

Chapter 13

Host Government Incentives for DFI Why would foreign governments provide MNCs with incentives to undertake DFI there?

Foreign governments sometimes expect that DFI will provide needed employment or technology for a country. For these reasons, they may provide incentives to encourage DFI.

DFI Location Decision Decko Co. is a U.S. firm with a Chinese subsidiary that produces smartphones in China and sells them in Japan. This subsidiary pays its wages and its rent in Chinese yuan, which is stable relative to the dollar. The smartphones sold to Japan are denominated in Japanese yen. Assume that Decko Co. expects that the Chinese yuan will continue to stay stable against the dollar. The subsidiary's main goal is to generate profits for itself and reinvest the profits. It does not plan to remit any funds to Decko, the U.S. parent.

- a. Assume that the Japanese yen strengthens against the U.S. dollar over time. How would this be expected to affect the profits earned by the Chinese subsidiary?

If the yen appreciates against the dollar, it appreciates against the yuan this is under the assumption that the yuan is stable against the dollar. This will result in higher yen cash flows to the Chinese subsidiary.

- c. If Decko Co. had established its subsidiary in Tokyo, Japan, instead of in China, would the subsidiary's profits be more exposed or less exposed to exchange rate risk?

If the subsidiary was established in Tokyo, Japan, it would be less exposed to exchange rate risk.

- d. Why do you think that Decko Co. established the subsidiary in China instead of Japan? Assume no major country risk barriers.

Decko Co. may have established the subsidiary in order to take advantage of the low-cost labor in China.

- e. If the Chinese subsidiary needs to borrow money to finance its expansion and wants to reduce its exchange rate risk, should it borrow U.S. dollars, Chinese yuan, or Japanese yen?

If the subsidiary needs to borrow money, it should borrow Japanese yen, because the revenue is denominated in yen.