Questions and Applications

14. **Sources of Supplies and Exposure to Exchange Rate Risk** Laguna Co. (a U.S. firm) will be receiving 4 million British pounds in one year. It will need to make a payment of 3 million Polish zloty in one year. It has no other exchange rate risk at this time. However, it needs to buy supplies and can purchase them from Switzerland, Hong Kong, Canada, or Ecuador. Another alternative is that it could also purchase one-fourth of the supplies from each of the four countries mentioned in the previous sentence.

    The supplies will be invoiced in the currency of the country from which they are imported. Laguna Co. believes that none of the sources of the imports would provide a clear cost advantage. As of today, the dollar cost of these supplies would be about $6 million regardless of the source that will provide the supplies.

    The spot rates today are as follows:

    1. British pound = $1.80
    2. Swiss franc = $.60
    3. Polish zloty = $.30
    4. Hong Kong dollar = $.14
    5. Canadian dollar = $.60

    The movements of the pound and the Swiss franc and the Polish zloty against the dollar are highly correlated. The Hong Kong dollar is tied to the U.S. dollar, and you expect that it will continue to be tied to the dollar. The movements in the value of the Canadian dollar against the U.S. dollar are not correlated with the movements of the other currencies. Ecuador uses the U.S. dollar as its local currency.

    Which alternative should Laguna Co. select in order to minimize its overall exchange rate risk? Transaction exposure is different from economic exposure, whereas transaction exposure only encompasses international transactions and economic exposure includes all changes to cash flow. Transaction exposure is a subset of economic exposure (Madura, J., 2020).

14. **Financing to Reduce Exchange Rate Exposure** Nashville Co. presently incurs costs of about 12 million Australian dollars (A$) per year for research and development expenses in Australia. It sells the products that are designed each year, and all of the products sold each year are invoiced in U.S. dollars. Nashville anticipates revenue of about $20