Chapter 7

FOREIGN EXCHANGE AND INTERNATIONAL FINANCE

7-1 Money Systems Around the World

7-2 Foreign Exchange and Currency Controls

7-3 Currency Transactions Between Nations
An Unexpected Currency for Ukraine

In the early 1990s, the formerly united Soviet Union divided into separate countries. When this occurred, the Russian ruble was no longer the monetary unit for these newly independent nations.

Ukraine was one of these nations. While the people of Ukraine were waiting to convert to a new currency, the need for money to be in circulation was critical. To prevent a financial crisis, the Ukrainian government issued coupons for use in buying the country’s limited supplies of food and other products.

These coupons were not originally intended to be the new Ukrainian currency. However, as Ukraine’s economy developed, these coupons became widely accepted as money. At first, Ukrainians were using both the coupons and the Russian ruble. As the new monetary system replaced the old one, rubles became less acceptable for making purchases. The acceptance of the ration coupons made them the unofficial currency of Ukraine.

Today Ukraine’s currency is the hryvnia. In recent years, in an effort to expand the country’s economic development, the World Bank has provided Ukraine with several major loans. Two of these were designed to improve agricultural productivity and to expand food product exports. Ukraine’s rich soil is well suited to growing grains, sugar beets, vegetables, and other farm products.

Think Critically

1. What problems can occur in an economy that does not have enough money in circulation?
2. What made the ration coupons valuable in the Ukrainian economy?
3. What made the Russian ruble less acceptable among Ukrainians?
Explain the role of money and currency systems in international business.

Identify factors that affect the value of currency.

**MONEY SYSTEMS AROUND THE WORLD**

**GOALS**

- Explain the role of money and currency systems in international business.
- Identify factors that affect the value of currency.

**MONEY AND CURRENCY SYSTEMS**

Each day billions of people buy goods and services using something called *money*. Have you ever thought about what makes money valuable? The metal and paper that make up coins and currency have very little actual value. So why can you use these items to buy goods and services? Most people take money for granted. If they have money and can buy what they need, they usually don’t care how it works. However, an understanding of how money works can help you better understand international business transactions.

**WHAT IS MONEY?**

*Money* is anything people will accept for the exchange of goods and services. Throughout history, many different things have served as money, including corn, cattle, tobacco, shells, and salt. There are almost 200 slang terms for money in English. Many are related to food, such as bread, cabbage, clams, and dough. Colors are also commonly associated with money in slang terms—gold, green, greenbacks, greenies, and lean green. Other money descriptors include do-re-mi, folding stuff, scratch, mint sauce, and palm soap (especially when referring to a bribe). No matter what it’s called, money has five main characteristics, as shown in Figure 7-1.
Acceptability  The most important characteristic of money is that it is *acceptable*. In other words, people must be willing to take an item in exchange for what they are selling.

Scarcity  For something to be used as money, it also must be *scarce*. If the item being used as money is very plentiful, it will not maintain its value. As items used for money become common, they lose their buying power.

Durability  A problem with some items used as money in the past, such as farm products, was that they spoiled or got damaged easily. Items used as money should be *durable*. Gold and silver, commonly used as money because of durability, were first made into coins in the seventh century B.C. in Greece.

Divisibility  For money to be useful, it should also be *divisible*. What would happen if someone wanted to buy an item using a cow as payment? The item to be purchased would have to be of equal value to the cow since livestock is not easy to divide into smaller monetary units. Most nations have...
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A Question of Ethics

PRINTING ADDITIONAL CURRENCY

In times of economic difficulties, a country might try to solve its problems by printing more money. As unemployment increases, the government would issue additional currency so people could buy needed goods and services. However, fewer items are being produced. Therefore, the increased demand would cause prices to rise, while the value of the currency declines. This higher inflation usually results in greater suffering among the people. In addition, the lower value of the currency hurts the country in the international trade marketplace.

Think Critically

According to the guidelines for ethical analysis in Chapter 1, how will the printing of additional money affect various groups in an economy?

WHY IS MONEY USED?

Money serves three main purposes. It acts as a medium of exchange, a measure of value, and a store of value. Before the widespread acceptance of money, people would make exchanges through barter. Barter is the direct exchange of goods and services for other goods and services. However, you may not want what someone else is offering. Money allows you to put a value on something you have to sell and to use the money received to buy something else.

Medium of Exchange  Money is useful only if people are willing to accept it in exchange for goods and services. As a medium of exchange, money makes business transactions easier. At a store, you know you can use coins, currency, or checks rather than having to trade a good or service.

Measure of Value  If you work for four hours, is your time worth a steak dinner or one pair of jeans? Without money, it would be difficult to put a value on such things as food and clothing. As a measure of value, money allows us to put a value on various goods and services. Money makes it possible to compare prices for different items so you can make the wisest spending decisions.

