



Chapter 1: Multinational Financial Management: An Overview

Study Questions

International Management (University of Houston-Downtown)



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Indicate whether the statement is true or false.

1. The Sarbanes-Oxley Act (SOX), which was enacted in 2002, required MNCs and other firms to implement an internal reporting process that could be easily monitored by executives and the board of directors.
 - a. True
 - b. False
2. If a U.S.-based MNC focused entirely on importing, then its valuation would likely be adversely affected if most currencies were expected to appreciate against the dollar over time.
 - a. True
 - b. False
3. The imperfect markets theory states that factors of production are somewhat immobile, allowing firms to capitalize on a foreign country's resources.
 - a. True
 - b. False
4. A decentralized management style, where subsidiary managers make the relevant decisions regarding their subsidiary, may result in better decision making, as subsidiary managers are generally better informed about their subsidiary's operations.
 - a. True
 - b. False
5. MNCs commonly consider acquiring an existing foreign operation because the cost is less expensive than establishing a new subsidiary of the same size.
 - a. True
 - b. False
6. The theory of comparative advantage begins by assuming that a given firm first becomes established in its home country and may subsequently penetrate foreign markets via geographic or product differentiation.
 - a. True
 - b. False
7. The Sarbanes-Oxley Act ensures a more transparent process for managers to report on the productivity and financial condition of their firm.
 - a. True
 - b. False
8. Licensing is the process by which a firm provides its technology (copyrights, patents, trademarks, or trade names) in exchange for fees or some other specified benefits.
 - a. True
 - b. False
9. A centralized management style for an MNC results in relatively high agency costs.
 - a. True
 - b. False

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10. The goal of a multinational corporation (MNC) is the maximization of shareholder wealth.
- True
 - False
11. A centralized management style, where major decisions about a foreign subsidiary are made by the parent company, results in an increase in agency costs.
- True
 - False
12. Institutional investors such as mutual funds or pension funds that have large holdings of an MNC's stock do not normally want to take control of it and therefore have no influence over management of the MNC.
- True
 - False
13. In determining the valuation of foreign projects, an MNC will always use the same required rate of return as it would for its domestic projects.
- True
 - False
14. A U.S.-based MNC has many foreign subsidiaries in Europe and does not expect to increase its investment there. Its value should increase if the value of the euro weakens over time.
- True
 - False
15. If markets were perfect, then labor and other costs of production would be perfectly stable (no movement across borders).
- True
 - False
16. Imperfect markets reflect conditions under which factors of production are immobile.
- True
 - False
17. Franchising is the process by which national governments sell state-owned operations to corporations and other investors.
- True
 - False
18. Under the imperfect markets theory, it is assumed that factors of production are entirely mobile, so that firms can capitalize on a foreign country's resources.
- True
 - False
19. U.S.-based MNCs are typically not monitored by mutual funds and pension funds, as these institutions rarely hold stock in MNCs.
- True
 - False

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20. Licensing allows firms to use their technology in foreign markets without a major investment in foreign countries.
- a. True
 - b. False
21. If markets were perfect, then labor and other costs of production would be easily transferable.
- a. True
 - b. False
22. Although MNCs may need to convert currencies occasionally, they do not face any exchange rate risk, as exchange rates are stable over time.
- a. True
 - b. False
23. If a publicly traded MNC's managers make poor decisions that reduce its value, that may encourage other firms to acquire the MNC.
- a. True
 - b. False
24. A decentralized management style results in relatively high agency costs for an MNC.
- a. True
 - b. False
25. The valuation of an MNC is reduced if the required rate of return on its investments in foreign countries is reduced.
- a. True
 - b. False
26. A macroeconomic perspective focuses on the financial management decisions that affect the value of an MNC.
- a. True
 - b. False
27. One of the most prevalent factors conflicting with the realization of the goal of an MNC is the existence of agency problems.
- a. True
 - b. False
28. If managers of foreign subsidiaries make decisions that maximize the values of their respective subsidiaries, they automatically maximize the value of the entire corporation.
- a. True
 - b. False
29. A product cycle is the process by which a firm provides a specialized sales or service strategy, support assistance, and possibly an initial investment in a franchise in exchange for periodic fees.
- a. True
 - b. False
30. When the parent's home currency is weak, remitted funds from foreign subsidiaries will convert to a smaller amount

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of the home currency.

