

## Multinational Finance by Kirt C. Butler

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- III Derivative Securities for Hedging Currency Risk
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- VI International Portfolio Investment and Asset Pricing

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## Chapter 1

### An Introduction to Multinational Finance

- > **Multinational financial management** is financial management conducted in more than one cultural, social, economic, or political environment
- > We'll develop a framework for evaluating the **opportunities**, **costs** and **risks** of operating in the world's markets for goods, services, and financial assets and liabilities

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## Vivé la difference

Cross-border differences can affect all areas of business, particularly through differences in

- Language & culture
- Accounting
- Distribution
- Financial markets
- Other business conventions (legal, accounting, taxation, regulation, etc.)
- Human resource management
- Marketing
- Logistics
- Corporate governance

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## Multinational financial management

- > **Multinational finance** is **interdisciplinary** within the field of finance
- > **Multinational financial managers must be familiar with**
  - Foreign exchange and Eurocurrency markets
  - Derivatives securities
  - International financial (debt & equity) markets
  - International markets for real assets
  - International portfolio investment

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## The MNC's opportunities

$$\text{Value} = \sum_t [E[CF_t] / (1+i_t)^t]$$

- > **Multinational investment policy**
  - Higher returns from existing investments
  - New investment opportunities
- > **Multinational financial policy**
  - Reduced capital costs through access to international capital markets

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## Perfect financial market assumptions

**Financial opportunities often involve a violation of one of these assumptions**

- > **Frictionless markets**
  - No government intervention or taxes
  - No transactions, agency, or bankruptcy costs
- > **Rational investors**
- > **Equal access to costless information**
- > **Equal access to market prices**

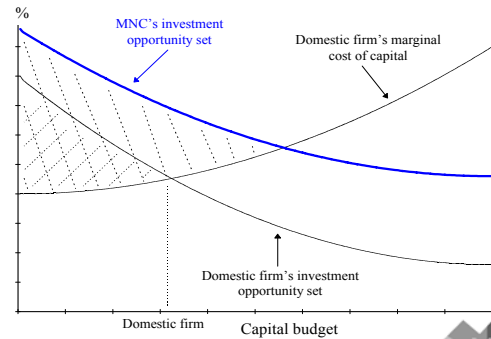
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## Market efficiency

- Frictionless markets ensure **operational efficiency**
- Rational investors with equal access to markets and information ensure **informational efficiency**
  - That is, a market in which prices reflect all relevant information
- Together, these promote **allocational efficiency**

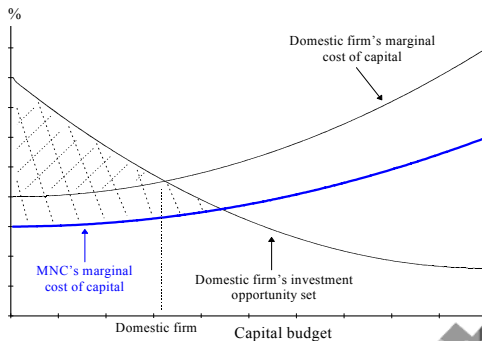
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## Investment opportunities



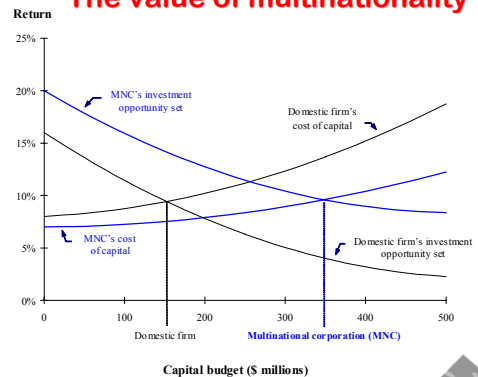
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## Financing opportunities



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## The value of multinationality



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## The MNC's additional risks