Store of Value  You may not want to spend all of your money at the same time. As a store of value, money can be saved for future spending. However, the amount you can buy with your money in the future may be reduced because prices increase.

What are the three main purposes of money?
Would you be willing to pay 40 pesos for a hamburger? Or is 4,200,000 yen a good price for an automobile? Business transactions between companies in different countries create money problems. Japanese companies want to receive payment in yen, while Mexican businesses expect to pay in pesos.

Since countries have different currency systems, a method of determining the value of one nation’s money in terms of another’s is needed. As companies in different countries exchange goods and services, payment must be made. A company usually wants its payment in the currency of its home country. As a result, the money of one country must be changed into the currency of another country. **Foreign exchange** is the process of converting the currency of one country into the currency of another country.

The **exchange rate** is the amount of currency of one country that can be traded for one unit of the currency of another country. Each day these values change slightly depending on changing conditions and perceptions. Figure 7-2 shows the value of various currencies in relation to the U.S. dollar in early 2004. For example, one peso was worth 8.8 cents in U.S. money, and you could exchange 11.40 pesos for one U.S. dollar.

The value of a currency, like most things, is affected by supply and demand. If a country’s money is believed to be a solid store of value, people will accept it as payment and its value will increase. However, if a country is having financial difficulties, its currency is likely to lose value compared to the money of other countries.

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### EXCHANGE RATES FOR SELECTED CURRENCIES

<table>
<thead>
<tr>
<th>Currency</th>
<th>Country</th>
<th>Symbol</th>
<th>Code</th>
<th>Value in U.S. Dollars</th>
<th>Units per U.S. Dollar</th>
</tr>
</thead>
<tbody>
<tr>
<td>pound</td>
<td>Britain</td>
<td>£</td>
<td>GBP</td>
<td>$1.84</td>
<td>0.54 pound</td>
</tr>
<tr>
<td>dollar</td>
<td>Canada</td>
<td>$</td>
<td>CAD</td>
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<td>1.31 Canadian dollars</td>
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<tr>
<td>euro</td>
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<td>€</td>
<td>EUR</td>
<td>1.23</td>
<td>0.81 euro</td>
</tr>
<tr>
<td>rupee</td>
<td>India</td>
<td>Rs</td>
<td>INR</td>
<td>0.0216</td>
<td>46.34 rupees</td>
</tr>
<tr>
<td>yen</td>
<td>Japan</td>
<td>¥</td>
<td>JPY</td>
<td>0.00902</td>
<td>110.79 yen</td>
</tr>
<tr>
<td>peso</td>
<td>Mexico</td>
<td>Mex$</td>
<td>MXN</td>
<td>0.088</td>
<td>11.40 pesos</td>
</tr>
<tr>
<td>riyal</td>
<td>Saudi Arabia</td>
<td>SRs</td>
<td>SAR</td>
<td>0.267</td>
<td>3.75 riyals</td>
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<td>South Africa</td>
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<td>ZAR</td>
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<td>6.16 rand</td>
</tr>
<tr>
<td>real</td>
<td>Brazil</td>
<td>R$</td>
<td>BRL</td>
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<td>3.022 real</td>
</tr>
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<td>Bs</td>
<td>VEB</td>
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<tr>
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<td>China</td>
<td>¥</td>
<td>CNY</td>
<td>0.12</td>
<td>8.28 yuan</td>
</tr>
</tbody>
</table>

Figure 7-2  Currencies from various nations have different values compared to the U.S. dollar.
Currency exchange rates between countries are affected by three main factors. These factors are the country’s balance of payments, its economic conditions, and its political stability, as shown in Figure 7-3.

**BALANCE OF PAYMENTS**

The *balance of payments* is a measure of the total flow of money coming into a country minus the total flow going out. When a country has a favorable balance of payments, the value of its currency is usually constant or rising. This situation arises when there is an increased demand for both the nation’s products and for its currency.

However, when a nation has an unfavorable balance of payments, its currency usually declines in value. This decline results from lower demand for the monetary unit since fewer companies need to obtain the currency to make payments for goods and services purchased.

**ECONOMIC CONDITIONS**

Every nation faces the economic conditions of potential inflation and changing interest rates. When prices increase and the buying power of the country’s money declines, its currency will not be as attractive. Inflation reduces the buying power of a currency. High inflation in Brazil, for example, would reduce the demand for the *real*.

The cost of borrowing money also affects the value of a currency. When individuals, businesses, and countries borrow money, they incur a cost. The *interest rate* is the cost of using someone else’s money. Higher interest rates mean more expensive products and lower demand among consumers. This
in turn reduces the demand for a nation’s currency, causing a decline in its value.

Interest rates are affected by three main factors.

- **Money supply and demand** When more people want to borrow than to save money, interest rates increase. In contrast, if money is available but few are borrowing, interest rates decline.

