PGDM International Business Trimester IV

End Term Examination 2014

International Financial Management

Paper Code IB401

Time 2.30 hours **MM 50**

This is a closed book examination. Use of ordinary calculator is permitted. In case of any doubts please make reasonable assumptions and proceed. Please write your name and roll no on the question paper as soon as you receive the same

Section A 15 Marks

A1) Why does BOP always balance?
A2) For each of the market participant identify the motive for buying/ selling the foreign exchange?
A3) What is the relationship between interest rate parity and forward rates ?
A4) An exporter has supplied readymade garments to a retailer in Switzerland on six months credit invoiced in 1 Million Swiss Franc . The spot rate and the 6 month forward rates in the Indian Market Swiss Franc is quoted at Rs 65 and Rs 67.50 respectively. If the exporter believes that Indian Rupee would depreciate by 5% p.a., should he hedge the receivables by booking 6 months forward contract?
A5) What is the mechanism of money market hedge for accounts payable?

Section B 20 Marks

There are three questions in this section. Attempt any two questions. Each question carries ten marks

B1) Assume that the Tata Steel had imported equipment worth 200 Million USD by raising equivalent amount of borrowing from US at 7%pa in 2014.The interest will be paid from 2015 and at the end of five years the entire loan is to be paid back. How will the of Balance of Payment will be impacted each year from 2014 to 2020 ?

B2) Last year General Electric spent $150 million to buy a controlling interest in Tungsram, the Hungarian state owned light bulb maker. Even in its best year, Tungsram earned less than a 4 percent return on equity (based on the price GE paid).What might account for GE's decision to spend so much money to acquire such a dilapidated, inefficient manufacturer?

B3) Spot Rates 1 USD = 65.10/20
3 Months forward = 65.50/60
Lending Rate for US 8%
Lending Rate for INR 10%
Deposit Rate for US 6%
Deposit Rate for INR 8%

Is there any interest covered arbitrage?

SECTION C Compulsory (15 Marks)

It was January 2002, and Toyota Motor Europe Manufacturing (TMEM) had a problem. More specifically, Mr. Toyoda Shuhei, the new President of TMEM, had a problem. He was on his way to Toyota Motor Company's (Japan) corporate offices outside Tokyo to explain the continuing losses of European manufacturing and sales operations. The CEO of Toyota Motor Company, Mr. Hiroshi Okuda, was expecting a proposal from Mr. Shuhei to reduce and eventually eliminate these losses. The situation was intense given that TMEM was the only major Toyota subsidiary losing money.

