CHAPTER 15

1. Acquisitions have increased in Europe to capitalize on the inception of the euro, which created a single currency for many European countries. This has not only eliminated the exchange rate risk on transactions between the participating European countries, it has also made it easier to compare valuations among European countries to determine where targets are undervalued.

2. Common restrictions include government regulations such as antitrust restrictions, environmental restrictions, and red tape.

3. The establishment of a new subsidiary allows an MNC to create the subsidiary it desires without assuming existing facilities or employees. However, the process of building a new subsidiary and hiring employees will normally take longer than the process of acquiring an existing foreign firm.

4. The divestiture is now more feasible because the dollar cash flows to be received by the U.S. parent are reduced as a result of the revised projections of the krona’s value.

CHAPTER 18

1. A firm may be able to obtain a lower coupon rate by issuing bonds denominated in a different currency. The firm converts the proceeds from issuing the bond to its local currency in order to finance local operations. However, there is exchange rate risk because the firm will need to make coupon payments (and the principal payment) in the currency denominating the bond. If that currency appreciates against the firm’s local currency, then the financing costs could become larger than expected.

2. The risk is that the Swiss franc would appreciate against the pound over time since the British subsidiary will periodically convert some of its pound cash flows to francs to make the coupon payments.

The risk here is less than it would be if the proceeds were used to finance U.S. operations. The Swiss franc’s movement against the dollar is much more volatile than the Swiss franc’s movement against the pound. The Swiss franc and the pound have historically moved in tandem to some degree against the dollar, which means that there is a fairly stable exchange rate between the two currencies.
3. If these firms borrow U.S. dollars and convert them to finance local projects, then they will need to use their own currencies to obtain dollars and make coupon payments. These firms would be highly exposed to exchange rate risk.

4. Paxson Co. is exposed to exchange rate risk. If the yen appreciates, the number of dollars needed for conversion into yen will increase. To the extent that the yen strengthens, Paxson’s cost of financing when financing with yen could be higher than when financing with dollars.

5. The nominal interest rate incorporates expected inflation (according to the international Fisher effect). Therefore, the high interest rates reflect high expected inflation. Cash flows can be enhanced by inflation because a given profit margin converts into larger profits as a result of inflation, even if costs increase at the same rate as revenues.

**Chapter 19**

1. The exporter may not trust the importer or may be concerned about the government imposing exchange controls that prevent payment to the exporter. Meanwhile, the importer may not trust that the exporter will ship the goods ordered and therefore may not pay until the goods are received. Commercial banks can help by providing guarantees to the exporter in case the importer does not pay.

2. In accounts receivable financing, the bank provides a loan to the exporter secured by the accounts receivable. If the importer fails to pay the exporter, the exporter is still responsible to repay the bank. Factoring involves the sales of accounts receivable by the exporter to a so-called factor, in which the exporter is no longer responsible for the importer’s payment.

3. The guarantee programs of the Export-Import Bank provide medium-term protection against the risk of nonpayment by the foreign buyer due to political risk.

**Chapter 20**

1. \[ r_f = (1 + i_f)(1 + e_f) - 1 \]
   
   If \( e_f = -6\% \), \( r_f = (1 + .09)(1 + (-.06)) - 1 \)
   
   \[ = .0246, \text{ or } 2.46\% \]
   
   If \( e_f = 3\% \), \( r_f = (1 + .09)(1 + .03) - 1 \)
   
   \[ = .1227, \text{ or } 12.27\% \]

2. \[ E[r_f] = 50\%(2.46\%) + 50\%(12.27\%) \]
   
   \[ = 1.23\% + 6.135\% \]
   
   \[ = 7.365\% \]

3. \[ e_f = \frac{1 + r_f}{1 + i} - 1 \]
   
   \[ = \frac{1 + .08}{1 + .05} - 1 \]
   
   \[ = .0286, \text{ or } 2.86\% \]
4. \[ E[e_f] = \frac{\text{Forward rate} - \text{Spot rate}}{\text{Spot rate}} \]
   \[ = \frac{(.60 - .62)}{.62} \]
   \[ = -.0322, \text{ or } -3.22\% \]
\[ E[e_f] = (1 + i_f)[1 + E[e_f]] - 1 \]
\[ = (1 + .09)[1 + (-.0322)] - 1 \]
\[ = .0548, \text{ or } 5.48\% \]

5. The two-currency portfolio will not exhibit much lower variance than either individual currency because the currencies tend to move together. Thus, the diversification effect is limited.

**Chapter 21**

1. The subsidiary in Country Y should be more adversely affected because the blocked funds will not earn as much interest over time. In addition, the funds will likely be converted to dollars at an unfavorable exchange rate because the currency is expected to weaken over time.

2. \[ E[r] = (1 + i_f)[1 + E[e_f]] - 1 \]
   \[ = (1 + .14)(1 + .08) - 1 \]
   \[ = .2312, \text{ or } 23.12\% \]

3. \[ E[e_f] = \frac{\text{Forward rate} - \text{Spot rate}}{\text{Spot rate}} \]
   \[ = \frac{(.19 - .20)}{.20} \]
   \[ = -.05, \text{ or } -5\% \]
\[ E[r] = (1 + i_f)[1 + E[e_f]] - 1 \]
\[ = (1 + .11)[1 + (.05)] - 1 \]
\[ = .0545, \text{ or } 5.45\% \]

4. \[ e_f = \frac{1 + r}{1 + i_f} - 1 \]
   \[ = \frac{1 + .06}{1 + .90} - 1 \]
   \[ = -.4421, \text{ or } -44.21\% \]

If the bolivar depreciates by less than 44.21 percent against the dollar over the 1-year period, then a 1-year deposit in Venezuela will generate a higher effective yield than a 1-year U.S. deposit.

5. Yes. Interest rate parity would discourage U.S. firms only from covering their investments in foreign deposits by using forward contracts. As long as the firms believe that the currency will not depreciate to offset the interest rate advantage, they may consider investing in countries with high interest rates.