- **Risk** The higher the risk associated with a loan, the higher the interest rate charged. The higher rates cover the business costs incurred when lenders try to collect on loans and when loans are not repaid.

- **Inflation** As prices rise, the buying power of money declines, so lenders charge higher interest rates on loans. Lenders need to collect more money for a loan when inflation is present so they can cover the lost buying power of the currency they receive in later payments from the borrowers.

To address concerns of an unstable currency and poor economic conditions, some countries use the currency of a more stable economy. For example, the U.S. dollar is the official currency of Ecuador, El Salvador, and Panama.

### POLITICAL STABILITY

Companies and individuals want to avoid risk when doing business in different nations. If a government changes unexpectedly to create an unfriendly business environment, a company may lose its building, equipment, or money on deposit in banks. Political instability may also occur when new laws and regulations are enacted. These rules may not allow foreign businesses to operate as freely.

Uncertainty in a country reduces the confidence businesspeople have in its currency. In 1979, for example, when a revolution changed the government in Iran, many foreign companies were closed, and several U.S. officials were taken hostage.

### CheckPoint

What three factors influence the value of a country’s currency?
Chapter 7  FOREIGN EXCHANGE AND INTERNATIONAL FINANCE

REVIEW GLOBAL BUSINESS TERMS

Define each of the following terms.

1. money  2. foreign exchange  3. exchange rate  4. interest rate

REVIEW GLOBAL BUSINESS CONCEPTS

5. What are the five characteristics of money?
6. How does a country’s balance of payments affect the value of its currency?
7. How does risk affect interest rates?
8. How does political instability affect the value of a country’s currency?

SOLVE GLOBAL BUSINESS PROBLEMS

Which of the characteristics of money would make each of the following items not practical to use as money, even if some people found them acceptable?

9. Shells
10. Works of art
11. Produce (fruit, vegetables, herbs, etc.)
12. Diamonds

THINK CRITICALLY

13. If a country had to create a money system other than coins and currency, what items might be used?
14. How would printing additional money affect the value of a country’s currency?

MAKE CONNECTIONS

15. TECHNOLOGY  What are the potential advantages and disadvantages with an electronic money system that uses plastic cards similar to credit cards?
16. LAW  What problems would be created in a country if every business were allowed to create its own money system?
17. CULTURAL STUDIES  Describe the types of events commonly portrayed on a country’s coins and currency.
18. ECONOMICS  Based on the data in the Country Profile, describe what influences the value of a country’s currency.
19. ECONOMICS  Use the Internet to find the current exchange rates for all the currencies in Figure 7-2 on page 177.
FOREIGN EXCHANGE ACTIVITIES

The value of a country’s currency is important for success in international business. If trading partners do not accept a country’s currency, the country may have to make payment in another currency. A currency that is not easy to exchange for other currencies is called soft currency. While the currency is a medium of exchange in its home country, the monetary units have limited value in the world marketplace.

In contrast to soft currencies, money such as the Japanese yen, the euro, the Swiss franc, and the U.S. dollar are accepted for most global transactions. Companies in most nations of the world accept these monetary units. Hard currency is a monetary unit that is freely converted into other currencies.

CHANGING EXCHANGE RATES

In years past, the value of a country’s currency was set in most countries by its government. More recently, most countries use a system of floating exchange rates. Floating exchange rate is a system in which currency values are based on supply and demand. When a country exports large amounts of goods and services, companies in that nation want payment in their own currency. To make these payments, buyers must purchase this monetary unit. As the demand for the currency increases, the value of that monetary unit also increases.

For most of the 1980s, Japan had a very favorable balance of payments as a result of high foreign demand for its automobiles, electronic products, and
other goods. Since Japanese companies wanted payment in yen, importers in other countries had to buy yen in order to make their payments. This demand for Japanese currency resulted in its increased value. In recent years, the yen has varied in value compared to the U.S. dollar as a result of changing economic conditions in Japan, as shown in Figure 7-4.

Figure 7-4 The value of the U.S. dollar compared to the Japanese yen has changed repeatedly in recent years.

Figure Critically
1. Conduct an Internet search to locate information about travel costs in other countries.
2. What factors influence the cost of different payment methods used when traveling to other countries?
THE FOREIGN EXCHANGE MARKET
The process of exchanging one currency for another occurs in the foreign exchange market. The foreign exchange market is the network of banks and other financial institutions that buy and sell different currencies. Most large banks are part of the foreign exchange market and may provide currency services for businesses and consumers. Before citizens travel outside of the United States, they can exchange dollars for the currencies of the countries they will visit. This exchange can be done at some large banks or companies that specialize in foreign currency services.

If a company knows it will need a certain currency in the future, it can enter into an agreement to buy that monetary unit later at a price agreed upon today. A currency future is a contract a person or company buys that allows the buyer the option to purchase a foreign currency sometime in the future at today's rate. For example, suppose an Australian company needs 20 million yen in two months to pay for imports from a Japanese company.

