

**MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.**

- 1) Another name for operating exposure is \_\_\_\_\_ exposure. 1) \_\_\_\_\_  
 A) competitive B) strategic  
 C) economic D) all of the above
  
- 2) What type of international risk exposure measures the change in present value of a firm resulting from changes in future operating cash flows caused by any unexpected change in exchange rates? 2) \_\_\_\_\_  
 A) transaction exposure B) accounting exposure  
 C) translation exposure D) operating exposure
  
- 3) \_\_\_\_\_ cash flows arise from intracompany and intercompany receivables and payments, while \_\_\_\_\_ cash flows are payments for the use of loans and equity. 3) \_\_\_\_\_  
 A) Financing; operating B) Operating; accounting  
 C) Operating; financing D) Accounting; financing
  
- 4) Which of the following is NOT an example of a financial cash flow? 4) \_\_\_\_\_  
 A) payment for goods and services B) interest on intrafirm lending  
 C) parent invested equity capital D) intrafirm principal payments
  
- 5) Which of the following is NOT an example of an operating cash flow? 5) \_\_\_\_\_  
 A) dividend paid to parent company  
 B) management fees and distributed overhead  
 C) rent and lease payments  
 D) royalties and license fees
  
- 6) \_\_\_\_\_ exposure is far more important for the long-run health of a business than changes caused by \_\_\_\_\_ or \_\_\_\_\_ exposure. 6) \_\_\_\_\_  
 A) Operating; translation; transaction B) Transaction; operating; translation  
 C) Translation; operating; transaction D) Accounting; translation; transaction
  
- 7) Simpson Sign Company based in Frostbite Falls, Minnesota has a 6-month C\$100,000 contract to complete sign work in Winnipeg, Manitoba, Canada. The current spot rate is \$1.02/C\$ and the forward rate is \$1.01/C\$. Under conditions of equilibrium, management would use \_\_\_\_\_ today when preparing operating budgets. 7) \_\_\_\_\_  
 A) \$100,000 B) \$101,000  
 C) \$102,000 D) none of the above
  
- 8) When considering the phases of adjustment and response to operating exposure in the LONG RUN, price changes tend to be \_\_\_\_\_ and volume changes tend to be \_\_\_\_\_. 8) \_\_\_\_\_  
 A) completely flexible; completely flexible. B) fixed/contracted; contracted.  
 C) fixed/contracted; completely flexible. D) completely flexible; contracted.

**TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.**

- 9) The goal of operating exposure analysis is to identify strategic operating techniques the firm might adopt to enhance value in the face of unanticipated exchange rate changes. 9) \_\_\_\_\_
- 10) Operating cash flows may occur in different currencies and at different times, but financing cash flows may occur only in a single currency. 10) \_\_\_\_\_
- 11) Expected changes in foreign exchange rates should already be factored into anticipated operating results by management and investors. 11) \_\_\_\_\_
- 12) Moral hazard may occur when a firm or individual takes on more risk when it knows that someone else will "pick up the tab." 12) \_\_\_\_\_
- 13) Even though contracts are often fixed in the short run, as time passes, prices and costs can be changed to reflect the new competitive realities caused by a change in exchange rates. 13) \_\_\_\_\_

