



**Model Answer  
End-Sem Examination-I, Winter 2025**

Academic Year: 2025-2026	Semester: III
Class: PG-II	Program: MBA
Branch Code: 10	Pattern: 2024
Name of Course: International Finance	Course Code: 2410613B

Q. No.	Details	Max. Marks
Q.1	<p>Discuss the meaning, scope and importance of international financial management in the context of globalization. How does it differ from domestic financial management?</p> <p><b>ANSWER:</b></p> <ul style="list-style-type: none"> <li>• <b>Meaning and scope:</b> <ul style="list-style-type: none"> <li>○ Management of financial decisions involving international transactions, currencies, markets and risks.</li> <li>○ Covers forex management, international capital budgeting, risk hedging, multinational working capital.</li> </ul> </li> <li>• <b>Importance in globalization:</b> <ul style="list-style-type: none"> <li>○ Firms face exchange rate volatility, political risks, differing tax systems and regulations.</li> <li>○ Need to access global capital, manage multicurrency cash flows, optimize global tax positions.</li> </ul> </li> <li>• <b>Differences from domestic financial management:</b> <ul style="list-style-type: none"> <li>○ Exchange rate risk absent in domestic context.</li> <li>○ Multiple political, regulatory, tax environments vs single jurisdiction.</li> <li>○ Different market conditions, interest rates, capital costs across countries.</li> <li>○ Complex parent-subsidary fund flows and transfer pricing issues.</li> </ul> </li> </ul>	[6]
Q.2	<p>Spot rate: USD/INR = 82.50. 3-month forward: USD/INR = 83.25. US 3-month interest rate = 5% p.a., India = 7% p.a.</p> <p>(i) Calculate annualized forward premium on USD. (ii) Check if covered interest parity approximately holds.</p> <p><b>ANSWER</b></p> <ul style="list-style-type: none"> <li>• (i) Annualized forward premium:           <ul style="list-style-type: none"> <li>○ 3-month premium = <math>(83.25-82.50)/82.50 = 0.00909</math> (0.909%).</li> <li>○ Annualized = <math>0.00909 \times (12/3) \times 100 = 3.64\%</math> p.a.</li> </ul> </li> <li>• (ii) Covered IRP check:           <ul style="list-style-type: none"> <li>○ IRP implied premium <math>\approx i_{\text{INR}} - i_{\text{USD}} = 7\% - 5\% = 2\%</math> p.a.</li> <li>○ Quarterly <math>\approx 0.5\%</math>; annualized <math>\approx 2\%</math>.</li> <li>○ Actual premium (3.64%) &gt; IRP (2%) → arbitrage opportunity exists.</li> </ul> </li> </ul> <p>Borrow USD, convert to INR, invest in India, sell INR forward.</p>	[6]
Q.3	<p>a) Define foreign exchange risk and explain why even firms with no direct foreign transactions face exchange rate exposure. Provide examples.</p>	[16]



