the following questions: 8%

Blades Inc.,

Blades, Inc. has been exporting to Thailand since its decision to supplement its declining U.S. sales by exporting there. Furthermore, Blades has recently begun exporting to a retailer in the United Kingdom. The supplier of the components needed by Blades for roller blade production (such as rubber and plastic) are located in the United States and Thailand. Blades decided to use Thai suppliers for rubber and plastic components needed to manufacture roller blades because of cost and quality considerations. All of Blades' exports and imports are denominated in respective foreign currency, for example, Blades pays for the Thai imports in Baht.

The decision to export to Thailand was supported by the fact that Thailand had been one of the world's fastest growing economies in recent years. Furthermore, Blades found an importer in Thailand that was willing to commit itself to the annual purchase of 180,000 pairs of Blades' Speedos, which are among the highest quality roller blades in the world. The commitment began last year and will last another two years, at which time it may be renewed by the two parties. Due to this commitment Blades is selling its roller blades for 4594 Baht per pair (apporx. $100 at current exchange rate) instead of the usual $120 per pair. Although this price represents a substantial discount from the regular price for a pair of Speedo blades, it still constitutes a considerable markup above cost. Because importers in other Asian countries were not willing to make this type of commitment, this was a decisive factor in the choice of Thailand for exporting purposes. Although Ben Holt, Blades' CFO, believes the sports product market in Asia has very high future growth potential, Blades has recently begun exporting to Jogs, Ltd., a British retailer. Jogs has committed itself to purchase 200,000 pairs of Speedos annually for a fixed price of £80 per pair.

For the coming year, Blades expects to import rubber and plastic components from Thailand sufficient to manufacture 80,000 pairs of Speedos, at a cost of approximately 3,000 baht per pair of Speedos.

You, as Blades' financial analyst, have pointed out Ben Holt that recent events in Asia have fundamentally affected the economic condition of Asian countries, including Thailand. For example, you have pointed out that the high level of consumer spending on leisure products such as roller blades has declined considerably. Thus, the Thai retailer may not renew its commitment with Blades in 2 years. Furthermore, you are worried that the current economic conditions in Thailand may lead to a substantial depreciation of the Thai baht, which would affect Blades negatively.

Despite recent developments, however, Ben Holt remains optimistic; he is convinced that Southeast Asia will exhibit high potential for growth when the impact of recent events in Asia subsides. Consequently, Holt has no doubt that the Thai customer will renew its commitment for another 3 years when the current agreement terminates. In your opinion, Holt is not considering all the factors that might directly or indirectly affect Blades. Moreover, you are worried that if the Thai importer renews its commitment for another 3 years. Infact you believe that a renewal of the existing agreement with the Thai customer may affect Blades negatively due to the high level of inflation in Thailand.

Since Holt is interesting in your opinion and wants to assess Blades' economic exposure in Thailand, he asked you to conduct an analysis of the impact of the value of the baht on next year's earning to assess Blades' economic exposure. You have gathered the following information:

- Blades has forecasted sales in the United States of 520,000 pairs of Speedos at regular prices; exports to Thailand of 180,000 pairs of Speedos for 4,594 baht a pair; and exports to the United Kingdom of 200,000 pairs of Speedos for £80 per pair.

- Cost of goods sold for 80,000 pairs of Speedos are incurred in Thailand; the remainder is incurred in the United States, where the cost of goods sold per pair of Speedos runs approximately $70.
- Fixed costs are $2 million, and variable operating expenses other than costs of goods sold represent approximately 11 per cent of U.S. sales. All fixed and variable operating expenses other than cost of goods sold are incurred in United States.
- Recent events in Asia have increased the uncertainty regarding certain Asian currencies considerably, making it extremely difficult to forecast the value of the baht at which the Thai revenues will be converted. The current spot rate of the baht is $0.22 and the current spot rate of the pound is $1.50. You have three scenarios and derived an expected value on average for the upcoming year based on each scenario given in the table below:
- Blades currently has no debt in its capital structure. However, it may borrow funds in Thailand if it establishes a subsidiary in the country.

Ben Holt asked you to answer the following questions:

1. How will Blades will be negatively affected by the high level of inflation in Thailand if the Thai customer renews its commitment for another 3 years?
2. For each of the three possible values of the Thai baht and the British pound, show the estimated cash flow for the next year. Briefly comment on the level of Blades' economic exposure. Ignore possible tax effects.
3. Reanalyze the previous question by assuming that the British pound and the Thai baht are perfectly correlated. For example, if the baht depreciates by 5 per cent, the pound will also depreciate by 5 per cent. Under this assumption, is Blades subject to a greater degree of economic exposure? Why or why not?
4. Based on your answers to the previous questions, what actions could Blades take to reduce its level of economic exposure to Thailand?