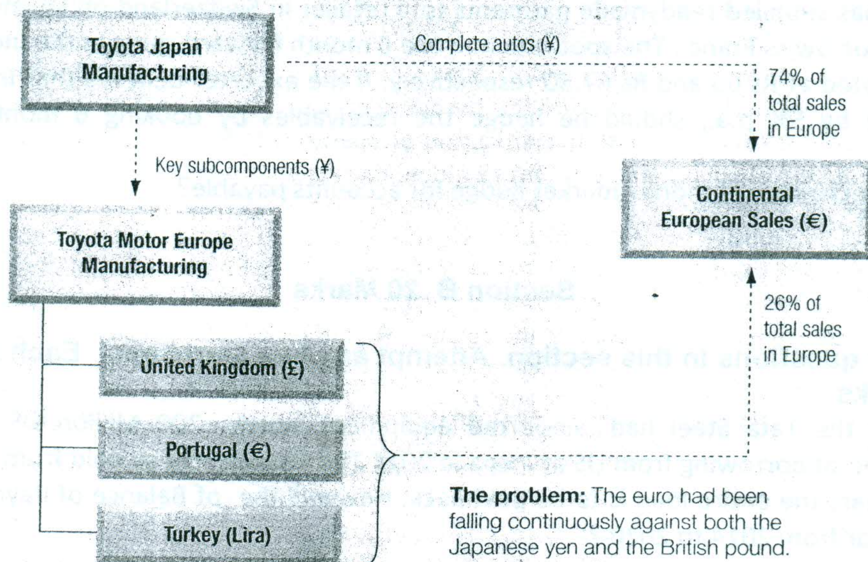
Toyota and Auto Manufacturing

Toyota Motor Company was the number one automobile manufacturer in Japan, the third largest manufacturer in the world by unit sales (5.5 million units or one auto every six seconds), but number eight in sales in continental Europe. The global automobile manufacturing industry, like many industries, had been experiencing continued consolidation in recent years as margins were squeezed, economies of scale and scope pursued, and global sales slowed.

Toyota was no different. It had continued to rationalize its manufacturing along regional lines and to increase the amount of local manufacturing in North America. In 2001, over 60% of Toyota's North American sales were locally manufactured. But Toyota's European sales were nowhere close to this yet. Most of Toyota's automobile and truck manufacturing for Europe was still done in Japan. In 2001, only 26% of the autos sold in Europe were manufactured in Europe (including the U.K.), the remainder being imported from Japan (see Exhibit 1).

Toyota Motor Europe sold 634,000 automobiles in 2000. Europe was the second largest foreign market for Toyota, second only to North America. TMEM expected

EXHIBIT 1 Toyota Motor's European Currency Operating Structure



significant growth in European sales and was planning to expand European manufacturing and sales to 800,000 units by 2005. But for fiscal 2001 the unit reported operating losses of ¥9.897 billion ($82.5 million at ¥120/$). TMEM had three assembly plants in the United Kingdom, one plant in Turkey, and one in Portugal. In November 2000, Toyota Motor Europe announced publicly that it would not generate profits for the next two years due to the weakness of the euro.

Toyota had recently introduced a new model to the European market, the Yaris, which was proving very successful. The Yaris, a super-small vehicle with a 1,000cc engine, had sold more than 180,000 units in 2000. Although the Yaris had been specifically designed for the European market, the decision had been made early on to manufacture it in Japan.

Currency Exposure

One source of the continuing operating losses suffered by TMEM was the falling value of the euro. Throughout 1999 and the first half of 2000 the yen strengthened against the euro (see Exhibit 2). Although the euro regained some ground in late 2000, it remained relatively weak.

As demonstrated in Exhibit 1, the cost base for most of the autos sold within the Continental European market was the Japanese yen. As the yen rose against the euro, costs increased significantly when measured in euro terms. If Toyota wished to preserve its price competitiveness in the European market, it had to absorb most of the exchange rate changes, suffering reduced or negative margins on both completed cars and key subcomponents shipped to its European manufacturing centers. Deciding to manufacture the Yaris in Japan had only exacerbated the problem.

Management Response

Toyota management was not passively sitting by. In 2001, they had started up some assembly operations in Valenciennes, France. Although Valenciennes still constituted a relatively small percentage of total European sales as of January 2002, Toyota planned to continue to expand its capacity and capabilities to source about 25% of European sales by 2004. Assembly of the Yaris was scheduled to be moved to Valenciennes in 2002. The continuing problem, however, was that it was an assembly facility, which meant that much of the expensive value-added content of the cars being assembled was still based in either Japan or the United Kingdom.

Mr. Shuhei, with the approval of Mr. Okuda, had also initiated a local sourcing and procurement program for the United Kingdom manufacturing operations. TMEM wished to decrease the number of key components imported from Toyota Japan to reduce the currency exposure of the U.K. unit. But again, the continuing problem of the euro's weakness against the British pound, as shown in Exhibit 3, reduced the effectiveness of even this solution.

