

Multinational Cash Management

Chapter Eighteen

18

Chapter Objective:

This chapter discusses various issues associated with multinational cash management.

Chapter Outline

- The Management of Multinational Cash Balances
- Cash Management Systems in Practice
- Transfer Pricing & Related Issues
- Blocked Funds

The Management of International Cash Balances

- The size of cash balances
- The currency **denomination**
- **Where** these cash balances are located

The Size of Cash Balances

- The optimal size of the firm's cash balances depend upon:
 - The cost of keeping “too much” cash on hand.
 - ◆ *i.e.* the opportunity costs of *holding* cash
 - The cost of not keeping enough cash on hand.
 - ◆ *i.e.* the trading costs associated with having *too little* cash
 - The variability of cash flows.

Choice of Currency

- By maintaining cash balances in a particular currency, the MNC is essentially speculating (or hedging?) in that currency.

Where Cash Balances are Located.

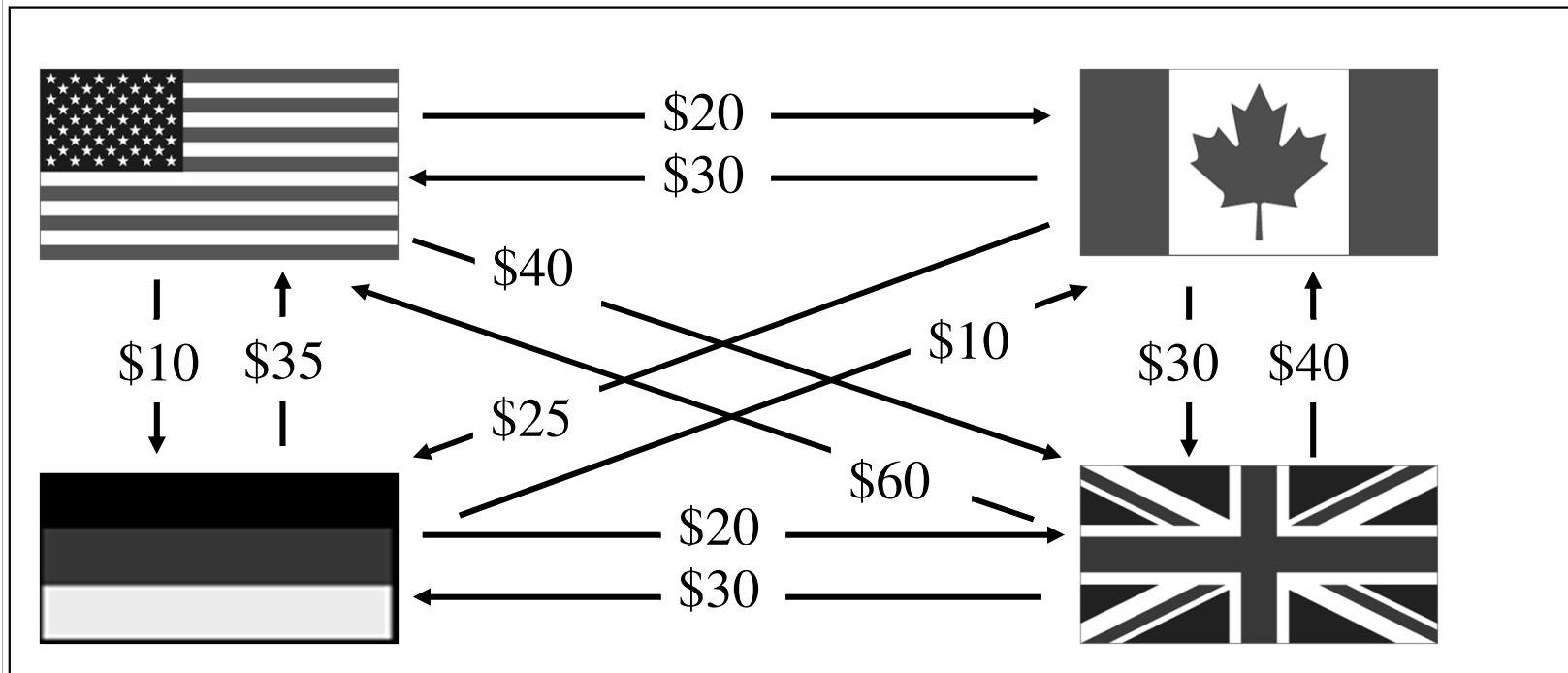
- Should the firm have centralized cash management in the home country?
- Or should the firm let each affiliate handle it locally?
- Where are borrowing costs lowest and investment returns highest?