By buying a currency future contract, the importer will get the yen in two months at today's exchange rate. This protects the Australian importer from the possibility of having to buy the currency later at a higher price. However, if yen are less expensive in two months, the importer does not have to

GLOBAL BUSINESS EXAMPLE
CALCULATING FOREIGN EXCHANGE
Calculating foreign exchange can be a confusing process. However, there are some steps you can take to make the process less confusing.

First, foreign exchange rates are usually quoted as a certain amount of one currency per unit of another currency. For example, a recent exchange rate was listed as 1.27 U.S. dollars per euro. An exchange rate is considered a price for foreign currency. In the example, the price of one euro is $1.27.

To buy five notepads that are $1.27 per notepad, multiply the price by 5. The notepads would cost $6.35.

\[ 5 \times 1.27 = 6.35 \]

So to buy 5 euros at 1.27 dollars per euro, it would cost $6.35.

Foreign exchange rates can work the other way as well. You can use an exchange rate to figure out how much of a foreign currency you can buy. For example, a recent exchange rate was listed as 1.88 U.S. dollars per British pound. For $1.88 you can buy £1. But how many pounds can you get for $1?

If gasoline is $1.88 per gallon and you have $10, to find out how many gallons you can buy, divide the amount you have by the price per gallon. You can buy 5.32 gallons of gasoline. (10 ÷ 1.88 = 5.32 to the nearest hundredth.)

So if you want to buy $10 worth of British pounds at 1.88 dollars per pound, you could buy £5.32.

Think Critically
1. How much would seven Brazilian reals cost you if the exchange rate is 0.34 U.S. dollars per real?
2. How many Saudi Arabian riyals could you buy with $25 if the exchange rate is 3.75 U.S. dollars per riyal?
3. Go to a web site that lists current exchange rates. Recalculate questions 1 and 2 with the current rates.
exercising the option to buy the yen at the contract price. Instead, the currency may be purchased at the going market price. The importer will allow the option in the contract to expire, without needing to take advantage of it. However, the buyer must still pay the fee to purchase the future contract.

**FOREIGN EXCHANGE CONTROLS**

To maintain the value of its currency, a nation may limit the flow of money out of the country. **Exchange controls** are government restrictions to regulate the amount and value of a nation’s currency. These controls can be either a fixed exchange rate or a limit on the amount and cost of currency. One common exchange control limits the amount of local currency a person can take out of a country. In past years, Australia, Bangladesh, France, Italy, Japan, Portugal, South Africa, Spain, and Sweden placed restrictions on exporting local currency.

**INTERNATIONAL FINANCIAL AGENCIES**

Exchange controls can help maintain the value of a nation’s money by limiting the amount in the foreign exchange market. Two international agencies, the International Bank for Reconstruction and Development and the International Monetary Fund, work to maintain a stable system of foreign exchange.

**THE WORLD BANK**

The International Bank for Reconstruction and Development, commonly called the World Bank, was created in 1944 to provide loans for rebuilding after World War II. Today the **World Bank** is a bank whose major function is to provide economic assistance to less developed countries. Its funds build communications systems, transportation networks, and energy plants.

The World Bank, with over 180 member countries, has two main divisions. The International Development Association (IDA) makes funds available to help developing countries. These loans can be paid back over many years (up to 50) and have very low interest rates. The International Finance Corporation (IFC) provides capital and technical assistance to businesses in nations with limited resources. The IFC encourages joint ventures between foreign and local companies to encourage capital investment within the developing nation.

**THE INTERNATIONAL MONETARY FUND (IMF)**

The **International Monetary Fund (IMF)** is an agency that helps to promote economic cooperation by maintaining an orderly system of world trade and exchange rates. The
IMF was established in 1946, when the economic interdependence among nations was escalating at a greater pace than ever before in history. Before the International Monetary Fund, a country could frequently change the value of its currency to attract more foreign customers. Then as other countries lost business, they would impose trade restrictions or lower the value of their currency. As one nation tried to outdo another, a trade war could have resulted. Today cooperation among IMF nations makes trade wars less likely.

The IMF, also with over 180 member nations, is a cooperative deposit bank that provides assistance to countries experiencing balance of payment difficulties. When a nation’s debt continues to increase, its currency declines in value, resulting in more debt. High debt payments mean less money is available for the country to improve its economic development. To prevent this situation, the International Monetary Fund has three main duties.

- **Analyze economic situations** In an attempt to help countries avoid economic problems, the IMF will monitor a country’s trade, borrowing, and government spending.
- **Suggest economic policies** After analyzing the economic factors of a nation, the IMF will suggest actions to improve the situation. If a country imposes restrictions that limit foreign trade, for example, the IMF may recommend changes to encourage global business.
- **Provide loans** When a country has a high foreign debt, the IMF lends money to help avoid major economic difficulties. These low-interest loans can keep a country from experiencing an escalating trade deficit and a declining currency value.

