

1. Decision to Expand Internationally – Blades, Inc.

Blades, Inc., is a U.S.-based company that has been incorporated in the United States for 3 years. Blades is a relatively small company, with total assets of only \$200 million. The company produces a single type of product, roller blades. Due to the booming roller blade market in the United States at the time of the company's establishment, Blades has been quite successful. For example, in its first year of operation, it reported a net income of \$3.5 million. Recently, however, the demand for Blades' "Speedos," the company's primary product in the United States, has been slowly tapering off, and Blades has not been performing well. Last year, it reported a return on assets of only 7 percent. In response to the company's annual report for its most recent year of operations, Blades' shareholders have been pressuring the company to improve its performance; its stock price has fallen from a high of \$20 per share 3 years ago to \$12 last year. Blades produces high-quality roller blades and employs a unique production process, but the prices it charges are among the top 5 percent in the industry. In light of these circumstances, Ben Holt, the company's chief financial officer (CFO), is contemplating his alternatives for Blades' future. There are no other cost-cutting measures that Blades can implement in the United States without affecting the quality of its product. Also, production of alternative products would require major modifications to the existing plant setup. Furthermore, and because of these limitations, expansion within the United States at this time seems pointless. Ben Holt is considering the following: If Blades cannot penetrate the U.S. market further or reduce costs here, why not import some parts from overseas and/or expand the company's sales to foreign countries? Similar strategies have proved successful for numerous companies that expanded into Asia in recent years to increase their profit margins. The CFO's initial focus is on Thailand. Thailand has recently experienced weak economic conditions, and Blades could purchase components there at a low cost. Ben Holt is aware that many of Blades' competitors have begun importing production components from Thailand. Not only would Blades be able to reduce costs by importing rubber and/or plastic from Thailand due to the low costs of these inputs, but it might also be able to augment weak U.S. sales by exporting to Thailand, an economy still in its infancy and just beginning to appreciate leisure products such as roller blades. While several of Blades' competitors import components from Thailand, few are exporting to the country. Long-term decisions would also eventually have to be made; maybe Blades, Inc., could establish a subsidiary in Thailand and gradually shift its focus away from the United States if its U.S. sales do not rebound. Establishing a subsidiary in Thailand would also make sense for Blades due to its superior production process. Ben Holt is reasonably sure that Thai firms could not duplicate the high quality production process employed by Blades. Furthermore, if the company's initial approach of exporting works well, establishing a subsidiary in Thailand would preserve Blades' sales before Thai competitors are able to penetrate the Thai market. As a financial analyst for Blades, Inc., you are assigned to analyze international opportunities and risk resulting from international business. Your initial assessment should focus on the barriers and opportunities that international trade may offer. Ben Holt has never been involved in international business in any form and is unfamiliar with any constraints that may inhibit his plan to export to and import from a foreign country. Mr. Holt has presented you with a list of initial questions you should answer.

- 1. What are the advantages Blades could gain from importing from and/or exporting to a foreign country such as Thailand?**
- 2. What are some of the disadvantages Blades could face as a result of foreign trade in the short run? In the long run?**
- 3. What long-range plans other than establishment of a subsidiary in Thailand are an option for Blades and may be more suitable for the company?**

2. Exposure to International Flow of Funds – Blades, Inc. (company from previous case study)

Ben Holt, chief financial officer (CFO) of Blades, Inc., has decided to counteract the decreasing demand for Speedos roller blades by exporting this product to Thailand. Furthermore, due to the low cost of rubber and plastic in Southeast Asia, Holt has decided to import some of the components needed to manufacture Speedos from Thailand. Holt feels that importing rubber and plastic components from Thailand will provide Blades with a cost advantage (the components imported from Thailand are about 20 percent cheaper than similar components in the United States). Currently, approximately \$20 million, or 10 percent, of Blades' sales are contributed by its sales in Thailand. Only about 4 percent of Blades' cost of goods sold is attributable to rubber and plastic imported from Thailand. Blades faces little competition in Thailand from other U.S. roller blades manufacturers. Those competitors that export roller blades to Thailand invoice their exports in U.S. dollars. Currently, Blades follows a policy of invoicing in Thai baht (Thailand's currency). Ben Holt felt that this strategy would give Blades a competitive advantage since Thai importers can plan more easily when they do not have to worry about paying differing amounts due to currency fluctuations. Furthermore, Blades' primary customer in Thailand (a retail store) has committed itself to purchasing a certain amount of Speedos annually if Blades will invoice in baht for a period of 3 years. Blades' purchases of components from Thai exporters are currently invoiced in Thai baht. Ben Holt is rather content with current arrangements and believes the lack of competitors in Thailand, the quality of Blades' products, and its approach to pricing will ensure Blades' position in the Thai roller blade market in the future. Holt also feels that Thai importers will prefer Blades over its competitors because Blades invoices in Thai baht. You, Blades' financial analyst, have doubts as to Blades' "guaranteed" future success. Although you believe Blades' strategy for its Thai sales and imports is sound, you are concerned about current expectations for the Thai economy. Current forecasts indicate a high level of anticipated inflation, a decreasing level of national income, and a continued depreciation of the Thai baht. In your opinion, all of these future developments could affect Blades financially given the company's current arrangements with its suppliers and with the Thai importers. Both Thai consumers and firms might adjust their spending habits should certain developments occur. In the past, you have had difficulty convincing Ben Holt that problems could arise in Thailand. Consequently, you have developed a list of questions for yourself, which you plan to present to the company's CFO after you have answered them. Your questions are listed here:

- 1. How could a higher level of inflation in Thailand affect Blades (assume U.S. inflation remains constant)?**
- 2. How could competition from firms in Thailand and from U.S. firms conducting business in Thailand affect Blades?**
- 3. How could a decreasing level of national income in Thailand affect Blades?**
- 4. How could a continued depreciation of the Thai baht affect Blades? How would it affect Blades relative to U.S. exporters invoicing their roller blades in U.S. dollars?**
- 5. If Blades increases its business in Thailand and experiences serious financial problems, are there any international agencies that the company could approach for loans or other financial assistance?**

3. Agency problem and joint venture - Escuela de Inglés

Assume that you live in the United States and invest \$60,000 to establish a language school called Escuela de Inglés in Mexico City, Mexico. You set up a small subsidiary in Mexico, with an office and an attached classroom that you lease. You hire local individuals in Mexico who can speak English and teach it to others. Your school offers two types of courses: a 1-month structured course in English and a 1-week intensive course for individuals who already know English but want to improve their skills before visiting the United States. You advertise both types of teaching services in the local newspapers. All revenue and expenses associated with your business are denominated in Mexican pesos. Your subsidiary sends most of the profits from the business in Mexico to you at the end of each month. Although your expenses are somewhat stable, your revenue varies with the number of clients who sign up for the courses in Mexico.

- 1. Discuss the corporate control of your business. Explain why your business in Mexico is exposed to agency problems.**
- 2. How would you attempt to monitor the ongoing operations of the business?**
- 3. Explain how you might be able to use a compensation plan to limit the potential agency problems.**
- 4. Assume that you have been approached by a competitor in Mexico to engage in a joint venture. The competitor would provide the classroom facilities (so you would not need to rent classroom space), while your employees would teach the classes. You and the competitor would split the profits. Discuss how your potential return and your risk would change if you pursue the joint venture.**
- 5. Explain the conditions that would cause your business to be adversely affected by exchange rate movements.**
- 6. Explain how your business could be adversely affected by political risk.**