

**PGDM International Business (2016-18)**  
**Trimester IV**  
**End Term Examination September 2017**  
**International Financial Management**  
**IB 401**

Time **2.30 hours**

MM 50

Roll No \_\_\_\_\_

**Instruction:** Students are required to write Roll No on every page of the question paper, Swriting **anything** except the Roll No will be treated as **Unfair Means**. All other instructions on the **reverse** of Admit Card should be followed meticulously.

Sections	No. of Questions to attempt	Marks	Marks
A	3 out of 5 (Short Q)	5 Marks each	3*5 = 15
B	2 out of 3 (Long Questions)	10 Marks each	2*10 = 20
C	Compulsory Case Study	15 Marks	15
		<b>Total Marks</b>	<b>50</b>

**Section A**

- A1) What is the relationship between interest rate parity and forward rates?
- A2) Why would anyone write an option knowing that the gain from receiving the option premium is fixed but the loss if the underlying price goes in wrong direction can be extremely large?
- A3) What is meant by tax morality?
- A4) Differentiate between TT buying and Bills buying rate?
- A5) Explain the advantage of Centralized Cash Management?

**Section B**

B1) Use the following data from IMF and answer the following questions-  
 Australia's Current Account

Million Us Dollars	2013	2014	2015	2016	2017
Goods Export	55854	56096	64052	63676	65099
Goods Import	-61215	-65857	-68865	-61890	-70530
Service Credit	16181	17399	18677	16689	17906
Service Debit	-17272	-18330	-18388	-16948	-18107
Income Credit	6532	7394	8984	8063	8194
Income Debit	-17842	-18968	-19516	-18332	-19884
Current Account Transfers Credit	2651	3003	2622	2242	2310
Current Account Transfers Debit	-2933	-3032	-2669	-2221	-2373

1. What is Australia's balance on goods trade?
2. What is Australia's balance on services?
3. What is Australia's balance on goods and services?
4. What is Australia's Current Account Balance?

B2) You are planning a vacation to Mt Blanc in France. You are negotiating rental with Chateau (a large French country house) one year from now. You are negotiating rentals of chateau. The Chateau owner wishes to preserve his real income both against inflation and exchange rate so that the present weekly rent of 9800 euro (Christmas Season) will adjust upward or downward for any change in the French cost of living between now and then. You are basing your budgeting on PPP. French inflation is expected to average 3.5% in the coming year while US dollar inflation is expected to be 2.5%. The current spot rate is \$1.3620/Euro. What should you budget as the US dollar cost of one week rental?

B3) Newly established foreign subsidiaries are often financed with the debt supplied by the parent, perhaps because a new subsidiary has no credit record or worthiness of its own or may be the parent company can acquire capital more cheaply. As soon as the subsidiary is operational, however the parent firms encourage their subsidiary to arrange their own local debt financing. How would this approach serve as a natural hedge for most subsidiaries?

### Section C Compulsory

The crash of Sir Freddie Laker's Skytrain had little to do with the failure of its navigational equipment or its landing gear; indeed, it can largely be attributed to misguided management decisions. Laker's management erred in selecting the financing mode for the acquisition of the aircraft fleet that would accommodate the booming transatlantic business spearheaded by Sir Freddie's sound concept of a "no-frill, low-fare, stand-by" air travel package.

In 1981, Laker was a highly leveraged firm with a debt of more than \$400 million. The debt resulted from the financing provided by the U.S. Eximbank and the U.S. aircraft manufacturer McDonnell Douglas. As most major airlines do, Laker Airways incurred three major categories of cost: (1) fuel, typically paid for in U.S. dollars (even though the United Kingdom is more than self-sufficient in oil); (2) operating costs incurred in sterling (administrative expenses and salaries), but with a nonnegligible dollar cost component (advertising and booking in the United States); and (3) financing costs from the purchase of U.S.-made aircraft, denominated in dollars. Revenues accruing from the sale of transatlantic airfare were about evenly divided between sterling and dollars. The dollar fares, however, were based on the assumption of a rate of \$2.25 to the pound. The imbalance in the currency denomination of cash flows (dollar-denominated cash outflows far exceeding dollar-denominated cash inflows) left Laker vulnerable to a sterling depreciation below the budgeted exchange rate of £1 = \$2.25. Indeed, the dramatic plunge of the exchange rate to £1 = \$1.60 over the 1981 to 1982 period brought Laker Airways to default

1. What were the key components of Laker Airways' operating exposure?
2. What options did it have to hedge its operating exposure?
3. Could Laker have hedged its "natural" dollar liability exposure?
4. Should Laker have financed its purchase of DC 10 aircraft by borrowing sterling from a British bank rather than using the dollar-denominated financing supplied by McDonnell Douglas and the Eximbank? Consider the fact that Eximbank, a U.S. government agency, subsidized this financing in order to promote U.S. exports.