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Roll No. ______________ Enrollment No. ______________

Kadi Sarva Vishwa Vidyalaya

MBA- Semester – III – Examination, April 2014

International Financial Management – FS 321

Date: 26/04/2014 **Total Marks: 40** **Time: 1:30 am to 4:00 pm**

Instructions:

1 Make assumptions wherever necessary and state it clearly
2 Working notes must form part of your answers

Q-1 (A) Explain the agency problem of MNCs. Why might agency costs be larger for an MNC than for a purely domestic firm? 4%

(B) 1. Compute the forward discount or premium for the Mexican peso whose 90-day forward rate is $.102 and spot rate is $.10. State whether your answer is a discount or premium. 2%

2. Assume the spot rate of the British pound is $1.73. The expected spot rate one year from now is assumed to be $1.66. What percentage depreciation does this reflect? 2%

OR

(B) How do the MNCs manage the threat of host government takeover? Explain the techniques in detail. 4%

Q-2 (A) Define Direct Foreign Investment. Discuss various motive of MNCs behind Direct Foreign Investment in detail. 4%

(B) Assume the following information: 4%

	Beal Bank	Yardley Bank
Bid price of New Zealand dollar	$.401	$.398
Ask price of New Zealand dollar	$.404	$.400

Given this information, is locational arbitrage possible? If so, explain the steps involved in locational arbitrage, and compute the profit from this arbitrage if you had $1,000,000 to use. What market forces would occur to eliminate any further possibilities of locational arbitrage?

OR

Q-2 (A) Discuss the methods used by MNCs to enter into the global market. 4%

(B) Diamond Bank expects that the Singapore dollar will depreciate against the dollar from its spot rate of $.43 to $.42 in 60 days. The following interbank lending and borrowing rates exist: 4%

	Lending Rate	Borrowing Rate
U.S. dollar	7.0%	7.2%
Singapore dollar	22.0%	24.0%

Diamond Bank considers borrowing 10 million Singapore dollars in the interbank market and investing the funds in dollars for 60 days. Estimate the profits (or losses) that could be earned from this strategy. Should Diamond Bank pursue this strategy?

Q-3 (A) "Government intervention in foreign exchange rate is desirable sometime." Do you agree? Explain the various methods through which government can influence the foreign exchange rate. 4%

(B) Explain the theory of purchasing power parity (PPP). Based on this theory, what is a general forecast of the values of currencies in countries with high inflation? 4%

OR

Q-3 (A) Which are the risks faced by MNCs when they expand themselves internationally? Explain in detail. 4%

(B) Explain various foreign exchange rate forecasting techniques in detail. 4%

Q-4 (A) What is the expected relationship between the relative real interest rates of two countries and the exchange rate of their currencies? 4%

(B) Alice Duever purchased a put option on British pounds for $.04 per unit. The strike price was $1.80 and the spot rate at the time the pound option was exercised was $1.59. Assume there are 31,250 units in a British pound option. What was Alice's net profit on the option? 4%

OR

Q-4 (A) Explain in detail why an MNC parent would consider financing from its subsidiaries. 4%

(B) Assume that Loras Corp. imported goods from New Zealand and needs 100,000 New Zealand dollars 180 days from now. It is trying to determine whether to hedge this position. Loras has developed the following probability distribution for the New Zealand dollar: 4%

Possible Value of New Zealand Dollar in 180 Days	Probability
$.40	5%
.45	10%
.48	30%
.50	30%
.53	20%
.55	5%

The 180-day forward rate of the New Zealand dollar is $.52. The spot rate of the New Zealand dollar is $.49. Develop a table showing a feasibility analysis for hedging. That is, determine the possible differences between the costs of hedging versus no hedging. What is the probability that hedging will be more costly to the firm than not hedging? Determine the expected value of the additional cost of hedging.