Cash Management Systems in Practice

- Multilateral Netting
 - Is an efficient and cost-effective mechanism for settling interaffiliate foreign exchange transactions.
- Not all countries allow MNCs to net payments
 - By limiting netting, more unnecessary foreign exchange transactions flow through the local banking system.

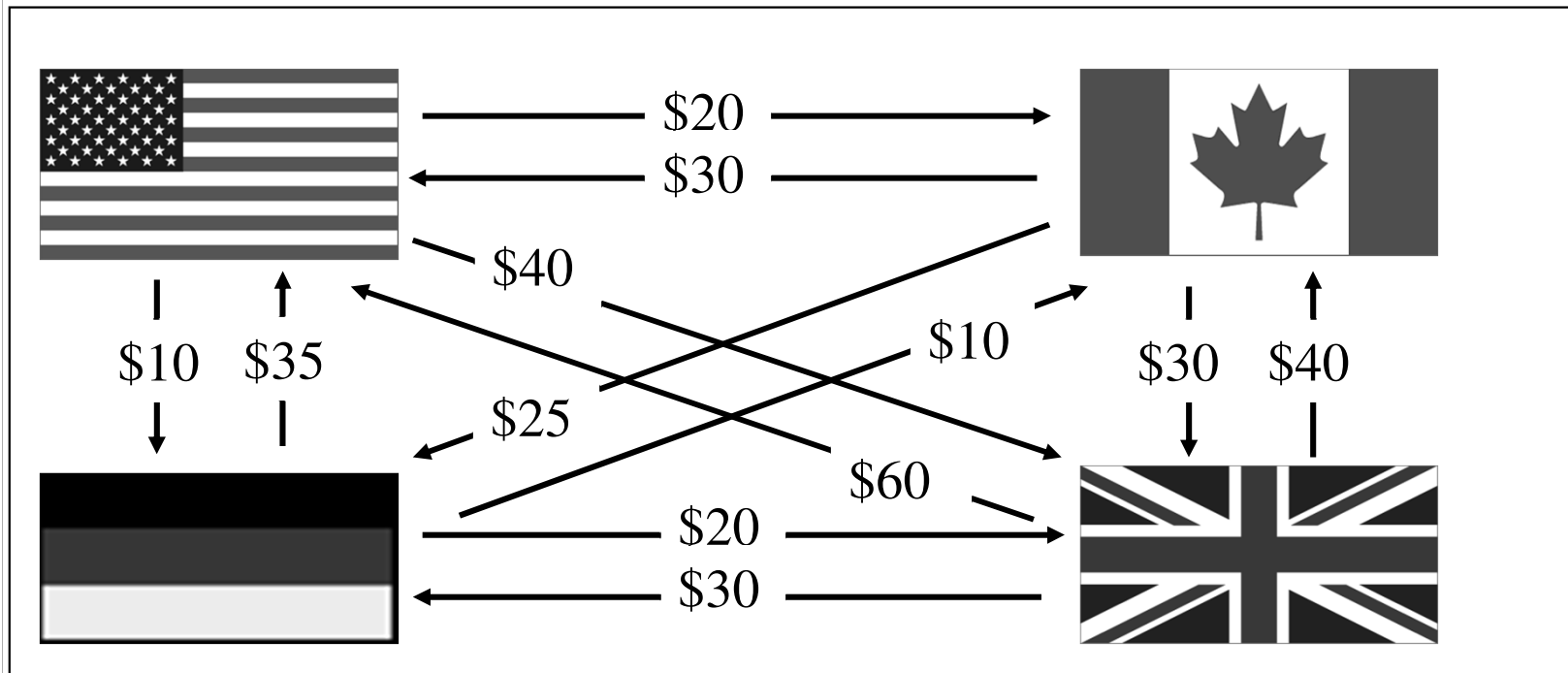
Multilateral Netting

Consider a U.S. MNC with three subsidiaries and the following foreign exchange transactions:



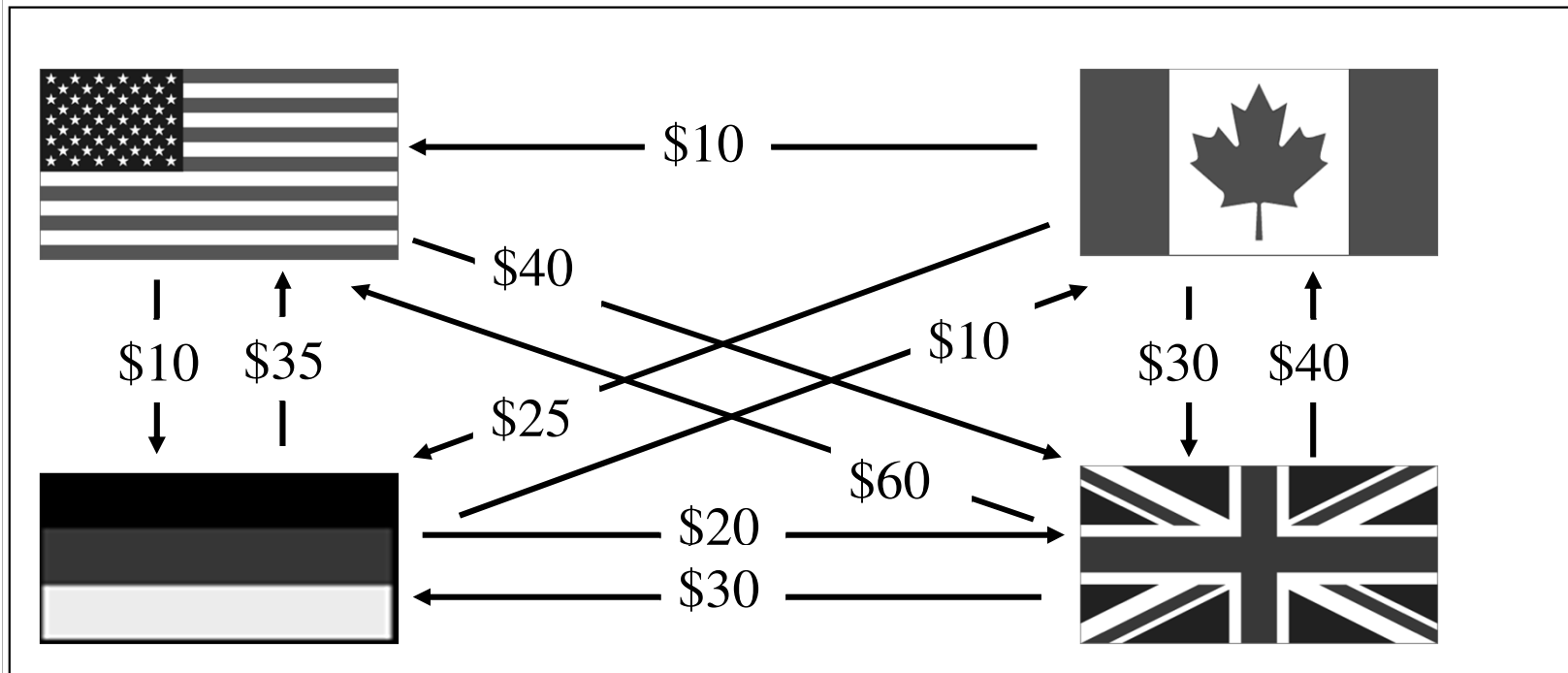
Multilateral Netting

Bilateral Netting would reduce the number of foreign exchange transactions by half:



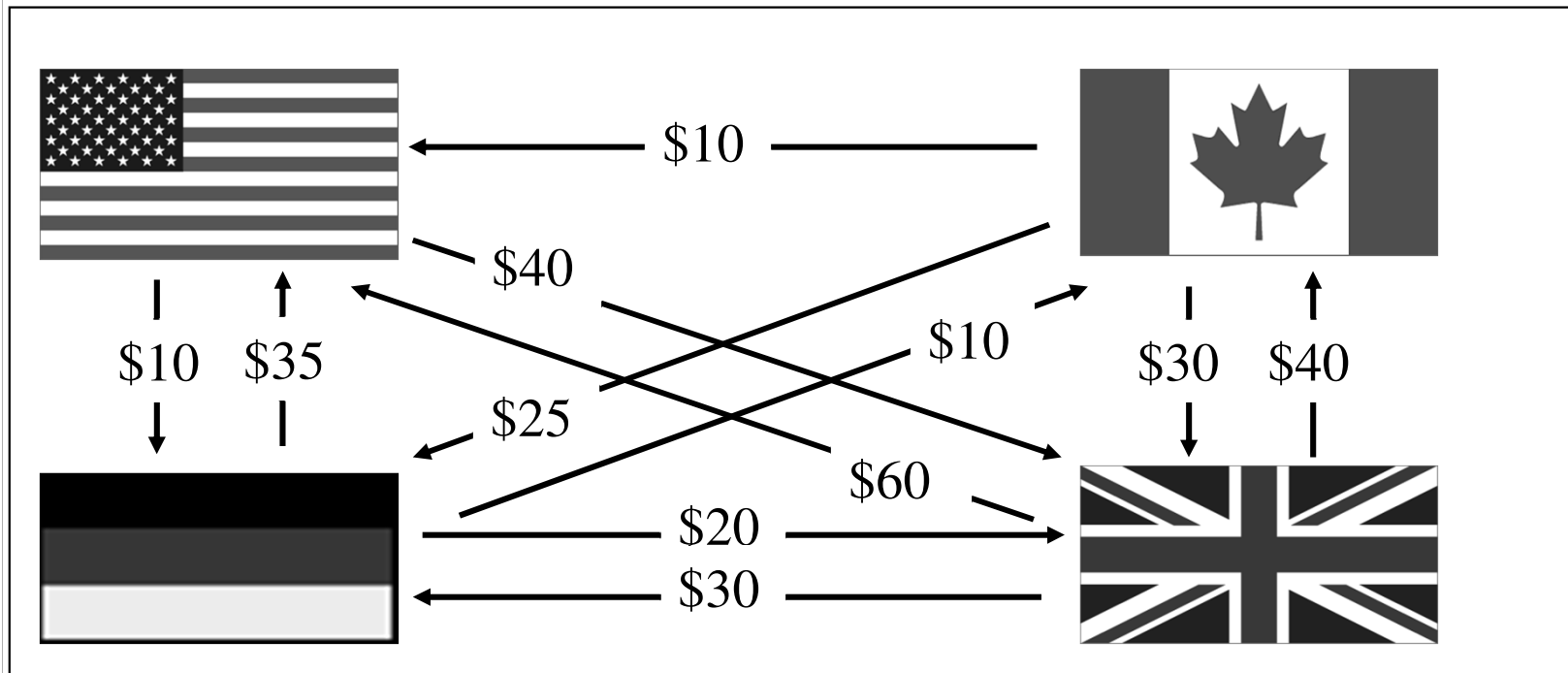
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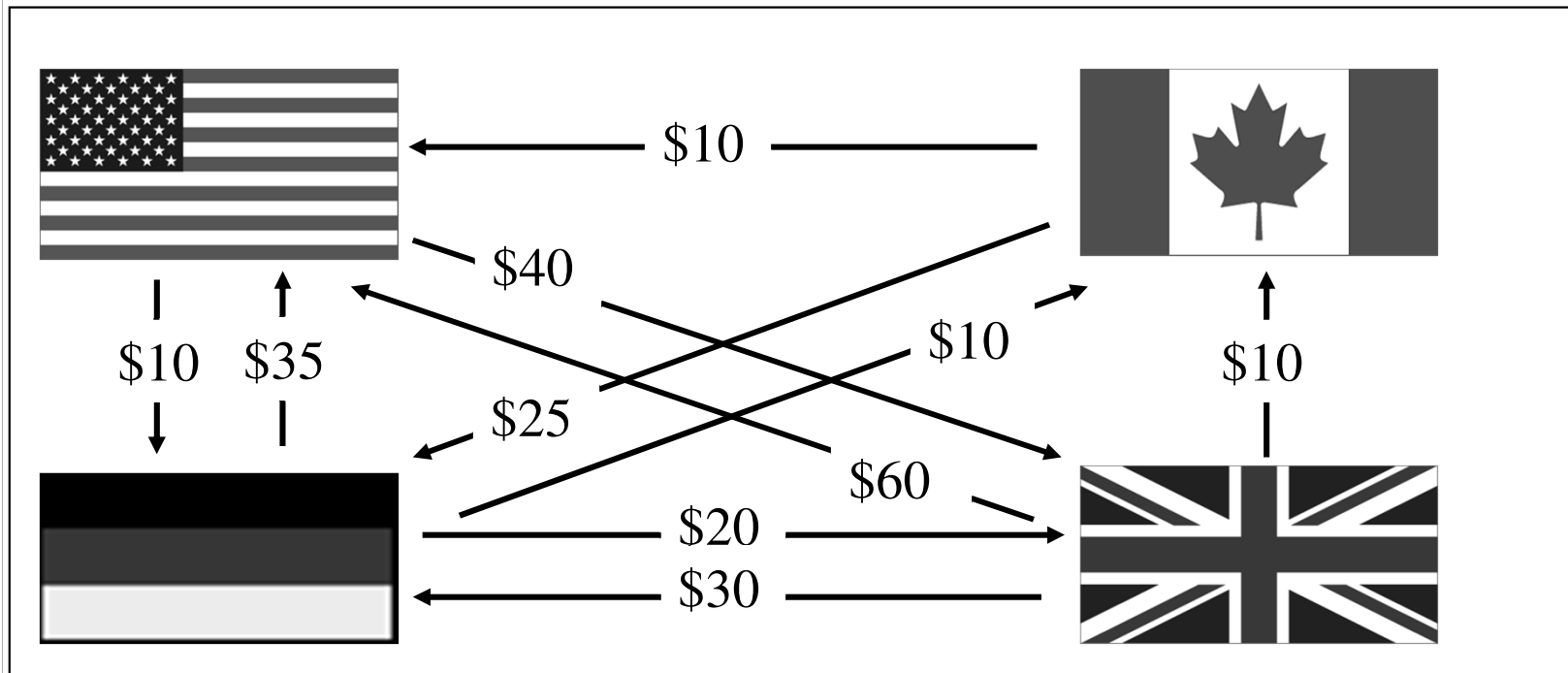