- **Country risk** - the risk that the business environment in a host country will unexpectedly change
  - **Political risk** - the risk that the business environment in a host country will change unexpectedly due to political events
  - **Financial risk** - the risk of unexpected change in the financial or economic environment of a host country

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## Risk versus risk exposure

- **Risk** exists whenever actual outcomes can differ from expectations
- A company has a **risk exposure** when its value can change with unexpected changes in business conditions

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## Foreign market entry

- **Export or import entry**
  - Agents or distributors (foreign or domestic)
  - Foreign sales branches or subsidiaries
- **Contract-based entry**
  - Licensing or franchising
- **Investment-based entry**
  - Foreign direct investments
  - Mergers and acquisitions
  - Strategic alliances or joint ventures

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## Export through agents or distributors

- **Export agents and distributors should have**
  - Technical knowledge of the product
  - Experience, expertise, and marketing contacts in the foreign country
  - Experience and expertise in shipping, documentation, and trade credit
  - Reliability and financial stability

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## Foreign sales branches/subsidiaries (versus agents or distributors)

- **Advantages**
  - Higher sales potential
  - Retains control over production, marketing, distribution
- **Disadvantages**
  - Higher resource commitment
  - Slower entry
  - High country risks and costs

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## Contract-based entry

- **Advantages**
  - quick and easy
  - low resource commitment
  - low cultural costs and risks
  - avoids import and investment barriers
- **Disadvantages**
  - limited fees/royalties on license agreements
  - loss of control over production technology
  - potential creation of competitors

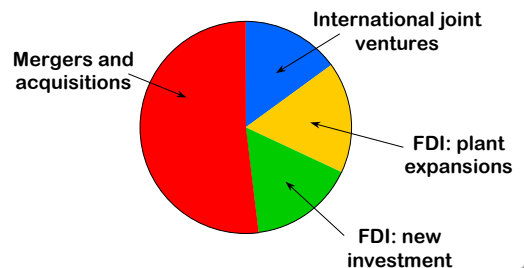
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## Investment-based entry

- **Advantages**
  - Potential for higher sales
  - Potential for lower costs
  - Diversifies manufacturing base and matches foreign currency costs to revenues
  - Avoids import quotas and tariffs
- **Disadvantages**
  - Higher resource commitment
  - Higher exit costs
  - Must overcome cultural differences
  - Must overcome investment barriers

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## Investment-based entry



Source: Ernst & Young

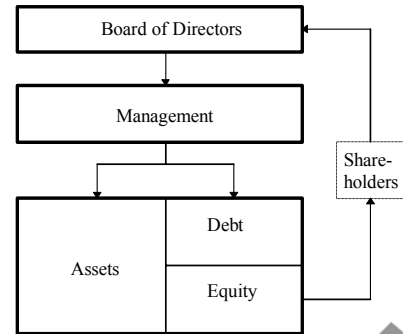
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## Investment-based entry

- > **Foreign direct investment**
  - Relatively slow entry
  - Maintains control over assets
- > **Cross-border M&A**
  - Relatively rapid entry, but possibly at a high price (acquisition premium)
- > **Cross-border joint ventures**
  - May avoid investment restrictions
  - Less exposure to country risks
  - Potential loss of control over intellectual property

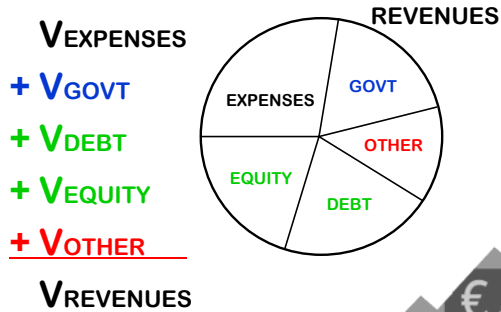
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## Governance of the MNC



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## Claims on corporate revenues



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## Multinational corporate strategy

- > **Invest in core competencies**
  - Core competencies are the things that a corporation does well
  - Core competencies derive from people and processes
  - The MNC must leverage its core competencies into new products and technologies

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