- a. True
- b. False

31. The parent of an MNC can implement compensation plans that directly reward the subsidiary managers for enhancing the value of the MNC.

- a. True
- b. False

32. The valuation of an MNC accounts for all the cash flows received by the foreign subsidiaries plus all the cash flows remitted by the subsidiaries.

- a. True
- b. False

33. Assume that an MNC has a subsidiary in Italy, which exports its products to various countries in Europe. Since all of the countries where it exports use the euro as their currency, this MNC is not subject to exchange rate risk.

- a. True
- b. False

34. Under the product cycle theory, foreign demand can be initially satisfied by exporting.

- a. True
- b. False

35. If a U.S.-based MNC focused entirely on exporting, then its valuation would likely be adversely affected if most currencies were expected to appreciate against the dollar over time.

- a. True
- b. False

36. A purely domestic firm may be affected by exchange rate fluctuations if it faces at least some foreign competition.

- a. True
- b. False

37. A microeconomic perspective focuses on external forces such as economic conditions that can affect the value of an MNC.

- a. True
- b. False

38. If a U.S. firm sets up a plant in Mexico to benefit from low-cost labor, it will likely have a comparative advantage over other firms in Mexico that sell the same product.

- a. True
- b. False

39. One form of exposure to political risk is terrorism.

- a. True
- b. False

40. International trade is the most common form of direct foreign investment (DFI).

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- a. True
- b. False

41. MNCs commonly consider establishing a new foreign subsidiary to replace their exporting business because it allows them to avoid exchange rate risk.

- a. True
- b. False

Indicate the answer choice that best completes the statement or answers the question.

42. Jensen Co. wants to establish a new subsidiary in Mexico that will sell computers to Mexican customers and remit earnings back to the U.S. parent. The value of this project will be favorably affected if the value of the peso ____ while Jensen establishes the new subsidiary and ____ when the subsidiary starts operations.

- a. depreciates;
appreciates
- b. appreciates;
appreciates
- c. appreciates;
depreciates
- d. depreciates;
depreciates

43. With regard to corporate goals, an MNC is mostly concerned with maximizing ____, and a purely domestic firm is mostly concerned with maximizing ____.

- a. shareholder wealth; short-term earnings
- b. shareholder wealth; shareholder wealth
- c. short-term earnings; sales volume
- d. short-term earnings; shareholder wealth

44. MNCs can improve their internal control process by all of the following, except:

- a. establishing a centralized database of information.
- b. ensuring that all data are reported consistently among subsidiaries.
- c. ensuring that the MNC always borrows from countries where interest rates are lowest.
- d. using a system that checks internal data for unusual discrepancies.

45. An MNC may be more exposed to agency problems if most of its shares are held by:

- a. a few mutual funds.
- b. a widely dispersed set of individual investors.
- c. a few pension funds.
- d. All of these would prevent agency problems.

46. The Sarbanes-Oxley Act improved corporate governance of MNCs because it:

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- a. made executives more accountable for verifying financial statements.
 - b. eliminated stock options as a form of compensation.
 - c. tied executive compensation to firm performance.
 - d. placed a limit on the amount of funds that managers can spend.
47. Assume that an American firm wants to engage in international business without making a major investment in the foreign country. Which method is least appropriate in this situation?
- a. international trade
 - b. licensing
 - c. franchising
 - d. direct foreign investment
48. Which of the following theories identifies the nontransferability of resources as a reason for international business?
- a. theory of comparative advantage
 - b. imperfect markets theory
 - c. product cycle theory
 - d. None of these are correct.
49. Assume that Live Co. has expected cash flows of \$200,000 from domestic operations, 200,000 Swiss francs from Swiss operations, and 150,000 euros from Italian operations at the end of the year. The Swiss franc's value and the euro's value are expected to be \$.83 and \$1.29, respectively, at the end of this year. What are the expected dollar cash flows of Live Co?
- a. \$200,000
 - b. \$559,500
 - c. \$582,500
 - d. \$393,500
50. Which of the following is not a way in which agency problems can be reduced through corporate control?
- a. executive compensation
 - b. threat of hostile takeover
 - c. acquisition of a foreign subsidiary
 - d. monitoring by large shareholders
51. Saller Co. has a subsidiary in Mexico. The expected cash flows in pesos to be received in the future from this subsidiary have not changed since last month, but the valuation of Saller Co. has declined since last month. What could have caused this decline in value?
- a. a weaker Mexican economy
 - b. lower Mexican interest rates
 - c. depreciation of the Mexican peso
 - d. appreciation of the Mexican peso
52. Which of the following is not mentioned in the text as a theory of international business?
- a. theory of comparative advantage