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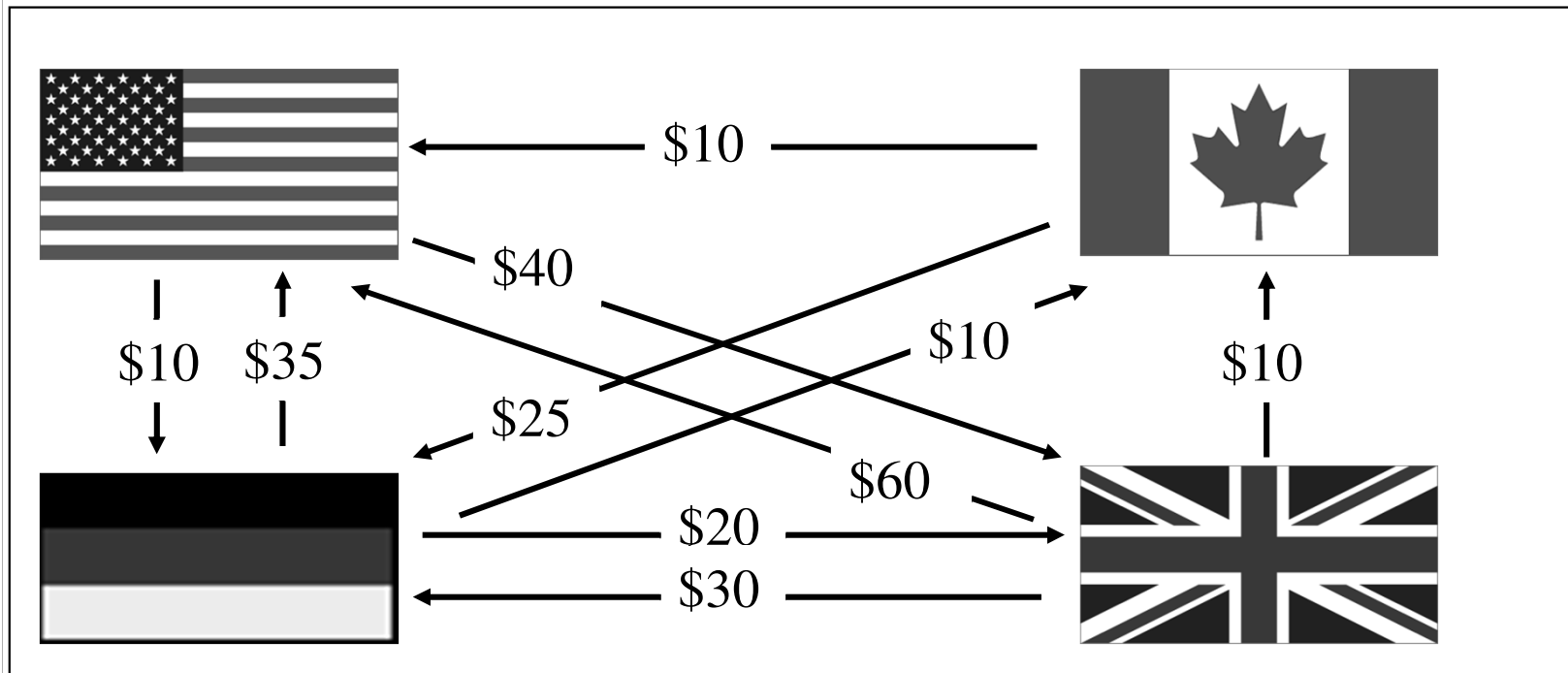
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