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December 2012

Master of Business Administration (MBA) Examination

IV Semester

International Strategic Finance

Time : 3 Hours] [Max. Marks : 80

Note : Attempt any four questions from Section A. Each question carries 15 marks. Section B is compulsory and carries 20 marks.

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Section A

1. What is International Financial Management ? Discuss theories of foreign exchange rate movement.
2. Capital budgeting for foreign project is considerable more complex than that in domestic case. Identify the factors that add complexity.
3. Describe the organization of foreign exchange market and distinguish between the spot market and forward market.
4. What do you mean by foreign exchange risk management ? Explain the different instrument of foreign exchange risk management.
5. Discuss the objectives of raising of resources from International Markets. Describe the different instruments through which the companies can raise funds from international markets.
6. Write a detail note on Multination Cash Management.
7. Write short notes on any two of the following :
   (a) GDR.
   (b) ADRs.
   (c) EURO Issues.
   (d) Purchasing Power Parity.

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Section B

CASE STUDY : SCRINTON TECHNOLOGIES

The party at the banquet hall of Grosvenor House Hotel in London was a glittering affair. A large number of top bankers, CEOs of industrial companies, and important government officials were attending the formal celebration marking the commissioning of Scrinton Technologies' new plant in Southampton, England, which would be manufacturing a small range of state-of-the-art medical diagnostic equipment, including computer-enhanced imagery and hi- tech scanning systems. Scrinton was a world leader in diagnostic equipment, and the new plant represented the most advanced manufacturing

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facility of its type in the world. Only Scrinton's own plant in Sacramento, California, was anywhere near this facility in terms of technical sophistication and advancement of production equipment and processes.

The Southampton plant was a major commitment for Scrinton, involving an outlay of US$110 million. Scrinton's top management had viewed this project as a strategic move, to have a manufacturing facility in Europe before further European Union expansion. At the same time, it was considered essential that only the highest technology and processes be used in the plant to ensure products of futuristic sophistication and unquestioned quality and reliability. The European market was large and growing but at the same time was highly sophisticated and competitive. Competition was particularly strong from German and Swiss companies, many of which had been supplying hospital equipment to medical centers all over Europe for several decades. Although it lacked the long-standing relationships of its competitors, Scrinton was confident that, with its edge in technology, it would be able to catch up with the competition and successfully wrest market share. Some European hospitals and clinics were already using Scrinton's equipment and were appreciative of the quality and reliability of its products. The need to keep a distinct technological edge over the competition, now and in the future, meant that the company had to find considerable resources to finance an ambitious and extremely expensive venture.

Scrinton had decided to go ahead with the Southampton plant. The financing was raised from five sources :

1. Syndicated Euromarket loan : € 40 million.
2. Bond issue in the U. S. market repayable in seven years : US$ 38 million.
3. Long-term loan from a consortium of major main commercial banks : US$ 16 million.
4. Equity issue on Wall Street : US$ 12 million.
5. Internal resources : US$ 4 million.

The project took three years to complete, and the debt service schedule of Scrinton UK, a wholly owned subsidiary that had taken the loans and made the equity and bond issues, was repayment of the bank loan in five years, repayment of the syndicated loan in seven years, and redemption of the bond issue in seven year's.

Revenues of the company were going to be principally in three currencies : pounds sterling, euros and Swiss francs. It was decided

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not to invoice products in other currencies, and as a matter of policy, all attempts would be made to invoice in only these currencies. Exceptions would be made only in rare cases, generally when a particular sale was of strategic or critical importance to the company.

The company expected to make substantial sales and generate adequate revenue to cover its entire amortization schedule (see opposite) without any need to draw on the resources of the parent company, but a major issue was the possible fluctuation of interest and exchange rates over the life of the repayment plan. The company was exposed because its syndicated loan in the Euromarket was at variable rates, and its liability could increase substantially if interest rates went up. Further, although its revenues were going to be denominated in three European currencies, it had substantial liabilities in U. S. dollars, and any major appreciation of the dollar against the European currencies would place the entire debt servicing of the project in serious jeopardy.

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Bill Smythe, finance director of Scrinton UK, was concerned about these issues as he made small talk with a London investment banker at the party. "I'll deal with this in the morning", he thought, forcing the problem away and beginning to pay more attention to his companion, who had moved away from the subject of a possible minicrash on the stock market in the next three months to the more timely subject of the latest rumors on the activities of the younger members of the British royal family.

The next morning, Bill Smythe looked over the projection of estimated revenues for each year. The pound liability was apparently no problem from an exchange-risk point of view, because the pound revenues of the company were sufficient to cover the liability. The syndicated loan, however was at a variable rate of 0.25 percent over the London inter-bank offered rate (LIBOR). If LIBOR moved up, the value of the pound liability could increase considerably and significantly increase the company's debt service costs.

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The dollar borrowings presented a bigger problem. Both exchange- and interest-rate exposure was present because the repayment obligations were denominated in dollars. Further, the long-term loan from the consortium of banks was at a variable rate of 0.5 percent over the prime rate.

"There are so many options available to hedge these risks", thought Smythe, "but should we ? After all, there is going to be substantial hedging cost and I wonder whether it will be worth it."

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