**GLOBAL BUSINESS EXAMPLE**

**THE ECONOMIC AND TRADE PROBLEMS OF GHANA**

Before taking a new course of action, Ghana, located on the west coast of Africa, had many economic problems. Inflation was 120 percent, exports had declined by 50 percent, and the nation had a crumbling infrastructure. An overvalued currency did not encourage extensive exporting of cocoa, Ghana’s main export. Between 1983 and 1990, the cedi decreased in value from 2.75 per U.S. dollar to 350 per U.S. dollar.

Ghana obtained suggestions from the International Monetary Fund. To improve the trade situation, quotas, tariffs, and other import controls were used to limit products coming into the country. These actions, along with lower tax rates, helped to improve Ghana’s balance of payments and stimulate economic growth for its economy.

**Think Critically**

1. Go to the web site of the International Monetary Fund (www.imf.org) to obtain current information about Ghana.
2. How did the suggestions from the IMF improve Ghana’s economy?

**CHECKPOINT**

How does the International Monetary Fund encourage economic development?
REVIEW GLOBAL BUSINESS TERMS

Define each of the following terms.

1. soft currency  
2. hard currency  
3. floating exchange rate  
4. foreign exchange market  
5. currency future  
6. exchange controls  
7. World Bank  
8. International Monetary Fund (IMF)

REVIEW GLOBAL BUSINESS CONCEPTS

9. What purpose do exchange controls serve?

10. What is the World Bank?

11. What are the main activities of the International Monetary Fund?

SOLVE GLOBAL BUSINESS PROBLEMS

Calculate the following.

12. A hamburger at a restaurant in Tokyo costs 400 yen. If the exchange rate is 0.008 U.S. dollars per yen, how much would the hamburger cost in U.S. dollars?

13. A Thai company is buying a computer from a company in the United Kingdom. The computer costs 1,700 British pounds. If the exchange rate is 0.025 pounds per Thai baht, how much does the computer cost in baht?

14. A Philippine company has 83,000 pesos to purchase grain from a Canadian farmer. If the exchange rate is 40 pesos per Canadian dollar, how many dollars' worth of grain can the Philippine company purchase?

THINK CRITICALLY

15. How might currency exchange controls affect the trade situation of a country?

16. Suggest ways in which the World Bank and the International Monetary Fund might reduce economic difficulties in developing nations.

MAKE CONNECTIONS

17. TECHNOLOGY Go to the web site of the International Monetary Fund (www.imf.org), and determine the source of funds for money loaned to member countries.

18. MATHEMATICS Select a country other than the United States. Using newspapers that report exchange rates, find the exchange rate for the country’s currency on the first day of the month for the last six months. Prepare a line graph of the rate.
When you go to a store to buy something, you must decide how to pay for the item. You can use cash. Other times, however, you might want to write a check or use a credit card. In a similar manner, global buyers must decide how to pay for an import purchase.

FOREIGN TRADE PAYMENT METHODS

Three types of payment methods are commonly used for international business transactions—cash in advance, letter of credit, and sale on account.

Cash in Advance

Making payment before receiving goods can be risky for the buyer. After paying in advance, you might not receive the items, or you might have difficulty obtaining a refund for damaged or returned goods. Cash in advance is not often used. This method, however, is usually required for first-time customers, small orders, or customers in high-risk countries. Since the payment was made before shipping, goods will usually be sent without delay.

Letter of Credit

A letter of credit is a financial document issued by a bank for an importer in which the bank guarantees payment. A letter of credit is a method of payment in which the importer pays for goods before they are received but after the goods are shipped. This agreement, issued by
the importer’s bank, promises to pay the exporter a set amount when certain documents are presented.

The letter of credit communicates to the exporter that it will receive payment once the goods are shipped. Before the payment is made, certain documents—usually including a bill of lading—must be presented as proof that the goods have been shipped.

**Sale on Account** Almost every business buys or sells on credit at one time or another. A very common practice in the United States is to sell on account. This means regular customers have a certain time period to make payment, usually 30 or 60 days.

**Credit terms** describe the time required for payment and other conditions of a sale on account.

When selling on account, a company wants to obtain its money as soon as possible. To encourage fast payment, a discount may be offered. In the United States, companies can sell on account with the following credit terms: 2/10, n/30. This means that customers can either take a 2 percent discount if they pay within 10 days or pay the net (full) amount in 30 days.

Another example of the credit terms for a sale on account would be 1/15, n/EOM. This means a 1 percent discount may be taken if paid in 15 days. The net amount is due by the end of the month (EOM).

