

Internal Assessment Test – II

Sub:	Global Financial Management							Code:	22MBAFM403
Date:	06-10-2025	Duration:	90 mins	Max Marks:	50	Sem:	IV	Branch:	MBA
SET - 2									

			OBE		
			Marks	CO	RBT
Part A - Answer Any Two Full Questions (2* 20 = 40 marks)					
Part B – Compulsory – Case Study (1*10 = 10 marks)					
1 (a)	Describe the role of International Banking Services such as Correspondent Banks and Foreign Branches?	[03]	CO3	L2	
(b)	Explain the structure and functioning of the International Equity Market?	[07]	CO3	L3	
(c)	Analyze the risks and benefits of investing in International Mutual Funds?	[10]	CO3	L4	
2 (a)	List the major types of Floating Rate Notes (FRNs)?	[03]	CO3	L2	
(b)	Calculate the Outright Rate of IND/JPY at 90 - day spot rate when IND/JPY is 2.50/2.10 - & 92-days swap is 0.0065/0.0050?	[07]	CO3	L3	
(c)	There are two currencies namely the EUR and GBP it is forecasted that EUR is valued at 86.33 and GBP 105.65, provided that expiry period is three months. But on expiry of three months, it is found that the actual value of EUR comes to 86.11 and the actual value of GBP comes to 105.94. Calculate forecast error of EUR and GBP?	[10]	CO3	L4	
3 (a)	Define translation exposure with examples?	[03]	CO4	L2	
(b)	Machine A costs \$2000 and produces \$1000 per year for the next 5 years. Machine B’s Cost is \$1600 and produces \$420 per year for the next five years. The discount rate is 12%. Which project can be selected?	[07]	CO4	L3	
(c)	A small British company that has exported goods to a U.S. customer and expects to receive 50,000 USD in one year. The Britain CEO views the current exchange rate of USD1 = GBP1.10 as favourable and would like to lock it in since they think that the GBP may appreciate over the year ahead (which would result in fewer GBP for the U.S. dollar export proceeds when received in a year). The British company can borrow USD at 1.75% for one year and can receive 2.5% per annum for British pound deposits. Give your suggestion regarding money market hedging?	[10]	CO4	L3	
Part B - Compulsory (01*10=10 marks)					
4					
	Mr. Roy an Indian importer, imports Furniture from the US worth \$20,000 and he has to make the payment after 90 days. Mr. Roy is expecting that the exchange rate will change and he is requesting that you help him to decide by considering the following information.	[10]	CO4	L5	
	- Spot rate is INR83.95/USD 90 Days Forward Rate is INR83.312/USD - Interest on borrowing in India is 6% p.a. and interest on deposit in USA is 5% p.a. 90 days call option is having a strike price of 83.5 and a premium of 0.04/USD 90 days Put option has a strike price of 83.90 and a premium of 0.05/USD. - Spot rate on the 90th day is 83.89/USD.				

Course Outcomes (COs)		PO1	PO2	PO3	PO4	PO5	PS01	PS02	PS03	PS04
CO1:	The student will have an understanding of the International Financial Environment.									
CO2:	The student will learn about the foreign exchange market, participants, and transactions.									
CO3:	The student will be able to use derivatives in foreign exchange risk management.				1a, 1b,1 c, 2a,2 b,2c				1a, 1b,1c , 2a,2b ,2c	
CO4:	The student will be able to evaluate the Firm's Exposure to risk in the international environment and various theories associated with it.		3a, 3b, 3c, 4							3a ,3 b, 3c ,4

Cognitive level	KEYWORDS
L1 - Remember	list, define, tell, describe, recite, recall, identify, show, label, tabulate, quote, name, who, when, where, etc.
L2 - Understand	describe, explain, paraphrase, restate, associate, contrast, summarize, differentiate interpret, discuss
L3 - Apply	calculate, predict, apply, solve, illustrate, use, demonstrate, determine, model, experiment, show, examine, modify
L4 - Analyze	classify, outline, break down, categorize, analyze, diagram, illustrate, infer, select
L5 - Evaluate	asses, decide, choose, rank, grade, test, measure, defend, recommend, convince, select, judge, support, conclude, argue, justify, compare, summarize, evaluate
L6 - Create	design, formulate, build, invent, create, compose, generate, derive, modify, develop, integrate

PO1–Theoretical Knowledge; PO2–Effective Communication Skills; PO3–Leadership Qualities; PO4 –Sustained Research Orientation; PO5 –Self-Sustaining Entrepreneurship

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HOD

Global Financial Management - IAT 2 (Set 2) Detailed Solutions

Q1

a) Describe the role of International Banking Services such as Correspondent Banks and Foreign Branches. [03]

International banking facilitates cross-border financial transactions, supports trade, and provides investment opportunities. There are two major types of international banking services:

1. Correspondent Banks:

- These are domestic banks that maintain accounts with foreign banks to provide services in markets where they have no physical presence.
- They handle international payments, trade financing, and foreign exchange transactions.
- Example: An Indian bank using a U.S. correspondent bank for dollar settlements.

2. Foreign Branches:

- These are overseas extensions of the parent bank, conducting business directly in the host country.
- They provide loans, accept deposits, and engage in international trade finance.
- Example: SBI New York branch serving Indian corporates operating in the U.S.

Thus, these services play a vital role in global trade facilitation, liquidity management, and financial integration.

b) Explain the structure and functioning of the International Equity Market. [07]

The International Equity Market enables corporations and investors to issue, buy, and sell equity securities across countries. It comprises two main segments:

- Primary Market – where companies raise fresh capital through international share issues like GDRs (Global Depositary Receipts) and ADRs (American Depositary Receipts).
- Secondary Market – where investors trade existing securities through stock exchanges such as NYSE, LSE, Tokyo Stock Exchange, and Euronext.