Q-5 St. Paul Co. does business in the United States and New Zealand. In attempting to assess its economic exposure, it compiled the following information. 8%

a. St. Paul's U.S. sales are somewhat affected by the value of the New Zealand dollar (NZ$), because it faces competition from New Zealand exporters. It forecasts the U.S. sales based on the following three exchange rate scenarios:

Exchange Rate of NZ$	Revenue from U.S. Business (in millions)
NZ$ = $.48	$100
NZ$ = .50	105
NZ$ = .54	110

b. Its New Zealand dollar revenues on sales to New Zealand invoiced in New Zealand dollars are expected to be NZ$600 million.

c. Its anticipated cost of materials is estimated at $200 million from the purchase of U.S. materials and NZ$100 million from the purchase of New Zealand materials.

d. Fixed operating expenses are estimated at $30 million.

e. Variable operating expenses are estimated at 20 percent of total sales (after including New Zealand sales, translated to a dollar amount).

f. Interest expense is estimated at $20 million on existing U.S. loans, and the company has no existing New Zealand loans.

Forecast net cash flows for St. Paul Co. under each of the three exchange rate scenarios. Explain how St. Paul's projected net cash flows are affected by possible exchange rate movements. Explain how it can restructure its operations to reduce the sensitivity of its net cash flows to exchange rate movements without reducing its volume of business in New Zealand.

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Seat No. ______________

Kadi Sarva VishwaVidyalaya, Gandhinagar
MBA – Semester – III – December 2014 Examination
International Financial Management (FS321)

Date:26/12/2014 **Weightage: 40%** **Duration: 2½ Hours**

Instructions:

1 Make assumptions wherever necessary and state them clearly
2 Working notes must form part of your answers
3. Figures to the right indicate weightage

Q-1 (A) Explain the following terms: 4%

1. Foreign Investment Risk Matrix (FIRM)
2. Economic Exposure
3. Callable swap
4. Non-deliverable forward contract

(B) Randy Rudecki purchased a call option on British pounds for $.02 per unit. The strike price was $1.45 and the spot rate at the time the option was exercised was $1.46. Assume there are 31,250 units in a British pound option. What was Randy's net profit on this option? 4%

OR

(B) Today you notice the following exchange rate quotations: 4%
$1 is equal to 3.00 Argentine pesos
1 Argentine peso = 0.50 Canadian dollars
You need to purchase 100,000 Canadian dollars with U.S. dollars. How many U.S. dollars will you need for your purchase?

Q-2 (A) What do you mean by foreign exchange rate? Discuss the factors that influence the exchange rate of country A's currency with that of country B's currency. 4%

(B) Reska. Inc., has constructed a long euro straddle. A call option on euros with an exercise price of $1.10 has a premium of $.025 per unit. A euro put option has a premium of $.017 per unit. Some possible euro values at option expiration are $0.90. $1.05, $1.50 and $2.00. 4%

a. Calculate the value of euro under call and put options and determine the net profit per unit to Reska Inc. for each possible future spot rate.
b. Determine the break-even point(s) of the long straddle. What are the break-even points of a short straddle using these options?

OR

Q-2 (A) Discuss various exchange rate systems. Which one you consider is the best. Support your answer with proper justification. 4%

(B) Diamond Bank expects that the Singapore dollar will depreciate against the dollar from its spot rate of $.43 to $.42 in 60 days. The following interbank lending and borrowing rates exist: 4%

	Lending Rate	Borrowing Rate
U.S. dollar	7.0%	7.2%
Singapore dollar	22.0%	24.0%

Diamond Bank considers borrowing 10 million Singapore dollars in the interbank market and investing the funds in dollars for 60 days. Estimate the profits (or losses) that could be earned from this strategy. Should Diamond Bank pursue this strategy?

Q-3 (A) Why do MNCs forecast foreign exchange rates? Which are the various ways to forecast foreign exchange rates. Discuss them in detail — 4%

(B) Assume that Loras Corp. imported goods from New Zealand and needs 100,000 New Zealand dollars 180 days from now. It is trying to determine whether to hedge this position. Loras has developed the following probability distribution for the New Zealand dollar: — 4%

Possible Value of New Zealand Dollar in 180 Days	Probability
$.40	5%
.45	10%
.48	30%
.50	30%
.53	20%
.55	5%

The 180-day forward rate of the New Zealand dollar is $.52. The spot rate of the New Zealand dollar is $.49. Develop a table showing a feasibility analysis for hedging. That is, determine the possible differences between the costs of hedging versus no hedging. What is the probability that hedging will be more costly to the firm than not hedging? Determine the expected value of the additional cost of hedging.

OR

Q-3 (A) Discuss the various factors that motivates the MNCs to opt Foreign Direct Investment — 4%

(B) Assume the following information: — 4%

Quoted Price	
Value of Canadian dollar in U.S. dollars	$.90
Value of New Zealand dollar in U.S. dollars	$.30
Value of Canadian dollar in New Zealand dollars	NZ$3.02

Given this information, is triangular arbitrage possible? If so. explain the steps that would reflect triangular arbitrage, and compute the profit from this strategy if you had $1,000,000 to use. What market forces would occur to eliminate any further possibilities of triangular arbitrage?

