

PGDM Trimester IV

International Financial Management

Term IV, DM-414 End Term Examination September 2016

Time 2.30 hours

MM 50

Roll No _____

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

Sections	No of Questions	Marks	Marks
A	3 out of 5 (Short Questions)	5 marks each	3*5=15
B	2 out of 3 (Long Questions)	10 marks each	10*2=20
C	Compulsory Case	15 marks	15 marks
		Total	50 marks

Section A 15 Marks

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

1. Is a floating-rate system more inflationary than a fixed-rate system? Explain.
2. What are some reasons for deviations from purchasing power parity?
3. When should a speculator purchase a call option on an Australian dollar?
4. How can the central bank use indirect intervention to change the value of a currency?
5. Shouldn't the IFE discourage investors from attempting to capitalize on higher foreign interest rates?

Section B 20 Marks

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

- B1) Dell Computer produces its machines in Asia with components largely imported from the United States and sells its products in various Asian nations in local currencies.
- a. What is the likely impact on Dell's Asian profits of a strengthened dollar? Explain.
 - b. What hedging technique(s) can Dell employ to lock in a desired currency conversion rate for its Asian sales during the next year?
 - c. Suppose Dell wishes to lock in a specific conversion rate but does not want to foreclose the possibility of profiting from future currency moves. What hedging technique would be most likely to achieve this objective?
 - d. What are the limits of Dell's hedging approach?
- B2) A U.S. company needs to borrow \$100 million for a period of seven years. It can issue dollar debt at 7 percent or yen debt at 3 percent.
- a. Suppose the company is a multinational firm with sales in the United States and inputs purchased in Japan. How should this affect its financing choice?

- b. Suppose the company is a multinational firm with sales in Japan and inputs that are primarily determined in dollars. How should this affect its financing choice?
- B3) The following transactions (expressed in U.S. \$ billions) take place during a year. Calculate the U.S. merchandise-trade, current-account, capital-account, and financial-account balances.
- The United States exports \$300 of goods and receives payment in the form of foreign demand deposits abroad.
 - The United States imports \$225 of goods and pays for them by drawing down its foreign demand deposits.
 - The United States pays \$15 to foreigners in dividends drawn on U.S. demand deposits here.
 - American tourists spend \$30 overseas using traveler's checks drawn on U.S. banks here.
 - Americans buy foreign stocks with \$60, using foreign demand deposits held abroad.
 - The U.S. government sells \$45 in gold for foreign demand deposits abroad.
 - In a currency support operation, the U.S. government uses its foreign demand deposits to purchase \$8 from private foreigners in the United States.

Section C 15 marks (Compulsory)

Multinational Manufacturing, Inc. (MMI), is a large manufacturing firm engaged in the production and sale of a widely diversified group of products in a number of countries throughout the world. Some product lines enjoy outstanding success in new fields developed on the basis of an active research and development program; other product lines, whose innovative leads have disappeared, face very severe competition.

Each domestic product line and foreign affiliate is a separate profit center. Headquarters influences these centers primarily by evaluating their managers on the basis of certain financial criteria, including return on investment, return on sales and growth in earnings.

Division and affiliate executives are held responsible for planning and evaluating possible new projects. Each project is expected to yield at least 15%. Projects requiring an investment below \$250,000 (about one-third of the projects) are approved at the division or affiliate level without formal review by headquarters management.

The present cutoff rate was established three years ago as part of a formal review of capital budgeting procedures. The conclusion at the time was that the company's weighted average cost of capital was 15%, and it should be applied when calculating net present values of proposed projects. In announcing the policy, Mr. Thomas Black, Vice President-Finance, said, "It's about time that we introduced some modern management techniques in allocating our capital resources." Now Mr. Black is concerned that the policy introduced three years ago is having some unintended consequences. Specifically, top management gets to review only obvious investment candidates. Low-risk, low-return projects and high-risk, high-return projects seem to be systematically screened out along the way. The basis for this screening is not entirely clear, but it appears to be related to the way in which managerial performance is evaluated. Local executives seem to be concerned that low-potential projects will hurt their performance appraisal, while high-potential projects can turn out poorly. The president of one foreign affiliate said privately when asked why he never submitted projects at the extremes of risk and return, "Why should I take any chances? When headquarters says it wants 15%, it means 15% and nothing less. My crystal ball isn't good enough to allow me to accurately

estimate sales and costs in this country, especially when I never know what the government is going to do."

Questions:

Make recommendations to Mr. Black concerning the following points:

1. Should MMI lower the hurdle rate in order to encourage the submission of more proposals, or should it drop the hurdle rate concept completely?
2. Should MMI invest in lower-return projects that are less risky and/or in high-risk projects that appear promising? What is the relevant measure of risk?
3. How should MMI factor in the additional political and economic risks it faces overseas in conducting these project analyses?
4. Why are projects at the extremes of risk and return not reaching top management for review?
5. What actions, if any, should Mr. Black take to correct the situation?