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- b. imperfect markets theory
 - c. product cycle theory
 - d. All of these are mentioned in the text as theories of international business.
53. Which of the following is not mentioned in the text as an additional risk resulting from international business?
- a. exchange rate fluctuations
 - b. political risk
 - c. interest rate risk
 - d. exposure to foreign economies
54. For an MNC, agency costs are typically:
- a. nonexistent.
 - b. larger than agency costs of a small purely domestic firm.
 - c. smaller than agency costs of a small purely domestic firm.
 - d. the same as agency costs of a small purely domestic firm.
55. An industry based on which of the following would most likely take advantage of lower costs in some less developed foreign countries?
- a. assembly line production
 - b. specialized professional services
 - c. nuclear missile programs
 - d. development of more sophisticated computer technology
56. Which of the following does not possibly represent a form of direct foreign investment?
- a. franchising
 - b. international trade
 - c. joint ventures
 - d. acquisitions of existing operations
 - e. establishment of new foreign subsidiaries
57. The valuation of an MNC should rise when an event causes the expected cash flows from foreign subsidiaries to _____ and when the foreign currencies denominating these cash flows are expected to _____.
- a. decrease; appreciate
 - b. increase; appreciate
 - c. decrease; depreciate
 - d. increase; depreciate
58. Agency costs faced by MNCs may be larger than those faced by purely domestic firms because:
- a. monitoring of managers located in foreign countries is more difficult.

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- b. foreign subsidiary managers raised in different cultures may not follow uniform goals.
 - c. MNCs are relatively large.
 - d. All of these are correct.
 - e. monitoring of managers located in foreign countries is more difficult AND foreign subsidiary managers raised in different cultures may not follow uniform goals.
59. Which of the following is not an example of political risk?
- a. Government may impose taxes on a subsidiary.
 - b. Government may impose barriers on a subsidiary.
 - c. Consumers may boycott the MNC.
 - d. Consumers' income levels may decrease, thus decreasing consumption.
60. Licensing obligates a firm to provide ____, while franchising obligates a firm to provide ____.
- a. a specialized sales or service strategy; its technology
 - b. its technology; a specialized sales or service strategy
 - c. its technology; its technology
 - d. a specialized sales or service strategy; a specialized sales or service strategy
 - e. its technology; an initial investment
61. The agency costs of an MNC are likely to be lower if it:
- a. scatters its subsidiaries across many foreign countries.
 - b. increases its volume of international business.
 - c. uses a centralized management style.
 - d. scatters its subsidiaries across many foreign countries AND increases its volume of international business.
62. Compared to other methods of international business, international trade generally results in ____ exposure to international political risk and ____ exposure to international economic conditions.
- a. higher; lower
 - b. higher; higher
 - c. lower; higher
 - d. lower; lower
63. When conducting international business, firms generally face the most risk when they:
- a. engage in franchising.
 - b. make acquisitions of existing operations.
 - c. establish new subsidiaries.
 - d. engage of international trade.
 - e. make acquisitions of existing operations AND establish new subsidiaries.
64. Which of the following is an example of direct foreign investment for a U.S.-based MNC?
- a. exporting to a country
 - b. licensing arrangements that will allow a foreign country to use the MNC's technology
 - c. purchasing existing companies in a country