**I. SOURCES OF INTERNATIONAL FINANCING**

Buying and selling on credit means that one party (an individual or a company) uses the money of another party (an individual, a company, or a financial institution). This is commonly called financing. Financing can be either short-term (one year or less) or long-term (more than one year).

**Short-Term Financing** The major portion of transacting business involves credit. A company may allow customers 30 days to make their payments. The same company probably buys store supplies, raw materials, and other items from suppliers on credit. Buying or selling on account is called trade credit. Trade credit comes in two forms, accounts receivable and accounts payable.

An **account receivable** is an amount due from a customer to a company that sells on credit. Accounts receivable are the result of sales on account. A company that sells on credit allows its customers a certain time period to pay for purchases. An **account payable** is an amount owed to a supplier. Accounts payable are the result of purchases on account.
Accounts receivable and accounts payable may seem confusing. A helpful way to distinguish between them is that receivables are amounts to be received and payables are amounts to be paid.

Business loans, also called commercial loans, are another source of short-term financing. Business loans are commonly obtained from banks and other financial institutions.

**Long-term financing** Some business activities require financing for more than one year. Companies commonly need large sums of money for expensive business projects that will occur over several years. For example, a Japanese company may need funds to build an electronic manufacturing plant in the United States. Or a German company may buy a food company in Mexico. An expensive, long-term financial activity is a capital project. Examples of capital projects include the following.

- Introducing new products
- Buying an existing company
- Building a factory
- Buying new equipment
- Opening a new office in another country

Capital projects often require millions of dollars. To pay for capital projects, companies can do one of two things, borrow the necessary funds from a bank or another financial institution or issue bonds. A **bond** is a certificate representing money borrowed by a company over a long period of time, usually between 5 and 30 years. This document represents the company’s promise to repay the money by a certain date with interest. Bonds are a type of financing commonly used by large companies.

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**CheckPoint**

Describe three common payment methods for international business transactions.
OTHER PAYMENT METHODS AND FINANCIAL DOCUMENTS

With hundreds of nations and millions of companies in the world, there are many ways of doing business. Besides the import-export documents and payment methods already mentioned, several other methods of payment are commonly used for global business.

**Promissory Note**  
A *promissory note* is a document that states a promise to pay a set amount by a certain date. Promissory notes are signed by buyers to confirm their intention to make payment. These documents communicate to both the buyer and the seller the amount of a purchase, the date by which payment must be paid, and any interest charges.

**Bill of Exchange**  
A *bill of exchange* is a written order by an exporter to an importer to make payment. The instructions to the importer include the amount, the due date, and the location of where to make the payment (usually a bank or another financial institution).

**Electronic Funds Transfer**  
Moving payments through banking computer systems is known as *electronic funds transfer (EFT)*. After an importer receives the ordered goods, a bank can be instructed to transfer the payment for the merchandise to the bank of the exporter. The main advantage of an EFT is prompt payment. Electronic funds transfer systems are commonly used by consumers to obtain cash, deposit money, and make payments.

**Commercial Invoice**  
A *commercial invoice*, prepared by the exporter, provides a description of the merchandise and the terms of the sale. This document includes details about the buyer, seller, merchandise, amounts, prices, shipping method, date of shipment, and terms of payment. A sample commercial invoice is shown in Figure 7-5.

**Insurance Certificate**  
Proof of insurance is usually a part of import-export transactions. An *insurance certificate* explains the amount of insurance coverage for fire, theft, water, or other damage that may occur to goods in shipment. This document also lists the name of the insurance company and the exporter.

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**E-COMMERCE IN ACTION**

**European E-Cash**

The European Union did not start using actual euro bills and coins until 2002, even though the new currency became effective in 1999. During this conversion period, some Europeans used e-cash. The Proton card stored Belgian francs and currencies of other nations on a silicon chip for use when making small purchases. The company that developed the card encourages consumers to use it for newspapers, coffee, pastries, and other snacks. Today, the use of e-cash continues to expand in Europe and around the world.

**Think Critically**

1. Conduct an Internet search to obtain additional information on the use of “e-cash,” “cyber-cash,” and other forms of electronic money and online payments.
2. What problems might occur with this monetary system?
A COMMERCIAL INVOICE

<table>
<thead>
<tr>
<th>PACKAGE NO</th>
<th>QUANTITY</th>
<th>OUR NO.</th>
<th>DESCRIPTION</th>
<th>PRICE PER UNIT</th>
<th>AMOUNT</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-40</td>
<td>100</td>
<td>10</td>
<td>Fire Extinguishers</td>
<td>US$ 40</td>
<td>US$ 4000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Total shipment EX WORKS MADEIRA</td>
<td>US$ 4000</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Plus: Inland Freight to Port</td>
<td>US$ 200</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Total Boston Port</td>
<td>US$ 4200</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Plus: Ocean Freight</td>
<td>US$ 75</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Plus: Insurance</td>
<td>US$ 23</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Total CIF Bangkok Thailand</td>
<td>US$ 4298</td>
<td></td>
</tr>
</tbody>
</table>

We certify that this invoice is true and correct and that the origin of these goods is the United States of America.

