21/5/2014

DOON UNIVERSITY, DEHRADUN
Semester Final Examination, Fourth Semester, 2014
School of Management

MBA-2 years
Course: MMS 536 – International Financial Management

Time Allowed: 3 Hours *Maximum Marks: 50*

Note: Attempt All Questions from Sections A,B,C.

Section A: Read the following case and answer below. **(15 marks)**

Abrahim India Ltd was a subsidy of Abrahim USA. The American principles could only hold equity of 50 percent in the Indian company due to the prevailing foreign exchange regulations in the country. Indian economy was, however, growing at a fast pace and the profit were good for Abrahim India Ltd. Abrahim USA wanted to increase its share of the profit in the Indian operations by increasing its equity holding. It appealed a number of times to the Government of India, each time giving a different reason, but all its requests for pumping in additional equity in Abrahim India Ltd were turned down.

Abrahim USA invested these funds that it had been keeping for increasing its stakes in Abrahim India Ltd for the purchase of a company, Special Valves Ltd in UK. Abrahim USA purchased 100 percent equity of the British company, which was expected to yield a return of 10% on the investment. Economy in UK was fairly stable and inflation was under control; its annual rate being 5%. Similarly value of pound against the dollar was more or less static. As against this, the inflation rate and the rate of return in India had been 10% and 24% per annum respectively. Secondly, the period of the government resorting to nationalization of foreign companies was long over and MNC's had been flourishing well. Change expected in the exchange rate between dollar, pound and the Indian rupee are given below:

Exchange Rate at that time	Exchange Rate after one year
\$ = 41.00 INR	**\$ = 46.00 INR**
\$ = 0.69 £	**\$ = 0.67 £**

After one year, the management of Abrahim USA examined their income in UK and estimated what it could have been had they been able to invest in the Indian company. The government of India had changed during the year under review. The incoming government has decided to give a high priority to controlling the spiraling inflation. The country was expected to bring down its inflation rate to 6% and maintain the exchange rate between INR and dollar with a maximum variation of 5% per annum. There was some slowing down in Indian economy, but the return on investment was still expected to remain at 18% per annum.

Director Overseas Operations at Abrahim USA hit upon a novel idea of increasing their holdings in India. A company, Special Valves India Ltd, was formed with 50% equity from Abrahim India Ltd and remaining 50% Special Valves, UK. This resulted in Abrahim USA getting 50% stake in Special Valves India through its British subsidy and 50% of 50% = 25% via Abrahim India Ltd. The US Company had thus managed 75% holding in Special Valves India Ltd. Management of Abrahim USA considered this to be a great strategic success because at that time return on capital in USA was only 7% per annum and the inflation was at 4% per annum.

The investment in Special Valves UK (which was earmarked for investment in India) was Rs 15 Cr and total investment in Special Valves India was Rs 5 Cr. Assume realistically and other data not given in the above narrative and the following questions:

a) Did Abrahim USA initially loose substantially by having to invest in UK instead of being allowed to increase their stakes in Abrahim India Ltd? Calculate the exact difference?
b) What did Abrahim USA gain by setting up and investing in Special Valves India Ltd instead of investing these additional funds in USA?
c) What other consideration would have entered in the minds of management of Abrahim USA if these investments were to be made in a country having a developing economy and political instability?

Section B: State True/False with reason (not more than 40 worlds). (2x10=20 marks)

a) Fisher Effect deals with the interplay of interest rates and inflation rates.
b) Interest Rate Parity Theorem deals with the money supply and foreign exchange rates.
c) International Fisher Effect contends that currency with higher interest depreciates.

d) Difference between Ask and Bid price gives rise to arbitrage in foreign exchange.

e) A cross rate is the average of spot and forward rates

f) Swap deals with the delivery of a physical asset.

g) Options contract is only an extended version of a futures contract.

h) β and σ cannot be used interchangeably

i) YTM of a bond is the same as the IRR of the bond investment.

j) CAPM helps in determining required rate of return.

Section C: Attempt any three questions. All questions carry the equal marks.

(5x3=15 marks)

a) Write a short note on the different types of exposure.

b) Write a short note on netting.

c) Explain financial swaps.

d) Explain difference between domestic and International CAPM.