

Globalization & the Multinational Firm

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Chapter Objectives:

- Understand why it is important to study international finance.
- Distinguish international finance from domestic finance.

Chapter One Outline

- What's Special about "International" Finance?
- Goals for International Financial Management
- Globalization of the World Economy
- Multinational Corporations
- Organization of the Text
- Summary

What's Special about “International” Finance?

- Foreign Exchange Risk
- Political Risk
- Market Imperfections
- Expanded Opportunity Set

What's Special about “International” Finance?

- Foreign Exchange Risk
 - The risk that foreign currency profits may evaporate in dollar terms due to unanticipated unfavorable exchange rate movements.
- Political Risk
 - Sovereign governments have the right to regulate the movement of goods, capital, and people across their borders. These laws sometimes change in unexpected ways.

What's Special about “International” Finance?

- Market Imperfections
 - Legal restrictions on movement of goods, people, and money
 - Transactions costs
 - Shipping costs
 - Tax arbitrage

What's Special about “International” Finance?

- Expanded Opportunity Set
 - It doesn't make sense to play in only one corner of the sandbox.
 - True for corporations as well as individual investors.

Goals for International Financial Management

- The focus of the text is to equip the reader with the “intellectual toolbox” of an effective global manager—but what goal should this effective global manager be working toward?
 - Maximization of shareholder wealth?
- or
- Other Goals?

Maximize Shareholder Wealth

- Long accepted as a goal in the Anglo-Saxon countries, but complications arise.
 - Who are and where are the shareholders?
 - In what currency should we maximize their wealth?

Other Goals

- In other countries shareholders are viewed as merely one among many “stakeholders” of the firm including:
 - Employees
 - Suppliers
 - Customers
- In Japan, managers have typically sought to maximize the value of the *keiretsu*—a family of firms to which the individual firms belongs.

Other Goals

- No matter what the other goals, they cannot be achieved in the long term if the maximization of shareholder wealth is not given due consideration.

Globalization of the World Economy: Recent Trends

- Emergence of Globalized Financial Markets
- Trade Liberalization and Economic Integration
- Privatization

Emergence of Globalized Financial Markets

- Deregulation of Financial Markets
coupled with
- Advances in Technology
have greatly reduced information and
transactions costs, which has led to:
- Financial Innovations, such as
 - Currency futures and options
 - Multi-currency bonds
 - Cross-border stock listings
 - International mutual funds

Economic Integration

- Over the past 50 years, international trade increased about twice as fast as world GDP.
- There has been a sea change in the attitudes of many of the world's governments who have abandoned mercantilist views and embraced free trade as the surest route to prosperity for their citizenry.

Liberalization of Protectionist Legislation

- The General Agreement on Tariffs and Trade (GATT) a multilateral agreement among member countries has reduced many barriers to trade.
- The World Trade Organization has the power to enforce the rules of international trade.
- The North American Free Trade Agreement (NAFTA) calls for phasing out impediments to trade between Canada, Mexico and the United States over a 15-year period.

Privatization

- The selling off state-run enterprises to investors is also known as “Denationalization”.
- Often seen in socialist economies in transition to market economies.
- By most estimates this increases the efficiency of the enterprise.
- Often spurs a tremendous increase in cross-border investment.

Multinational Corporations

- A firm that has incorporated on one country and has production and sales operations in other countries.
- There are about 60,000 MNCs in the world.
- Many MNCs obtain raw materials from one nation, financial capital from another, produce goods with labor and capital equipment in a third country and sell their output in various other national markets.

Top 10 MNCs

1	General Electric	United States
2	Ford Motor Company	United States
3	Royal Dutch/Shell Group	Netherlands/ UK Netherlands/U.K.
4	General Motors	United States
5	Exxon Corporation	United States
6	Toyota	Japan
7	IBM	United States
8	Volkswagen Group	Germany
9	Nestlé SA	Switzerland
10	Daimler-Benz AG	Germany

The Organization of the Text



Part I

Chapters 1-5

Part II

Chapters 6-11

Parts III & IV

Chapters 12-20

End Chapter One