	<ul style="list-style-type: none"><li>• FX risk:<ul style="list-style-type: none"><li>○ Adverse impact of unexpected exchange rate changes on firm value.</li></ul></li><li>• Indirect exposure examples:<ul style="list-style-type: none"><li>○ Import competition: INR appreciation → cheaper imports → lower domestic sales.</li><li>○ Input costs: INR depreciation → higher cost of imported raw materials.</li><li>○ Substitute products: Competitor has foreign costs affected by rates.</li></ul></li></ul> <p>OR</p> <p>b) Explain internal techniques for managing FX risk: netting, matching, leading/lagging, re-invoicing. When is each appropriate?</p> <ul style="list-style-type: none"><li>• Netting: Offset receivables/payables in same currency between subsidiaries.<ul style="list-style-type: none"><li>○ Appropriate: Intragroup transactions.</li></ul></li><li>• Matching: Revenue/expenses in same currency.<ul style="list-style-type: none"><li>○ Appropriate: Natural hedges exist.</li></ul></li><li>• Leading/lagging: Accelerate (lead) or delay (lag) payments based on expected depreciation/appreciation.<ul style="list-style-type: none"><li>○ Appropriate: Arms-length affiliates.</li></ul></li><li>• Re-invoicing: Central subsidiary invoices affiliates, manages FX risk.<ul style="list-style-type: none"><li>○ Appropriate: Complex MNC structures.</li></ul></li></ul>	
	<p>(c) Explain transaction exposure and methods used to measure transaction exposure.</p> <p>ANSWER</p> <ul style="list-style-type: none"><li>• Transaction exposure arises due to changes in exchange rates affecting contractual foreign currency cash flows.</li><li>• It occurs when a firm has receivables or payables denominated in foreign currency.</li><li>• Any fluctuation in exchange rates between the contract date and settlement date leads to gain or loss.</li></ul> <p>Sources of Transaction Exposure</p> <ul style="list-style-type: none"><li>• Export and import transactions</li><li>• Foreign currency loans</li><li>• Dividend and royalty payments</li><li>• Forward contracts</li></ul> <p>Measurement of Transaction Exposure</p> <ul style="list-style-type: none"><li>• Identify all foreign currency receivables and payables.</li><li>• Net the foreign currency position.</li><li>• Calculate potential gain or loss using expected exchange rate changes.</li><li>• Sensitivity analysis may be used to assess impact.</li></ul> <p>Example</p> <ul style="list-style-type: none"><li>• An Indian exporter expecting USD receipts faces loss if USD depreciates against INR.</li></ul> <p>OR</p>	



	<p>(d) Explain economic exposure and discuss why it is difficult to measure and manage.</p> <p><b>ANSWER</b></p> <ul style="list-style-type: none"> <li>• Economic exposure refers to the impact of exchange rate changes on the long-term value and competitiveness of a firm.</li> <li>• It affects future revenues, costs, market share, and cash flows.</li> <li>• Unlike transaction exposure, it is not linked to specific contracts.</li> </ul> <p>Sources of Economic Exposure</p> <ul style="list-style-type: none"> <li>• Changes in export competitiveness</li> <li>• Imported input costs</li> <li>• Competition from foreign firms</li> <li>• Demand shifts due to price changes</li> </ul> <p>Why it is Difficult to Measure</p> <ul style="list-style-type: none"> <li>• Long-term and uncertain impact</li> <li>• No specific contractual amounts</li> <li>• Depends on market structure and competition</li> <li>• Affected by multiple macroeconomic variables</li> </ul> <p>Management</p> <ul style="list-style-type: none"> <li>• Operational hedging</li> <li>• Market diversification</li> <li>• Flexible sourcing and pricing strategies</li> </ul>	
<p>Q.4</p>	<p>a) Discuss main steps in multinational capital budgeting. How are political risk and exchange rate risk incorporated?</p> <ul style="list-style-type: none"> <li>• Steps:             <ul style="list-style-type: none"> <li>○ Identify/estimate project cash flows in local currency.</li> <li>○ Adjust for taxes, blocked funds, subsidies.</li> <li>○ Convert to parent currency using appropriate rates.</li> <li>○ Discount at parent hurdle rate.</li> </ul> </li> <li>• Political risk: Scenario analysis, adjust cash flows, higher discount rate.</li> <li>• FX risk: Expected rates, certainty equivalents, scenario/sensitivity analysis.</li> </ul> <p>OR</p> <p>b) Explain financial integration vs market segmentation. How do they affect MNC investment decisions?</p> <ul style="list-style-type: none"> <li>• Integration: Free capital flows, arbitrage eliminates pricing differences.             <ul style="list-style-type: none"> <li>○ MNCs: Lower cost of capital, global diversification.</li> </ul> </li> <li>• Segmentation: Barriers prevent flows.             <ul style="list-style-type: none"> <li>○ MNCs: Higher local costs, country-specific risks.</li> <li>○ Investment decisions: Segmented markets → local NPV; integrated → global NPV.</li> </ul> </li> </ul>	<p>[16]</p>
	<p>c) Explain ADRs and GDRs as instruments for raising international equity capital.</p> <p><b>Model Answer</b></p> <ul style="list-style-type: none"> <li>• American Depository Receipts (ADRs) are negotiable instruments</li> </ul>	