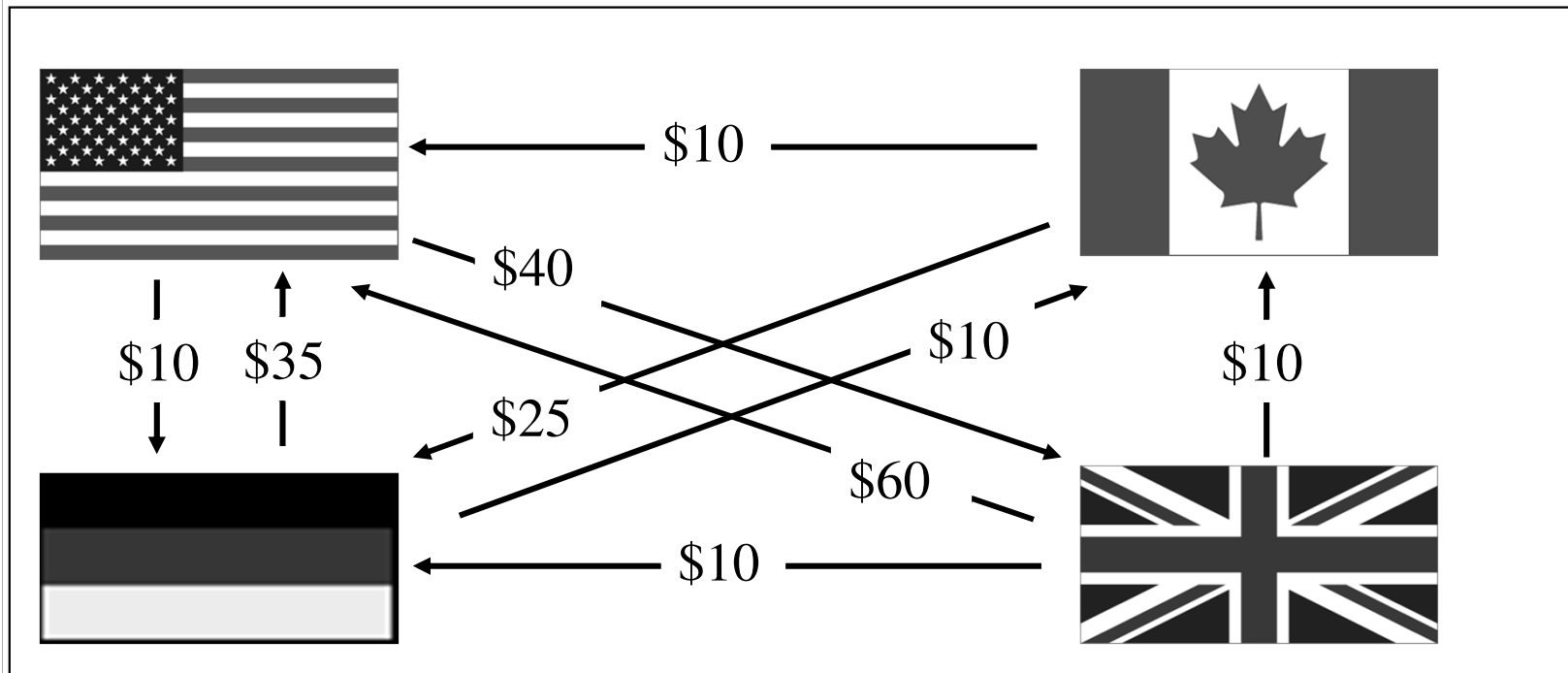
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