Q-4 (A) How do MNCs can reduce their exchange rate risk? Discuss the various techniques available in detail. — 4%

(B) The one-year interest rate in New Zealand is 6 percent. The one-year U.S. interest rate is 10 percent. The spot rate of the New Zealand dollar (NZ$) is $.50. The forward rate of the New Zealand dollar is $.54. Is covered interest arbitrage feasible for U.S. investors? Is it feasible for New Zealand investors? In each case, explain why covered interest arbitrage is or is not feasible. — 4%

OR

Q-4 (A) Discuss the various ways which an MNC can use to assess a country before making investment in the same. — 4%

(B) The one-year interest rate in New Zealand is 6 percent. The one-year U.S. interest — 4%

rate is 10 percent. The spot rate of the New Zealand dollar (NZ$) is $.50. The forward rate of the New Zealand dollar is $.54. Is covered interest arbitrage feasible for U.S. investors? Is it feasible for New Zealand investors? In each case, explain why covered interest arbitrage is or is not feasible.

Q-5 Read the below mentioned case and answer the questions given at the end of the case. 8%

Blades Inc.

Blades, Inc., is a U.S. based company that has been incorporated in the United States for three years. Blades is a relatively small company, with total assets of only $200 million. The company produces a single type of product, roller blades. Due to the booming roller blade market in the United States at the time of the company's establishment, Blades has been quite successful. For example, in its first year of operation, it reported a net income of $3.5 million. Recently, however, the demand for Blades' "speedos", the company's primary product in the United States, has been slowly tapering off, and Blades has not been performing well. Last year, it reported a return on assets of only 7 per cent. In response to the company's annual report for its most recent years of operations, Blades' shareholders have been pressuring the company to improve its performance; its stock price has fallen from a high of $20 per share three years ago to $ 12 last year. Blades produces high quality roller blades and employs a unique production process, but the prices it charges are among the top 5 percent in the industry.

In light of these circumstances, Ben Holt, the company's chief financial officer (CFO), is contemplating his alternatives for Blades' future. There are no other cost-cutting measures that Blades can implement in the United States without affecting the quality of its product. Also, production of alternative products would require major modifications to the existing plant setup. Furthermore, and because of these limitations, expansion within the United States at this time seems pointless.

Ben Holt is considering the following: If Blades cannot penetrate the U.S. market further or reduce costs here, why not import some parts from overseas and/or expand the company's sales to foreign countries? Similar strategies have proved successful for numerous companies that expanded into Asia in recent years to increase their profit margins. The CFO's initial focus is on Thailand. Thailand has recently experienced weak economic conditions, and Blades could purchase components there at a low cost. Ben is aware that many of Blades' competitors have begun importing production components from Thailand.

Not only would Blades be able to reduce costs by importing rubber and/or plastic from Thailand due to the low costs of these inputs, but it might also be able to augment weak U.S. sales by exporting to Thailand, an economy still in its infancy and just beginning to appreciate leisure products such as roller blades. While several of Blades' competitors import components from Thailand, few are exporting to the country. Long-term decisions would also eventually have to be made; maybe Blades, Inc., could establish a subsidiary in Thailand and gradually shift its focus away from the United States if its U.S. sales do not rebound. Establishing a subsidiary in Thailand would also make sense for Blades due to its superior production process. Ben Holt is reasonably sure that Thai firms could not duplicate the high quality production process employed by Blades. Furthermore, if the company's initial approach of exporting works well establishing a subsidiary in Thailand would preserve Blades' sales before Thai competitors are able to penetrate the Thai market.

As a financial analyst for Blades, Inc., you are assigned to analyze international opportunities and risk resulting from international business. Your initial assessment should focus on the barriers and opportunities that international trade may offer. Ben Holt has never been involved in international business in any form and is unfamiliar with any constraints that may inhibit his plan to export to and import from a foreign country. Mr. Holt has presented you with a list of initial questions you should answer:

1. What are the advantages Blades could gain from importing from and/or exporting to foreign country such as Thailand?
2. What are some of the disadvantages Blades could face as a result of foreign trade in the short run? In the long run?
3. Which theories of international business apply to Blades, Inc., in the short run? In the long run?
4. What long-range plans other than establishment of a subsidiary in Thailand are options for Blades and may be more suitable for the company.

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