

### Financial Management – Sample Solution

Question - An international portfolio has lower risk and higher return than a domestic portfolio. Explain why this is the case for investors. Include any examples of how non-domestic indexes or markets have performed/produced returns over the past 10 years or so. Then, relate the concepts of risk and return to what it means for a company to diversify its sales or business by expanding beyond its borders. How do you think companies benefit from diversification -- and how is this concept similar, as well as different, from the gains enjoyed by investors?

**Solution:** An international portfolio offers lower risk and higher return than a domestic portfolio. This also provides more opportunities to the investors. It is because the international portfolio includes investment in larger firms than in the domestic portfolio. The securities in domestic portfolio can be affected from the change in the economic position of the country, while in international portfolio the change in economic condition of a country would not affect the return from the portfolio. Thus, an international portfolio has lower risk and higher return than a domestic portfolio.



(Source: Yahoo Finance, 2010)

The above describes the return of London Stock Exchange over the last five years. It shows a continuous increase in the return for the investors. The past data of LSE also describes a significant return to the investors from this non-domestic market index. But currently the return in this index is decreasing because of the current economic crisis in world economy.

The international diversification of the business leads to a greater risk return tradeoff. This is because the business diversification stabilizes return for the business and defuses risk from the business. The loss from the business operation in one country is tradeoff with the profits in another country. The diversification of business beyond national boundaries includes different economic cycles that reduces business risks and provides stable or higher return to the business. It is because; systematic risk in one country may be unsystematic risk in another country (Levi, 2005). The business also grabs the opportunity of expanding its business in emerging markets that reduce risk and improves return for the business.

This concept is quite similar as the gain enjoyed by the investors through international portfolio than domestic portfolio. The investor invests their capital in different nation's securities and the business men also operate their business in different nations. Thus, the profit from diversification is similar for investors as well as for businesses. On the other hand, this concept is also different from profits to the investors through the diversification as investors enjoy the benefits from the economic cycles while businesses enjoy profits from different business cycles.

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