**FIN 415 Term Project Part I**

CP Inc. is a producer of drinks in Jax, Florida. Currently, the company has mainly operated in U.S., but it wants to expand into Europe. The first step is setting up subsidiaries in Spain and Sweden, then to set up a plant in Spain, and, finally, to distribute the product throughout the European market. However, the CFO worried about the implications of the foreign expansion on the firm’s financial management. She has asked you, a consultant as a financial analyst, to develop a PPT package that explains the basics of multinational financial management. To get you started, please answer to the following questions.

a. What is a multinational corporation? Why do firms expand into other countries?

b. What are the major factors which distinguish multinational financial management from financial management as practiced by a purely domestic firm?

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| c. Consider the following illustrative exchange rates. | | | | | | |
|  |  |  | U.S. Dollars Required to Buy | | |
|  |  |  | One Unit of Foreign Currency | | |
|  | Euro |  | 1.2500 | | |
|  | Swedish krona | | 0.1481 | | |
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| 1. Are these currency prices direct quotations or indirect quotations? | | | | | | |
| 1. Calculate the indirect quotations for euros and kronor (Hint: the plural of krona is kronor). | | | | | | |
| 1. What is a cross rate? Calculate the two cross rates between euros and kronor. | | | | | | |
| 1. Assume CP can produce a liter of juice and ship it to Spain for $1.75. If the firm wants a 50 percent markup on the product, what should the juice sell for in Spain? | | | | | | |
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1. Now, assume CP begins producing the same liter of juice in Spain. The product costs 2.0 euros to produce and ship to Sweden, where it can be sold for 20 kronor. What is the dollar profit on the sale?
2. What is exchange rate risk?

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| d. Briefly describe the current international monetary system. How does the current system differ from the system that was in place prior to August 1971? |
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| e. What is a convertible currency? What problems arise when a multinational company operates in a country whose currency is not convertible? |
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| f. What is the difference between spot rates and forward rates? When is the forward rate at a premium to the spot rate? At a discount? |
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g. What is interest rate parity? Currently, you can exchange 1 euro for 1.27 dollars in the 180-day forward market, and the risk-free rate on 180-day securities is 6 percent in the United States and 4 percent in Spain. Does interest rate parity hold? If not, which securities offer the highest expected return?

h. What is purchasing power parity? If grapefruit juice costs $2.00 a liter in the United States and purchasing power parity holds, what should be the price of grapefruit juice in Spain?

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| i. What impact does relative inflation have on interest rates and exchange rates? |
| j. Briefly discuss the international capital markets. |

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| k. Using the data below, evaluate a potential investment by a U.S. company in Japan. | | | | | | | | |
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| Intital cost in million of yen = | | | ¥1,000 |  | ¥ |  |  |  |
| Year 1 CF in yen = | |  | ¥500 |  |  |  |  |  |
| Year 2 CF in yen = | |  | ¥800 |  |  |  |  |  |
| U.S. project cost of capital = | | | 10.0% |  |  |  |  |  |
| Current indirect exchange rate = | | | 110.0 | ¥/$ |  |  |  |  |
| Current direct exchange rate = | | | 0.0091 | $/¥ |  |  |  |  |
| 1-Year U.S. bond interest rate = | | | 2.0% |  |  |  |  |  |
| 2-Year U.S. bond interest rate = | | | 2.8% |  |  |  |  |  |
| 1-Year Japan bond interest rate = | | | 0.05% |  |  |  |  |  |
| 2-Year Japan bond interest rate = | | | 0.26% |  |  |  |  |  |
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| Use the interest rate parity relationship to estimate the future expected exchange rates: | | | | | | |  |  |
| f t | = | e0 [(1+r h) / (1+r f)]t | |  |  |  |  |  |