Case Presentation

Hedging Currency Risks at AIFS

Objectives
The case provides an introduction to how currency mismatches create exposures, why companies hedge those exposures and how they hedge those exposures. In short, the case forces you to decide if to hedge, how much to hedge, and what instruments to use to hedge. The case allows you to:
1. Identify the sources of exposures to exchange rate fluctuations and why companies choose to manage these risks
2. Consider the use of different instruments in hedging foreign exchange exposure
3. Evaluate different hedging strategies in the presence of volume uncertainty
4. Consider what outcomes should be hedged against

Questions
1. What gives rise to the currency exposure at AIFS?
2. What would happen if Archer-Lock and Tabaczynski did not hedge at all?
3. What would happen with a 100% hedge with forwards? A 100% hedge with options? Use the forecasted final sales volume of 25,000 and analyze the possible outcomes relative to the ‘zero impact’ scenario described in the case.
4. What happens if sales volumes are lower or higher than expected as outlined at the end of the case?
5. What hedging decision would you advocate?

Innocents Abroad

Objectives
To apply Mean/Variance Optimization Theory

Questions
1. Compute the annualized returns and standard deviations for the equity markets of Australia, Canada, France, Germany, Hong Kong, Japan, the United Kingdom, and the U.S. from 1981-2003 and over two sub-periods, 1981-1991 and 1992-2003, using both native currency based returns and USD based returns. Interpret and analyze the results. Why do some countries have return and standard deviations in that magnitude and why are they different across times?
2. Compute correlations between the different markets over the entire period and over the same subperiods using first the returns data based on local currencies and the US dollar based data. Why are the results different? Explain.
3. The annual performance of foreign equities (as measured by the EAFE index) relative to US equities (as measured by the S&P 500 index) from 1981-2003 and the decomposition of that relative performance into local equity returns and currency returns. Explain why the results are different across time. Which factors drive the results?
4. The returns and standard deviations of a series of portfolios based on different mixes of foreign and US equities, using the returns on the S&P 500 and EAFE indices (both native currency and dollar based) to construct these portfolios. Again, Mayer planned
to present the results for different time periods: 1981-2003, 1981-1991, and 1992-2003, and wanted to use the data to map efficient frontiers for each of different time periods.
5. If you are interested to invest in Australia, Canada, France, Germany, Hong Kong, Japan, the U.K., and the U.S, what are the investment proportions that define the minimum variance portfolio with and without short-selling restriction? What is the variance of this portfolio under these circumstances?
6. What are the investment proportions of portfolio that maximize Sharpe’s ratio with and without short-selling restriction? What is the variance of this portfolio?

**BMW Currency Hedging 2007**

**Objectives**
To understand corporate exposure to changes in exchange rates on transactions and possible currency hedging strategies

**Questions**
1. Evaluate the operating and transaction exposure that BMW faces
2. Should the company hedge the dollar exposure? Why or why not? To what extent?
3. What are the methods available for hedging this exposure?
4. What are the costs and benefits of each
5. Discuss methods used by the company and to what extent they should be used
6. Estimate the impact of the $ per pound rate on the company profits in the following years

**Nodal Logistics and Custo Brasil**

**Objectives**
To apply corporate finance, international finance, foreign exchange risk management, and real estate investment trusts (REITs)

**Questions**
1. What is a REIT?
2. Why is Nodal Logistics interested in entering the Brazilian market?
3. What special challenges does Nodal face entering the Brazilian market?
4. What kind of currency risk does the Brazilian project pose to Nadal?
5. What are the primary management methods to be considered in managing the risk?
6. What degree of risk does Nodal face if it chose to remain uncovered?
7. What are the expected dollar proceeds for the various hedging alternatives?
8. Which among the various hedging alternatives would you recommend if you were John? Explain your reasoning.

**Foreign Exchange Hedging Strategies at General Motors: Competitive Exposures**

**Objectives**
1. To identify the sources of competitive exposures
2. To examine different methodologies for quantifying these risks
3. To explore how competitive issues have financial consequences

Questions
1. Why is GM worried about the yen?
2. How important is the competitive exposure to the yen?
3. How would you go from the information in the case about competitive interactions with Japanese manufacturers to a value exposure for GM?
4. Are there less information-intensive methods that might allow you to assess the competitive exposures of GM, specifically, or other firms generally? How would you implement such a method?

Foreign Exchange Hedging Strategies at General Motors: Transactional and Translational Exposures

Objectives
1. To examine the reasons for hedging
2. To identify the different types of exchange rate risks faced by companies with international operations
3. To understand the decisions that have to be made to construct a hedging policy and evaluate one such policy
4. To analyze how changes in exchange rates affect a company’s financial statements using GM’s exposure to the Canadian dollar
5. To compare the use of futures and options in implementing hedges
6. To evaluate risk management decisions in the more extreme setting of an imminent devaluation

Questions
1. Should multinational firms hedge foreign exchange rate risk? If not, what are the consequences? If so, how should they decide which exposures to hedge?
2. What do you think of GM’s foreign exchange hedging policies? Would you advise any changes?
3. Should GM deviate from its policy in hedging its CAD exposure? Why or why not?
4. If GM does deviate from its formal policy for its CAD exposure, how should GM think about whether to use forwards or options for the deviation from the policy?
5. Why is GM worried about the ARS exposure? What operational decisions could it have made or now make to manage this exposure?