	<p>representing shares of a foreign company traded in the US markets.</p> <ul style="list-style-type: none"> <li>• ADRs are denominated in US dollars and traded on US stock exchanges.</li> <li>• Global Depository Receipts (GDRs) are similar instruments traded in international markets such as London and Luxembourg.</li> <li>• GDRs allow companies to access a broader global investor base.</li> </ul> <p>Benefits</p> <ul style="list-style-type: none"> <li>• Access to international capital</li> <li>• Increased liquidity</li> <li>• Enhanced global visibility</li> <li>• Diversification of investor base</li> </ul> <p>OR</p> <p>d) Explain international bond instruments such as Eurobonds and foreign bonds.</p> <p>Model Answer</p> <ul style="list-style-type: none"> <li>• International bonds are debt instruments issued in global capital markets.</li> </ul> <p>Eurobonds</p> <ul style="list-style-type: none"> <li>• Issued outside the country of the currency denomination.</li> <li>• Not subject to domestic regulations.</li> <li>• Example: USD-denominated bond issued in Europe.</li> </ul> <p>Foreign Bonds</p> <ul style="list-style-type: none"> <li>• Issued in a domestic market by a foreign borrower.</li> <li>• Subject to local regulations.</li> <li>• Examples: Yankee bonds (USA), Samurai bonds (Japan).</li> </ul> <p>Advantages</p> <ul style="list-style-type: none"> <li>• Lower cost of capital</li> <li>• Access to wider investors</li> <li>• Currency diversification</li> </ul>	
Q.5	<p>a) Explain functions of SWIFT and CHIPS in international payments. How do they improve efficiency and security?</p> <ul style="list-style-type: none"> <li>• SWIFT: <ul style="list-style-type: none"> <li>○ Global messaging network for secure financial messages.</li> <li>○ Standardizes payment instructions between 11,000+ institutions.</li> </ul> </li> <li>• CHIPS: <ul style="list-style-type: none"> <li>○ US private clearing system for large-value USD payments.</li> <li>○ Real-time gross settlement with multilateral netting.</li> </ul> </li> <li>• Benefits: Speed, standardization, security, reduced settlement risk.</li> </ul> <p>OR</p> <p>b) Discuss importance of KYC and AML in international finance. How do they affect cross-border banking?</p> <ul style="list-style-type: none"> <li>• KYC: Verify customer identity, beneficial ownership.</li> <li>• AML: Monitor/prevent money laundering, terrorist financing.</li> <li>• Cross-border impact: <ul style="list-style-type: none"> <li>○ Enhanced due diligence for high-risk jurisdictions.</li> </ul> </li> </ul>	[16]



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	<ul style="list-style-type: none"><li>○ Transaction monitoring, suspicious activity reporting.</li><li>○ Correspondent banking restrictions for non-compliant countries.</li></ul>	
	<p>c) Explain major trade-related risks faced in international trade transactions. ANSWER</p> <ul style="list-style-type: none"><li>• Credit Risk: Risk of non-payment by importer.</li><li>• Currency Risk: Loss due to exchange rate fluctuations.</li><li>• Country Risk: Political or economic instability in buyer's country.</li><li>• Carriage Risk: Damage or loss of goods during transit.</li><li>• Legal Risk: Differences in laws across countries.</li></ul> <p>OR</p> <p>d) Explain the concept and working of Letters of Credit in international trade. ANSWER</p> <ul style="list-style-type: none"><li>• A Letter of Credit (LC) is a written undertaking by a bank to pay the exporter on behalf of the importer.</li><li>• Issued by importer's bank in favour of exporter.</li><li>• Payment is made on submission of specified documents.</li><li>• Ensures security to exporter and credibility to importer.</li></ul> <p>Importance</p> <ul style="list-style-type: none"><li>• Reduces credit risk</li><li>• Facilitates smooth international trade</li><li>• Builds trust between trading parties</li></ul>	