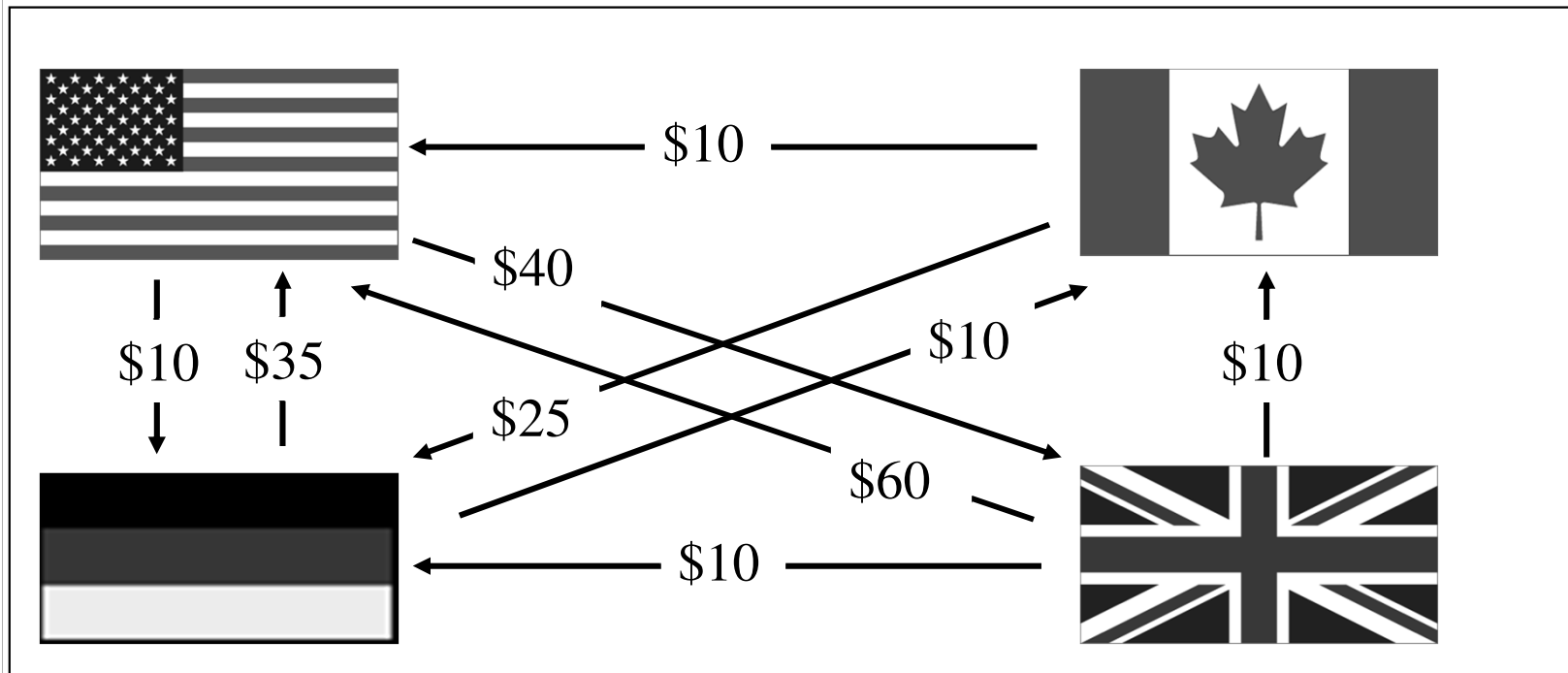
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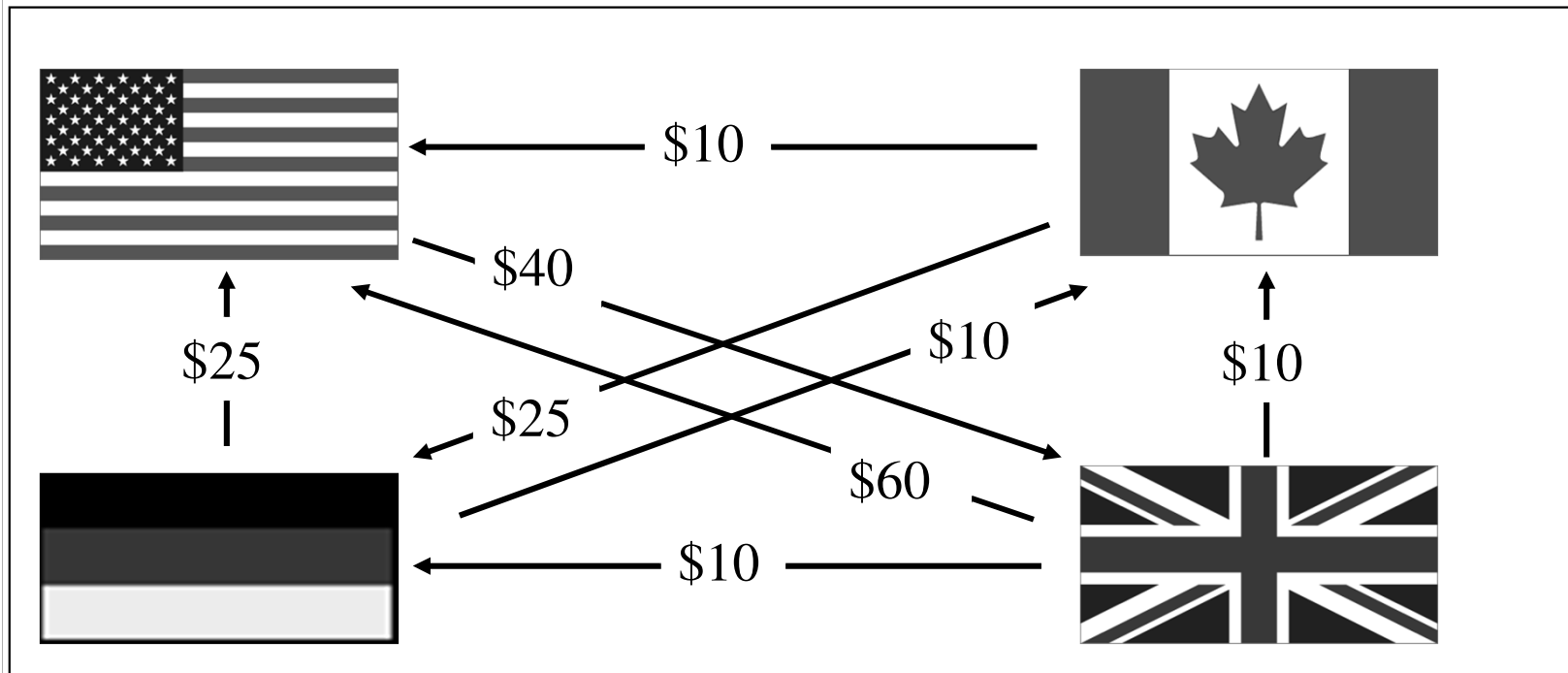