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- d. investing directly (without brokers) in foreign stocks
65. International trade:
- a. is a relatively conservative approach to foreign market penetration.
 - b. entails minimal risk.
 - c. does not require a large amount of investment.
 - d. All of these are correct.
66. The commonly accepted goal of an MNC is to:
- a. maximize short-term earnings.
 - b. maximize shareholder wealth.
 - c. minimize risk.
 - d. maximize short-term earnings AND minimize risk.
 - e. maximize international sales.
67. Livingston Co. has a subsidiary in Korea. The subsidiary reinvests half of its net cash flows into operations and remits half to the parent. Livingston's expected cash flows from domestic business are \$100,000, and the Korean subsidiary is expected to generate 100 million Korean won at the end of the year. The expected value of the won is \$.0012. What are the expected dollar cash flows of Livingston Co.?
- a. \$100,000
 - b. \$200,000
 - c. \$160,000
 - d. \$60,000
68. According to the text, licensing allows a firm to:
- a. import without being subject to government restrictions.
 - b. provide its technology for a fee.
 - c. export without government restrictions.
 - d. None of these are correct.
69. Four MNCs generate the same level of sales. The MNC that _____ would likely have the most direct foreign investment.
- a. exports all of its products
 - b. produces and sells its products locally
 - c. imports products from unrelated firms in other countries and sells them locally
 - d. acquires a foreign firm that produces most of its products to be sold in that foreign country
70. The least risky method by which firms conduct international business is:
- a. franchising.
 - b. acquisitions of existing operations.
 - c. international trade.
 - d. the establishment of new subsidiaries.

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- e. licensing.
71. Which of the following theories suggests that firms seek to penetrate new markets over time?
- a. theory of comparative advantage
 - b. imperfect markets theory
 - c. product cycle theory
 - d. None of these are correct.
72. The goal of an MNC is to:
- a. minimize taxes on funds remitted from foreign subsidiaries.
 - b. establish subsidiaries in any country where operations would provide a return over and above the cost of capital, even if better projects are available domestically.
 - c. maximize shareholder wealth.
 - d. maximize the social benefits resulting from actions such as the employment of foreign managers.
73. Which of the following could reduce agency problems for an MNC?
- a. stock options as managerial compensation
 - b. hostile takeover threat
 - c. investor monitoring
 - d. All of these are forms of corporate control that could reduce agency problems for an MNC.
74. Which of the following theories identifies specialization as a reason for international business?
- a. theory of comparative advantage
 - b. imperfect markets theory
 - c. product cycle theory
 - d. None of these are correct.
75. An MNC's value depends on all of the following, except:
- a. the MNC's required rate of return.
 - b. the amount of the MNC's cash flows in a particular currency.
 - c. the exchange rate at which cash flows are converted to dollars.
 - d. all of these are factors.
76. Due to the risks involved in international business, firms should:
- a. only consider international business in major countries.
 - b. maintain international business to no more than 20% of total business.
 - c. maintain international business to no more than 35% of total business.
 - d. None of these are correct.
77. Which of the following is not one of the more common methods used by MNCs to improve their internal control process?
- a. establishing a centralized database of information
 - b. ensuring that all data are reported consistently among subsidiaries

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- c. speeding the process by which all departments and all subsidiaries have access to the data that they need
- d. making executives more accountable for financial statements by personally verifying their accuracy
- e. All of these are common methods used by MNCs to improve their internal control process.

78. Assume that Boca Co. wants to expand its business to Japan and wants complete control over the operations in Japan. Which method of international business is most appropriate for Boca Co?

- a. joint venture
- b. licensing
- c. partial acquisition of an existing Japanese firm
- d. establishment of a Japanese subsidiary

79. Assume that an MNC purchases a foreign building, and then leases the building to another party and allows that party to operate the business in the building for 30 years if the party follows standards set by the MNC. This process is referred to as:

- a. a foreign acquisition.
- b. franchising.
- c. a licensing agreement.
- d. exporting.

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Answer Key

1. True
2. False
3. True
4. True
5. False
6. False
7. True
8. True
9. False
10. True
11. False
12. False
13. True
14. False
15. False
16. True
17. False
18. False
19. False
20. True
21. True
22. False
23. True
24. True
25. False

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26. False

27. True

28. False

29. False

30. False

31. True

32. False

33. False

34. True

35. False

36. True

37. False

38. False

39. True

40. False

41. False

42. a

43. b

44. c

45. b

46. a

47. d

48. b

49. b

50. c

51. c

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52. d

53. c

54. b

55. a

56. b

57. b

58. d

59. d

60. b

61. c

62. d

63. e

64. c

65. d

66. b

67. c

68. b

69. d

70. c

71. c

72. c

73. d

74. a

75. d

76. d

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77. e

78. d

79. a