These goods licensed by the United States for ultimate destination Thailand.
Diversion contrary to U.S. law prohibited. LIC. G-DEST.

Jennifer Hamm, Export Manager
ExIm Express

Figure 7-5 A commercial invoice gives the details of an international business transaction.
Chapter 7 FOREIGN EXCHANGE AND INTERNATIONAL FINANCE

HISTORY:
VIETNAM: A NATION DIVIDED

Political differences split Vietnam into communist North Vietnam and democratic South Vietnam in 1954. For the next 21 years, military battles continued between the two areas. Between 1963 and 1975, 1.3 million Vietnamese, along with 56,000 U.S. soldiers, were killed. On April 30, 1975, the South surrendered and the country united.

Today Vietnam is divided in another way. One part of the economy consists of traditional open markets with fish, farm products, and handmade items. At stores just a few steps away, shoppers wearing NBA shirts are buying Coca-Cola, Huggies diapers, and Suave shampoo. Many Vietnamese live in single-room huts or on boats along one of the rivers that flows into the South China Sea, while others reside in modern apartments with various home entertainment electronics.

Vietnamese companies have established business relationships with enterprises in Japan, Germany, Canada, and the United States. As Vietnam expands its trading partners, hopes are that economic development will improve living standards for most of the nation’s people. As of the late 1990s, the country had a trade deficit in its economic relationship with other countries.

Economic reform in Vietnam can also be viewed in other ways. In the late 1980s, the nation’s currency, the dong, had an annual inflation rate of 700 percent. More recently, annual cost of living increases were less than 10 percent. A stock exchange in Hanoi was started to build on the dong-U.S. dollar foreign currency exchange activities that were already in operation.

Think Critically
1. What factors influenced the “divided” societies in Vietnam over the years?
2. What actions might be taken by the country to improve economic development?
3. Conduct a web search to obtain current information about the economic and cultural situation in Vietnam.

✔ CheckPoint
Name five different payment methods and financial documents.
**REVIEW GLOBAL BUSINESS TERMS**

Define each of the following terms.

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>1</td>
<td>letter of credit</td>
</tr>
<tr>
<td>2</td>
<td>credit terms</td>
</tr>
<tr>
<td>3</td>
<td>trade credit</td>
</tr>
<tr>
<td>4</td>
<td>account receivable</td>
</tr>
<tr>
<td>5</td>
<td>account payable</td>
</tr>
<tr>
<td>6</td>
<td>capital project</td>
</tr>
<tr>
<td>7</td>
<td>bond</td>
</tr>
<tr>
<td>8</td>
<td>promissory note</td>
</tr>
<tr>
<td>9</td>
<td>bill of exchange</td>
</tr>
<tr>
<td>10</td>
<td>bill of exchange (EFT)</td>
</tr>
<tr>
<td>11</td>
<td>commercial invoice</td>
</tr>
<tr>
<td>12</td>
<td>insurance certificate</td>
</tr>
</tbody>
</table>

**REVIEW GLOBAL BUSINESS CONCEPTS**

13. Why is cash not usually paid in advance of shipping?
14. Why do capital projects usually require a company to borrow money?

**SOLVE GLOBAL BUSINESS PROBLEMS**

Which type of financial document or payment method would be appropriate for the following situations?

15. A business in India needs to borrow money to build a factory that produces computers.
16. A company wants to delay payment for 60 days but is willing to pay interest on the amount owed during that time period.
17. A business in Costa Rica needs to make payment to a supplier in Thailand today.
18. A supplier in Canada requires that its customer in Singapore have a bank guarantee payment for a shipment of machine parts.

**THINK CRITICALLY**

19. Why do you think the letter of credit is the most popular payment method used for international business transactions?
20. What are the benefits for a company that offers a discount to customers who pay within 30 days?

**MAKE CONNECTIONS**

21. **TECHNOLOGY** How does technology result in new capital projects for companies expanding their business operations to other countries?
22. **MATHEMATICS** You receive an invoice from a company in India for 100,000 rupee with payment terms as 2/20, n/60. What would be the amount of the discount you could take if you pay within 20 days?
CHAPTER SUMMARY

7-1 MONEY SYSTEMS AROUND THE WORLD

Money has five characteristics: acceptability, scarcity, durability, divisibility, and portability. The purpose of money is that it serves as a medium of exchange, a measure of value, and a store of value.

A country’s balance of payments, economic conditions, and political stability influence the value of money. Money supply and demand, inflation, and risk affect interest rates.

