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| **SESSION** | **JUL-AUG ‘24** |
| **PROGRAM** | **MASTER of business administration (MBA)** |
| **SEMESTER** | **IV** |
| **course CODE & NAME** | **DFIN402 – TREASURY MANAGEMENT** |
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**1. Explain Repo Market Differentiating from Tri-Party Repo**

**Ans 1.**

The **Repo Market** (Repurchase Agreement Market) is a critical component of the money market where short-term borrowing and lending occur, primarily between financial institutions. In this market, the borrower sells securities (such as government bonds) to a lender with an agreement to repurchase them at a predetermined price on a specified date. The difference between the initial sale price and the repurchase price reflects the interest rate or cost of borrowing, often called the repo rate.

The **Tri-Party Repo** is a specific type of repurchase agreement where a third party acts as an intermediary to facilitate the transaction, providing additional security and operational

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**2. Identify and Explain Major Functions of Financial Markets**

**Ans 2.**

Financial markets are platforms where buyers and sellers engage in the trade of financial assets, such as stocks, bonds, derivatives, and currencies. They play a crucial role in the efficient allocation of resources, fostering economic growth and stability. The functions of financial markets can be broadly categorized into liquidity provision, price determination, risk sharing, and capital allocation.

**1. Liquidity Provision**

Financial markets ensure that assets can be bought or sold quickly without significant price

**3. The common stock of ABC Ltd. is trading in the market at ₹ 140/- a share. A contract (Call option) is written allowing the buyer of this contract to purchase 100 shares of ABC Ltd. stock at ₹ 140/- at any time over the next three months. The seller has agreed to deliver the 100 shares at this price on demand. For granting this option, a fee (premium) of ₹ 8 per share is charged by the writer of this option.**

**Scenario 1: If, after two months, the stock rises to ₹ 165/- a share, will this option be exercised by the buyer. If yes what will be the profit/loss to the buyer in this transaction.**

**Scenario 2: If, after two months, the stock declined to ₹ 130/- a share, will this option be exercised by the buyer. If yes what will be the profit/loss to the buyer in this transaction.**

**Ans 3:**

**Analysis of Call Option Scenarios**

In the given case, the buyer of the call option has the right, but not the obligation, to purchase 100 shares of ABC Ltd. at ₹ 140 per share (the strike price) anytime within the next three months. The premium paid for this right is ₹ 8 per share, amounting to ₹ 800 for 100 shares. The profitability of exercising this option depends on whether the market price of the stock exceeds the strike price plus the premium (break-even point).

**Scenario 1: Stock Price Rises to ₹ 165/- Per Share**

If the stock price rises to ₹ 165 after two months, the buyer will likely exercise the call option,

**4. Discuss risk mitigation tools for liquidity risk management differentiating liquidity risk in a Non-Financial Organisation (e.g. a garment trader) and a financial institution (e.g. a Bank). Formulate reasons for liquidity risk.**

**Ans 4.**

**Risk Mitigation Tools for Liquidity Risk Management**

Liquidity risk arises when an organization faces difficulties in meeting its financial obligations due to insufficient cash or liquid assets. Effective liquidity risk management is crucial to ensure smooth operations and avoid disruptions. The tools and strategies employed to mitigate liquidity risk vary depending on the nature of the organization, such as a non-financial

### **5. Common Tools for Interest Rate Risk Mitigation**

**Ans 5.**

Interest rate risk arises when fluctuations in interest rates affect the value of assets, liabilities, or income streams. To mitigate this risk, businesses and financial institutions use a variety of tools, including derivatives and financial instruments.

#### Common Tools for Mitigating Interest Rate Risk

* **Interest Rate Swaps:** Agreements to exchange fixed interest payments for floating rates or vice versa. For example, a company with a variable-rate loan can swap its

### **6a. Interest Rate Parity (IRP) and Spot-Forward Rate Relationship**

**Ans 6a.**

Interest rate parity (IRP) is a fundamental concept in foreign exchange markets that links spot and forward exchange rates with interest rate differentials between two countries. According to IRP, the forward rate reflects the interest rate difference between two countries, ensuring no arbitrage opportunities.

#### IRP Formula:

$$F=S×\left(\frac{1+i\_{d}}{1+i\_{f}}\right)$$

Where:

* $F$: Forward exchange rate
* $S$: Spot exchange rate