EXHIBIT 2 Daily Exchange Rates: Japanese Yen per Euro

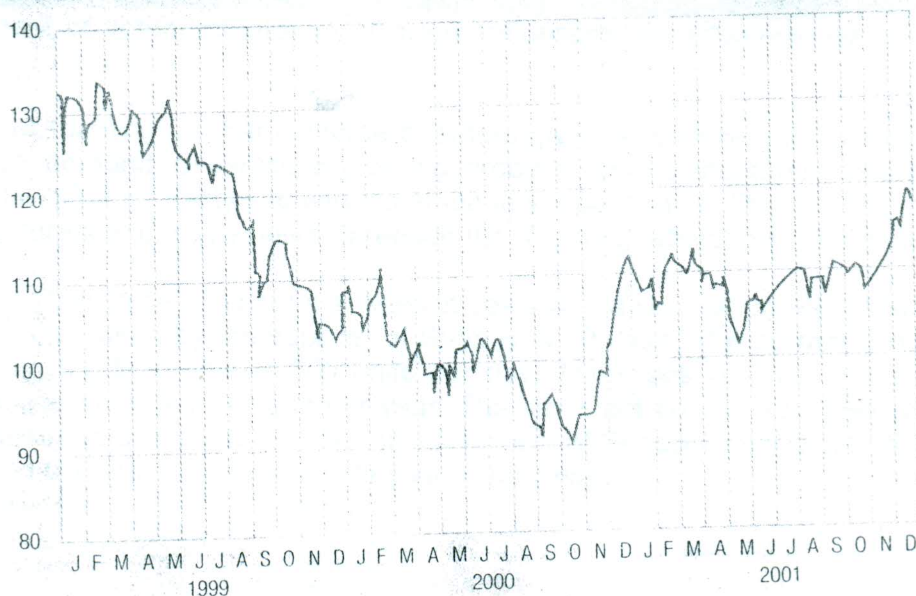
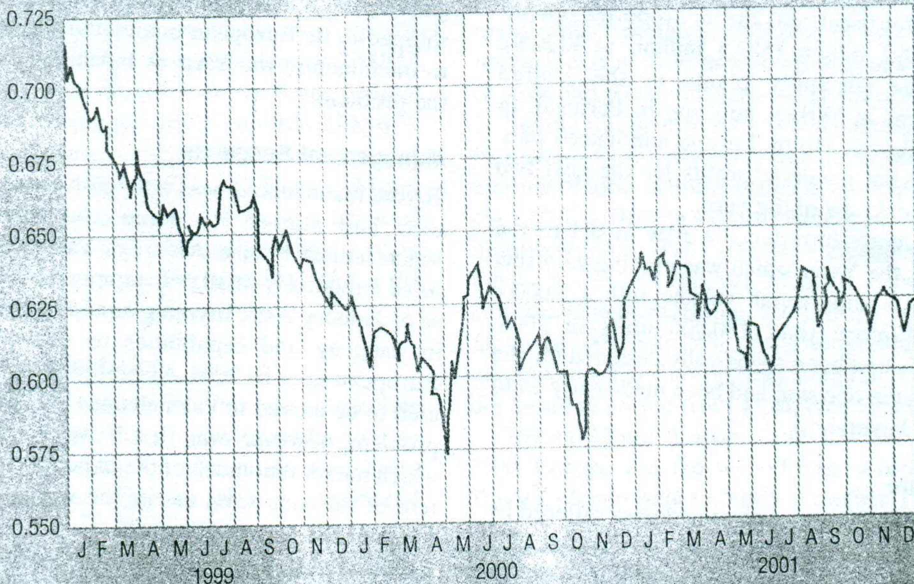


EXHIBIT 3 Daily Exchange Rates: British Pounds per Euro



Case Questions

1. Why do you think Toyota waited so long to move much of its manufacturing for European sales to Europe?
2. If Britain were to join the European Monetary Union, would the problem be resolved? How likely do you think it is that Britain will join?
3. If you were Mr. Shuhei, how would you categorize your problems and solutions? What was a short-term and what was a long-term problem?
4. What measures would you recommend Toyota Europe take to resolve the continuing operating losses?