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- 14) Recently the British Pound suffered an unexpected depreciation in value. Which of the following actions being considered by Coventry Furniture of London, a purely domestic furniture manufacturer and retailer, would be considered a *highly unlikely* response to the depreciation of the pound? 14) \_\_\_\_\_
- A) Coventry might try to lower domestic prices because competing imports are now priced higher in England.
  - B) Coventry might choose to maintain its domestic sales prices constant in pound terms.
  - C) Coventry might try to raise domestic prices because competing imports are now priced higher in England.
  - D) none of the above
- 15) Recently the Canadian dollar realized an unexpected appreciation in value. Which of the following actions being considered by Tall Timber Exports, a Canadian logging firm specializing in exporting raw forest products, would be considered a *highly unlikely* response to the appreciation of the Canadian dollar? 15) \_\_\_\_\_
- A) Tall Timber Exports might leave export prices as they are and wait to determine what actions to take if any in the future.
  - B) Tall Timber Exports might lower export prices in an effort to maintain market share.
  - C) Tall Timber Exports might raise export prices only slightly in an effort to increase market share.
  - D) all of the above
- 16) For a firm that competes internationally to sell its products, a depreciation of its domestic currency relative to markets where the firm exports goods, should eventually result in \_\_\_\_\_ sales at home and \_\_\_\_\_ sales abroad, other things equal. 16) \_\_\_\_\_
- A) fewer; fewer
  - B) fewer; greater
  - C) greater; fewer
  - D) greater; greater

- 17) Brimmo Motorcycles Inc., a U.S.-based firm, manufactures and sells electric motorcycles both domestically and internationally. A sudden and unexpected appreciation of the U.S. dollar should allow sales to \_\_\_\_\_ at home and \_\_\_\_\_ abroad. (Assume other factors remain unchanged.) 17) \_\_\_\_\_
- A) increase; increase  
B) decrease; increase  
C) increase; decrease  
D) decrease; decrease

**TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.**

- 18) The strategy management undertakes in response to unexpected changes in exchange rates depends to a large measure on their opinion about the price elasticity of demand. 18) \_\_\_\_\_
- 19) Unexpected changes in exchange rates is never good news for a firm's operating income. 19) \_\_\_\_\_

**MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.**

- 20) Which of the following is NOT an example of diversifying operations? 20) \_\_\_\_\_
- A) diversifying location of operations  
B) diversifying sales  
C) sourcing raw materials in more than one country  
D) raising funds in more than one country
- 21) Which of the following is NOT an example of diversification in financing? 21) \_\_\_\_\_
- A) raising funds in more than one market  
B) diversifying sales  
C) raising funds in more than one country  
D) All of the above qualify.
- 22) When disequilibria in international markets occur, management can take advantage by: 22) \_\_\_\_\_
- A) recognizing disequilibria faster than purely domestic competitors.  
B) shifting operational of financing activities to take advantage of the disequilibria.  
C) doing nothing if they are already diversified and able to realize beneficial portfolio effects.  
D) all of the above
- 23) Purely domestic firms will be at a disadvantage to MNEs in the event of market disequilibria because: 23) \_\_\_\_\_
- A) domestic firms lack comparative data from its own sources.  
B) all of the domestic firm's raw materials are imported.  
C) international firms are already so large.  
D) None of the above; domestic firms are not at a disadvantage.
- 24) Which of the following is probably NOT an advantage of foreign exchange risk management? 24) \_\_\_\_\_
- A) reduced cost of capital  
B) the reduction of the variability of cash flows due to domestic business cycles  
C) increased availability of capital  
D) All of the above are potential advantages of foreign exchange risk management.

- 25) Which of the following is NOT an example of a form of *political* risk that might be avoided or reduced by foreign exchange risk management? 25) \_\_\_\_\_
- A) expropriation of assets
  - B) unfavorable legal changes
  - C) war
  - D) destruction of raw materials through natural disaster

**TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.**

- 26) Management must be able to predict disequilibria in international markets to take advantage of diversification strategies. 26) \_\_\_\_\_
- 27) If a firm diversifies its financing sources, it will be pre-positioned to take advantage of temporary deviations from the International Fisher Effect. 27) \_\_\_\_\_
- 28) Diversifying the *financing base* means diversifying sales, location of production facilities, and raw material sources. 28) \_\_\_\_\_
- 29) The variability of a firm's operating cash flows is probably reduced by international diversification of its production, sourcing, and sales because exchange rate changes under disequilibrium conditions are likely to increase the firm's competitiveness in some markets while reducing it in others. 29) \_\_\_\_\_

**ESSAY. Write your answer in the space provided or on a separate sheet of paper.**

- 30) Diversification is possibly the best technique for reducing the problems associated with international transactions. Provide one example each of international financial diversification and international operational diversification and explain how the action reduces risk.

**MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.**

- 31) Which of the following is NOT identified by your authors as a proactive management technique to reduce exposure to foreign exchange risk? 31) \_\_\_\_\_
- A) matching currency cash flows
  - B) remaining a purely domestic firm
  - C) parallel loans
  - D) cross-currency swaps
- 32) Which one of the following management techniques is likely to best offset the risk of long-run exposure to receivables denominated in a particular foreign currency? 32) \_\_\_\_\_
- A) Lend money in the foreign currency in question.
  - B) Borrow money in the foreign currency in question.
  - C) Increase sales to that country.
  - D) Increase sales in this country.

- 33) Which one of the following management techniques is likely to best offset the risk of long-run exposure to payables denominated in a particular foreign currency? 33) \_\_\_\_\_
- A) Lend money in the foreign currency in question.
  - B) Rely on the Federal Reserve Board to enact monetary policy favorable to your exposure risk.
  - C) Borrow money in the foreign currency in question.
  - D) none of the above
- 34) The particular strategy of trying to offset stable inflows of cash from one country with outflows of cash in the same currency is known as: 34) \_\_\_\_\_
- A) diversification.
  - B) balancing.
  - C) matching.
  - D) hedging.
- 35) Which of the following is NOT an acceptable hedging technique to reduce risk caused by a relatively predictable long-term foreign currency inflow of Japanese yen? 35) \_\_\_\_\_
- A) Import raw materials from Japan denominated in yen to substitute for domestic suppliers.
  - B) Import raw materials from Japan denominated in dollars.
  - C) Acquire debt denominated in yen.
  - D) Pay suppliers from other countries in yen.
- 36) An MNE has a contract for a relatively predictable long-term inflow of Japanese yen that the firm chooses to hedge by seeking out potential suppliers in Japan. This hedging strategy is referred to as: 36) \_\_\_\_\_
- A) diversification.
  - B) a natural hedge.
  - C) matching.
  - D) currency-switching.
- 37) An MNE has a contract for a relatively predictable long-term inflow of Japanese yen that the firm chooses to hedge by paying for imports from Canada in Japanese yen. This hedging strategy is known as: 37) \_\_\_\_\_
- A) matching.
  - B) diversification.
  - C) currency-switching.
  - D) a natural hedge.
- 38) A U.S. timber products firm has a long-term contract to import unprocessed logs from Canada. To avoid occasional and unpredictable changes in the exchange rate between the U.S. dollar and the Canadian dollar, the firms agree to split between the two firms the impact of any exchange rate movement. This type of agreement is referred to as: 38) \_\_\_\_\_
- A) currency-switching.
  - B) risk-sharing.
  - C) matching.
  - D) a natural hedge.
- 39) A \_\_\_\_\_ occurs when two business firms in separate countries arrange to borrow each other's currency for a specified period of time. 39) \_\_\_\_\_
- A) forward loan
  - B) currency switch loan
  - C) back-to-back loan
  - D) natural hedge loan