The Refinancing of Shanghai General Motors

Objectives
1. Evaluate joint ventures from the standpoints of both multinationals and local firms and identify the advantages and disadvantages from the perspective of each party
2. Discuss alternative motivations for foreign direct investment and their consequences for organizational form decisions
3. Examine the financing of a multinational’s overseas subsidiary from its founding through a proposed financing
4. Explore how the currency composition of debt can influence a firm
5. Consider how financial policy within a firm resembles and differs from, financial policy outside the firm

Questions
1. Why might GM have chosen to enter China through a joint venture?
2. What conflicts might arise with the JV partner and were sufficient actions taken to mitigate these conflicts?
3. What are the competitive consequences of China’s entry into the World Trade Organization? How does it affect customer behavior? Supplier behavior? JV partner behavior? Bank lending behavior? Regulator behavior?
4. What were some of the most significant costs of the first financing? What drove the initial choices to incur these costs? Were there alternatives?
5. How would you prioritize your concerns as Newman as you approached the refinancing?
6. Why would GM want its Shanghai subsidiary to borrow funds directly from the local markets when GM might be able to more attractive terms?
7. How should multinational firms develop a strategy for the major financial decisions for their subsidiaries? How do these decisions differ from key financial decisions at the firm level?

Wiley International

Objectives
To value an international project
To understand the risks of doing business in an emerging market
To evaluate projects in these markets

Questions
1. Why would Wiley consider investing in Brazil?
2. What are the advantages and disadvantages to locating its operations in Brazil?
3. Based on the 5—year life of the project, does this project look attractive for Wiley? Be prepared to support your answer.
4. What discount rate would you use to discount the cash flows from the project? Does this adequately capture the risk of investing in Brazil?
5. What is the value of the financing being provided by the Japanese manufacturer? How does this change the viability of the project?
6. As Esposito, would you approve the proposal?

AES

Objectives
To examine country risk, cost of capital, valuation, emerging markets, and capital budgeting
Questions
1. How would you evaluate the capital budgeting method used historically by AES? What’s good and bad about it?
2. If Venerus implements the suggested methodology, what would be the range of discount rates that AES would use around the world?
3. Does this make sense as a way to do capital budgeting?
4. What is the value of the Pakistan project using the cost of capital derived from the new methodology? If this project was located in the U.S., what would its value be?
5. How does the adjusted cost of capital for the Pakistan project reflect the probability of real events? What does the discount rate adjustment imply about expectations for the project because it is located in Pakistan and not the U.S?

Ashai Glass
Objectives
To understand the unique nature of the Japanese financial system, the alternative ways of organizing a global firm, and the ways in which EVA can be adapted to a multinational setting.

Questions
1. How did main-bank relationships impact Japanese corporate governance?
2. What do you view as the primary obstacles facing Ishizu as he continues to try to transform Asahi Glass? What prompted the organizational changes? Do these changes matter?
3. What are the premises of EVA systems? Do they make sense?
4. How would you evaluate the EVA system implemented by Asahi? Would you recommend any changes?
5. Would you buy stock in Asahi?

Drilling South
Objectives
1. To explore issues of corporate governance in emerging markets
2. To consider how and why shares of foreign firms are listed in the U.S.
3. To identify key valuation issues in emerging markets and in cross-border acquisitions
4. To explore how political considerations impact a firm’s financial and strategic decisions
5. To examine the effects of the currency denomination of debt on a firm
6. To evaluate how currency crises affect firms and the risks and opportunities of such crises

Questions
1. Would you invest in Petrobras stock?
2. What you be most worried about?
3. Why did Petrobras cross-list?
4. Why do firm cross-list?
5. What are the consequences of cross-listing?
6. How should Petrobras value Pecom?

Fonderia Di Torino S.p.A

Objectives
1. To understand the mechanisms of DCF analysis of go/no-go capital-investment decisions
2. To consider the principle of incremental analysis as the foundation for identifying relevant cash flows for a project
3. To explore the classic tradeoffs in capital-for-labor investment
4. To review the analytical adjustments that are required to compare projects of unequal lives

Questions
1. Please assess the economic benefits of acquiring the Vulcan Mold-Maker machine.
2. What is the initial outlay?
3. What are the benefits over time?
4. What is an appropriate discount rate?
5. Does the NPV warrant the investment in the machine?
6. What uncertainties or qualitative considerations might influence your recommendation?
7. How, if at all, would an inflation rate of 3% (or higher) affect the attractiveness of the Vulcan Mold-Maker?
8. Please estimate the impact on NPV from a change in any of those elements?
9. Should Francesca Cerini proceed with the project?

Please assume that the semiautomated equipment could be operated for 2 more years beyond the end of its depreciable life thanks to ordinary maintenance. Therefore, the lives of both the semiautomated and Vulcan Mold-Maker alternatives will be 8 years.