The process involves regulatory approval, cross-listing, foreign investor participation, and settlement through global clearing houses like Euroclear or Clearstream.

Benefits: Global diversification, enhanced liquidity, and access to international funds.

Risks: Currency volatility, differing regulations, and political instability.

c) Analyze the risks and benefits of investing in International Mutual Funds. [10]

International mutual funds invest in foreign securities, enabling investors to gain exposure to global markets. These funds may focus on specific regions, countries, or global sectors.

Benefits:

- Diversification – reduces country-specific risk.
- Higher Returns – opportunities in emerging markets.
- Professional Management – expert selection of foreign portfolios.
- Access to markets otherwise unavailable to retail investors.

Risks:

- Currency Risk – depreciation of foreign currencies may reduce returns.
- Political and Economic Risk – policy changes or recessions in foreign countries.
- Regulatory and Taxation Differences – may affect repatriation of profits.
- Market Liquidity – some markets may be illiquid.

Conclusion: While international mutual funds enhance diversification, investors must assess exchange rate volatility and economic conditions.

Q2

a) List the major types of Floating Rate Notes (FRNs). [03]

1. Capped FRNs – Coupon rate cannot exceed a maximum limit.
2. Floored FRNs – Coupon rate cannot fall below a minimum rate.
3. Collared FRNs – Have both cap and floor limits.
4. Inverse FRNs – Coupon moves inversely to reference rate.
5. Perpetual FRNs – Have no maturity, interest paid indefinitely.

b) Calculate the Outright Rate of IND/JPY at 90-day spot rate when IND/JPY is 2.50/2.10 and 92-days swap is 0.0065/0.0050. [07]

Given:

Spot Rate (IND/JPY): 2.50 / 2.10

Swap Points (92 days): 0.0065 / 0.0050

Outright Rate = Spot Rate $\pm$ Swap Points

Since swap points are added when at premium, the calculation is:

Bid = 2.50 + 0.0065 = 2.5065

Ask = 2.10 + 0.0050 = 2.1050

Thus, Outright Rate = IND/JPY = 2.5065 / 2.1050

c) Calculate forecast error for EUR and GBP. [10]

Forecast Error (%) = (Actual Rate – Forecast Rate) / Forecast Rate $\times$ 100

EUR:

= (86.11 – 86.33)/86.33 $\times$ 100 = (-0.22 / 86.33) $\times$ 100 = -0.25% (Overestimated)

GBP:

$$= (105.94 - 105.65) / 105.65 \times 100 = (0.29 / 105.65) \times 100 = +0.27\% \text{ (Underestimated)}$$

Therefore, EUR was overvalued and GBP undervalued in forecast.

Q3

a) Define translation exposure with examples. [03]

Translation exposure is the risk that a company's financial statements in foreign subsidiaries will change in value when converted to the parent's reporting currency due to exchange rate fluctuations.

Example: A U.S. company with a U.K. subsidiary holding £1,000,000 in assets faces translation loss if GBP/USD declines from 1.30 to 1.20 — value drops from \$1.3M to \$1.2M.

b) Compare Machine A and B using NPV method. [07]

Given:

Machine A: Cost \$2000, Cash inflow \$1000 for 5 years

Machine B: Cost \$1600, Cash inflow \$420 for 5 years

Discount Rate = 12%

$$\text{PV Factor @12\% for 5 years} = (1 - (1 + 0.12)^{-5}) / 0.12 = 3.6048$$

Machine A:

$$\text{NPV} = (1000 \times 3.6048) - 2000 = 3604.8 - 2000 = \$1604.8$$

Machine B:

$$\text{NPV} = (420 \times 3.6048) - 1600 = 1514.0 - 1600 = -\$86$$

Hence, Machine A is preferred as it has a higher positive NPV.

c) Money Market Hedge for British Exporter expecting \$50,000 in 1 year. [10]

Spot: USD 1 = GBP 1.10

Borrow USD @1.75%, Deposit GBP @2.5%

Step 1: Compute PV of USD receivable:

$$\text{PV} = 50,000 / (1 + 0.0175) = 49,141.32 \text{ USD}$$

$$\text{Step 2: Convert to GBP} = 49,141.32 / 1.10 = 44,674.84 \text{ GBP}$$

Step 3: Invest GBP at 2.5%:

$$\text{Future Value} = 44,674.84 \times (1 + 0.025) = 45,791.7 \text{ GBP}$$

Therefore, the company can lock in £45,791.7 after one year by using a money market hedge, protecting against GBP appreciation.

Q4. Case Study

Mr. Roy, an Indian importer, imports furniture worth \$20,000 payable after 90 days. Spot rate = ₹83.95/USD, Forward rate = ₹83.312/USD, Call option = ₹83.5 (premium ₹0.04), Put option = ₹83.9 (premium ₹0.05), 90-day spot = ₹83.89/USD.

We evaluate three hedging alternatives:

1. Forward Hedge: $₹83.312 \times 20,000 = ₹16,66,240$
2. Call Option Hedge: $(83.5 + 0.04) \times 20,000 = ₹16,70,800$
3. No Hedge: $₹83.89 \times 20,000 = ₹16,77,800$

Comparison:

Forward gives the lowest payable amount. Call option allows participation if INR strengthens, but costs a premium. Hence, Forward Contract is recommended for certainty and lower cost.