- 40) A Canadian firm with a U.S. subsidiary and a U.S. firm with a Canadian subsidiary agree to a parallel loan agreement. In such an agreement, the Canadian firm is making a/an \_\_\_\_\_ loan to the \_\_\_\_\_ subsidiary while effectively financing the \_\_\_\_\_ subsidiary. 40) \_\_\_\_\_  
A) direct; Canadian; U.S. B) indirect; Canadian; U.S.  
C) direct; U.S.; Canadian D) indirect; U.S.; Canadian
- 41) Which of the following is NOT an important impediment to widespread use of parallel loans? 41) \_\_\_\_\_  
A) the risk that one of the parties will fail to return the borrowed funds when agreed  
B) the process does not avoid exchange rate risk  
C) difficulty in finding an appropriate counterparty  
D) All of the above are significant impediments.
- 42) A \_\_\_\_\_ resembles a back-to-back loan except that it does not appear on a firm's balance sheet. 42) \_\_\_\_\_  
A) counterparty B) currency swap  
C) forward loan D) currency hedge
- 43) A \_\_\_\_\_ is the term used to describe a foreign currency agreement between two parties to exchange a given amount of one currency for another, and after a period of time, to give back the original amounts. 43) \_\_\_\_\_  
A) currency swap B) back-to-back loan  
C) matched flow D) none of the above
- 44) A British firm and a U.S. Corporation each wish to enter into a currency swap hedging agreement. The British firm is receiving U.S. dollars from sales in the U.S. but wants pounds. The U.S. firm is receiving pounds from sales in Britain but wants dollars. Which of the following choices would best satisfy the desires of the firms? 44) \_\_\_\_\_  
A) The British firm pays dollars to a swap dealer and receives dollars from the dealer. The U.S. firm pays pounds to the swap dealer and receives pounds.  
B) The British firm pays pounds to a swap dealer and receives pounds from the dealer. The U.S. firm pays dollars to the swap dealer and receives dollars.  
C) The U.S. firm pays dollars to a swap dealer and receives pounds from the dealer. The British firm pays pounds to the swap dealer and receives dollars.  
D) The British firm pays dollars to a swap dealer and receives pounds from the dealer. The U.S. firm pays pounds to the swap dealer and receives dollars.
- 45) Reinvocing centers provide the following benefit(s): 45) \_\_\_\_\_  
A) effectively guarantee the exchange rate for future orders.  
B) help manage intra-subsiary cash flows.  
C) aid in the management of foreign exchange exposure.  
D) all of the above

- 46) NorthRim Inc. (NRI), imports extreme condition outdoor wear and equipment from the Allofit Territories Company (ATC) located in Canada. With the steady decline of the U.S dollar against the Canadian dollar NRI is finding a continued relationship with ATC to be an increasingly difficult proposition. In response to NRI's request, ATC has proposed the following risk-sharing arrangement. First, set the current spot rate as the base rate. As long as spot rates stay within 5% (up or down) NRI will pay at the base rate. Any rate outside of the 5% range, ATC will share equally with NRI the difference between the spot rate and the base rate. If the current spot rate is C\$1.20/\$, what are the upper and lower limits for trading to take place at C\$1.20? 46) \_\_\_\_\_
- A) C\$1.14/\$ - C\$1.26/\$                      B) C\$1.205/\$ - C\$1.195/\$  
 C) C\$1.15/\$ - C\$1.25/\$                      D) none of the above
- 47) NorthRim Inc. (NRI), imports extreme condition outdoor wear and equipment from The Allofit Territories Company (ATC) located in Canada. With the steady decline of the U.S dollar against the Canadian dollar NRI is finding a continued relationship with ATC to be an increasingly difficult proposition. In response to NRI's request, ATC has proposed the following risk-sharing arrangement. First, set the current spot rate as the base rate. As long as spot rates stay within 5% (up or down) NRI will pay at the base rate. Any rate outside of the 5% range, ATC will share equally with NRI the difference between the spot rate and the base rate. If NRI has a payable of C\$100,000 due today and the current spot rate is C\$1.17/\$, how much does LBC owe in U.S. dollars? 47) \_\_\_\_\_
- A) \$83,333                      B) \$117,000                      C) \$85,837                      D) \$85,470
- 48) Costs associated with the purchase of sizeable put options positions include each of the following EXCEPT: 48) \_\_\_\_\_
- A) executive salaries of having corporate offices in more than one country.  
 B) the opportunity cost of buying the options rather than diversifying operations to reduce risk.  
 C) the purchase price of the options.  
 D) none of the above

**TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.**

- 49) Currency swaps are exclusively for periods of time under one year. 49) \_\_\_\_\_
- 50) Most swap dealers arrange swaps so that each firm that is a party to the transaction does not know who the counterparty is. 50) \_\_\_\_\_
- 51) Most swap dealers arrange swaps so that each firm that is a party to the transaction knows who the counterparty is. 51) \_\_\_\_\_
- 52) Swap agreements are treated as off-balance sheet transactions via U.S. accounting methods. 52) \_\_\_\_\_
- 53) Swap agreements are treated as line items on the balance sheet via U.S. accounting methods. 53) \_\_\_\_\_
- 54) After being introduced in the 1980s, currency swaps have remained a relatively insignificant financial derivative instrument. 54) \_\_\_\_\_

55) After being introduced in the 1980s, currency swaps have gained increasing importance as financial derivative instruments. 55) \_\_\_\_\_

56) The empirical evidence strongly supports the proposition that contractual hedges can effectively eliminate operating exposure. 56) \_\_\_\_\_

**ESSAY. Write your answer in the space provided or on a separate sheet of paper.**

57) A British firm has a subsidiary in the U.S., and a U.S. firm, known to the British firm, has a subsidiary in Britain and then provide an example for each of the following management techniques for reducing the firm's operating flows. The following are techniques to consider:

- a) matching currency cash flows
- b) risk-sharing agreements
- c) back-to-back or parallel loans



## Answer Key

Testname: UNTITLED3

- 1) D
- 2) D
- 3) C
- 4) A
- 5) A
- 6) A
- 7) B
- 8) A
- 9) TRUE
- 10) FALSE
- 11) TRUE
- 12) TRUE
- 13) TRUE
- 14) A
- 15) C
- 16) D
- 17) D
- 18) TRUE
- 19) FALSE
- 20) D
- 21) B
- 22) D
- 23) A
- 24) D
- 25) D
- 26) FALSE
- 27) TRUE
- 28) FALSE
- 29) TRUE
- 30) An MNE well known in the financial markets could borrow money in a country in which the firm receives foreign currency. The MNE could then use the receivables to repay the loan in the foreign currency and avoid uncertainties in exchange rates. An MNE could establish production facilities in several countries. This could be beneficial in at least two ways. First, diversification reduces the probability of unfavorable changes in exchange rates for one country from significantly reducing the firm's profitability. Second, an MNE with facilities in several countries is well positioned by using internal sources to recognize when a disequilibrium in the market arises.
- 31) B
- 32) B
- 33) A
- 34) C
- 35) B
- 36) B
- 37) C
- 38) B

## Answer Key

Testname: UNTITLED3

39) C

40) C

41) B

42) B

43) A

44) D

45) D

46) A

47) A

48) A

49) FALSE

50) TRUE

51) FALSE

52) TRUE

53) FALSE

54) FALSE

55) TRUE

56) FALSE

- 57) a) Matching currency cash flows requires that the British firm with dollar receivables must establish an equivalent dollar payable. They could do this by borrowing dollars and repaying the loan with the proceeds from the receivables account. They could move all or part of their operations to the U.S. so that both receivables and payables would be in U.S. dollars.
- b) Risk-sharing agreements are contractual clauses whereby both parties agree to an acceptable range of exchange rate at the time the international sale is made. A spot rate at time of exchange outside of the agreed upon range results in an adjustment to the actual exchange rate that shares the difference between the spot rate and the acceptable range of exchange rate.
- c) Back-to-back loans provide for parent-subsidary cross border financing without incurring direct currency exposure. For example, using our British and U.S. firms, the British firm could lend pounds to the U.S. subsidiary in Britain at the same time that the U.S. firm lends an equivalent amount of dollars to the British subsidiary in the U.S. Later, the loans would be simultaneously repaid.