Reg. No. | | | | | | | | | |

MBAS 554

Fourth Semester M.B.A. Degree Examination, September/October 2022
(Regular and Repeater)
BUSINESS ADMINISTRATION
International Financial Management

Time : 3 Hours Max. Marks : 70

Instructions : *1) Answer **all** Sections.*
*2) Marks are indicated against **each** Section.*

SECTION – A

Answer **any two** questions. **Each** question carries **10** marks. Answer to **each** question should **not** exceed **5** pages. **(2×10=20)**

1. What do you understand by foreign exchange risk ? What are the different internal and external exposure management techniques which are used by importers and exporters ? Discuss.

2. Define Balance of Payments. Why would it be useful to examine a country's Balance of Payments ? Discuss the recent trends in India's Balance of Payments.

3. 'Capital budgeting for a foreign project is considerably more complex than the domestic case'. What are the factors that add complexity ? How should an MNE factor the host country inflation into its evaluation of an investment proposal ?

SECTION – B

Answer **any three** questions. **Each** question carries **12** marks. Answer to **each** question should **not** exceed **6** pages. **(3×12=36)**

4. a) Why did the International Monetary system move from a Fixed Exchange Rate System to a Floating Exchange Rate System ? What has been its impact ?

   b) Do developing countries face special problems in financing their international trade ? If so, what are these problems ?

P.T.O.

5. a) Discuss the IRP Theory with its limitations. How is it different from PPP Theory ?

   b) If US inflation rate is expected to average about 3% annually, while the inflation rate in India is to average out at 8% annually. If the current spot rate for the rupee is $ 0.0126, what is the expected spot rate two years hence ?

6. a) Discuss the different types of foreign exchange exposures in brief.

   b) Cray Research sold a super computer to the Max Planck Institute in Germany on credit and invoiced €10 million payable in six months. Currently, the six-months forward exchange rate is $ 1.10/€ and the foreign exchange advisor for Cray Research predicts that the spot rate is likely to be $ 1.05/€ in six months.

      i) What is the expected gain/loss from the forward hedging ?

      ii) If you were the financial manager of Cray Research, would you recommend hedging this euro receivable ? Why or why not ?

      iii) Suppose the foreign exchange advisor predicts that the future spot rate will be the same as the forward exchange rate quoted today. Would you recommend hedging in this case ? Why or why not ?

7. Write short notes on :

   a) International Cash Management, and

   b) International Capital Market Instruments.

8. a) Briefly discuss the multinational tax management.

   b) A portfolio manager holds a portfolio that mimics the S and P 500 index. The S and P 500 index started the year at 800 and is currently at 923.33. The December S and P 500 futures price is currently 933.33. The manager's fund was valued at $ 10 million at the beginning of the year. Since the fund has already generated a handsome return for the year, the manager wishes to lock in its current value. That is, the manager is willing to give up potential increases in order to ensure that the value of the fund does not decrease. How can you lock in the value of the fund implied by the December futures contract ? Show that the hedge does work by considering the value of your net hedged position when the S and P 500 index finishes the year at 833.33 and 1,000.

SECTION – C

Note : This Section is **compulsory**. It carries **Fourteen** marks. **(1×14=14)**

9. Dorchester Ltd., is an old-line confectioner specializing in high-quality chocolates. Through its facilities in the United Kingdom, Dorchester manufactures candies that it sells throughout Western Europe and North America (United States and Canada). With its current manufacturing facilities, Dorchester has been unable to supply the U.S. market with more than 225,000 pounds of candy per year. This supply has allowed its sales affiliate, located in Boston, to be able to penetrate the U.S. market no farther West than St. Louis and only as far South as Atlanta. Dorchester believes that a separate manufacturing facility located in the United States would allow it to supply the entire U.S. market and Canada (which presently accounts for 65,000 pounds per year). Dorchester currently estimates initial demand in the North American market at 390,000 pounds, with growth at a 5 percent annual rate. A separate manufacturing facility would, obviously, free up the amount currently shipped to the United States and Canada. But Dorchester believes that this is only a short-run problem. They believe the economic development taking place in Eastern Europe will allow it to sell there the full amount presently shipped to North America within a period of five years.

   Dorchester presently realizes £ 3.00 per pound on its North American exports. Once the U.S. manufacturing facility is operating, Dorchester expects that it will be able to initially price its product at $ 7.70 per pound. This price would represent an operating profit of $ 4.40 per pound. Both sales price and operating costs are expected to keep track with the U.S. price level; U.S. inflation is forecast at a rate of 3 percent for the next several years. In the U.K., long-run inflation is expected to be in the 4 to 5 percent range, depending on which economic service one follows. The current spot exchange rate is $ 1.50/£1.00. Dorchester explicitly believes in PPP as the best means to forecast future exchange rates.

   The manufacturing facility is expected to cost $ 7,000,000. Dorchester plans to finance this amount by a combination of equity capital and debt. The plant will increase Dorchester's borrowing capacity by £ 2,000,000, and it plans to borrow only that amount. The local community in which Dorchester has decided to build will provide $ 1,500,000 of debt financing for a period of seven years at 7.75 percent. The principal is to be repaid in equal installments over the life of the loan. At this point, Dorchester is uncertain whether to raise the remaining debt it desires through a domestic bond issue or a Eurodollar bond issue. It believes it can borrow pounds sterling at 10.75 percent per annum and dollars at 9.5 percent. Dorchester estimates its all-equity cost of capital to be 15 percent.

The U.S. Internal Revenue Service will allow Dorchester to depreciate the new facility over a seven-year period. After that time the confectionery equipment, which accounts for the bulk of the investment, is expected to have substantial market value.

Dorchester does not expect to receive any special tax concessions. Further, because the corporate tax rates in the two countries are the same--35 percent in the U.K. and in the United States--transfer pricing strategies are ruled out.

Should Dorchester build the new manufacturing plant in the United States ? Show in detail necessary workings.