7-2 FOREIGN EXCHANGE AND CURRENCY CONTROLS

Foreign exchange involves the process of exchanging one currency for another in the foreign exchange market. This market consists of banks and other financial institutions that buy and sell different currencies.

The main activity of the World Bank is to provide economic assistance to less developed countries. The International Monetary Fund helps to promote economic cooperation among countries by maintaining an orderly system of world trade and exchange rates.

7-3 CURRENCY TRANSACTIONS BETWEEN NATIONS

Cash in advance, a letter of credit, and sale on account are the main payment methods for international business. The main financing sources for international business transactions are trade credit, bank loans, and bonds.

Common payment methods and financial documents used in international trade include the promissory note, bill of exchange, electronic funds transfer (EFT), commercial invoice, and insurance certificate.

GLOBAL REFOCUS

Read the Global Focus at the beginning of this chapter, and answer the following questions.

1. What actions can a government take to create and maintain an appropriate currency system?

2. Go to the web site of the World Bank (www.worldbank.org) or the website of the International Monetary Fund (www.imf.org) to obtain current information on Ukraine and other developing economies in Eastern Europe.
REVIEW GLOBAL BUSINESS TERMS

Match the terms listed with the definitions. Some terms may not be used.

1. The network of banks and other financial institutions that buy and sell different currencies.
2. The amount of currency of one country that can be traded for one unit of the currency of another country.
3. The cost of using someone else’s money.
4. Anything people will accept for the exchange of goods and services.
5. A currency that is not easy to exchange for other currencies.
6. A certificate representing money borrowed by a company over a long period of time.
7. Buying or selling on account.
8. An expensive, long-term financial activity.
9. A contract a person or company buys that allows the buyer the option to purchase a foreign currency sometime in the future at today’s rate.
10. A financial document issued by a bank for an importer in which the bank guarantees payment.
11. Government restrictions to regulate the amount and value of a nation’s currency.
12. A monetary unit that is freely converted into other currencies.
13. A method of moving payments through banking computer systems.
14. A system in which currency values are based on supply and demand.

MAKE GLOBAL BUSINESS DECISIONS

15. What actions could a country take to make its currency more widely accepted around the world?
16. Some people believe that interest rates are one of the most important economic indicators. How are people and businesses affected by interest rates?
17. Give some examples of capital projects in your community. How do capital projects benefit the people of a community?
18. What are some concerns people might have about electronic banking?
Chapter 7  ASSESSMENT

GLOBAL CONNECTIONS

19. GEOGRAPHY  Research travel costs for three different countries in various regions of the world. Obtain information on the costs of hotels, meals, rental cars, and other travel expenses.

20. COMMUNICATIONS  Interview a local business owner about buying and selling on credit. Ask the owner about the benefits and problems encountered when doing business on account.

21. VISUAL ARTS  Prepare a poster, bulletin board, newsletter, web site, or another visual that displays the changing value of the dollar in relation to other major currencies of the world.

22. HISTORY  Conduct research on the history of money systems that have been used in other countries.

23. CULTURAL STUDIES  Interview a person who has traveled to another country. Obtain information about how purchases were made and the exchange rate that was paid.

24. MATHEMATICS  Calculate the following foreign exchange transactions.

   a. A U.S. citizen is renting a hotel room in Paris for $184.92 a night. If one euro equals $1.20 in U.S. funds, how many francs will the tourist need for each night's stay?

   b. A U.S. tourist receives a $5AUS traffic ticket in Australia. If each Australian dollar is equal to $0.74 in U.S. money, what is the cost of this driving violation in U.S. dollars?

   c. A videotape made in the United States costs 115 kroner in Norway. If each krone is worth $0.15 in U.S. funds, what is the cost of the videotape in U.S. dollars?

25. CAREER PLANNING  Obtain information about the value of a nation's currency. Explain how changes in a country's exchange rate might affect the jobs in that nation.
THE CHANGING VALUE OF CURRENCIES

Select a country, and research its currency. Obtain information to answer the following questions.

1. What is the main monetary unit used in the country? How is it divided into other units?

2. Over the past couple of years, what have been the economic conditions of the country (inflation, interest rates, unemployment)? How have these affected the value of the currency?

3. How has the country’s balance of payments affected the value of its currency?

4. How have political factors affected the value of the currency?

5. Describe any exchange controls used by the country.

6. What factors might affect changes for this currency over the next few months?

7. Graph the recent value of the currency in relation to two other major currencies (e.g., U.S. dollar, Japanese yen, British pound, the euro, Swiss franc).

Prepare a written report with a summary of this information and your graphs. Indicate on the graph any events that have caused a major increase or decrease in the value of the currency.

Sources of information include the following.

- reference books such as encyclopedias and almanacs
- current newspaper articles from the news, business, and travel sections
- web sites such as www.xe.com, www.x-rates.com, and www.oanda.com can provide current information on foreign currency values.