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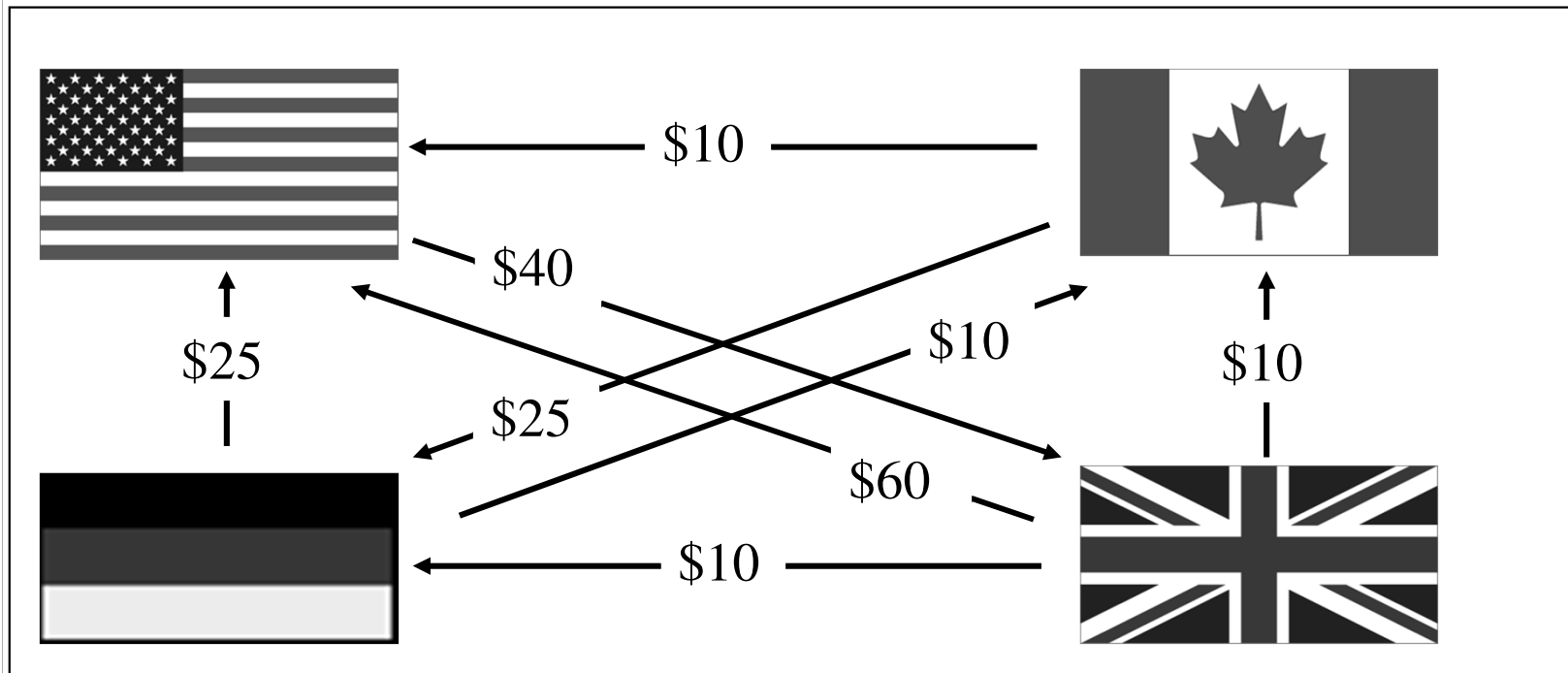
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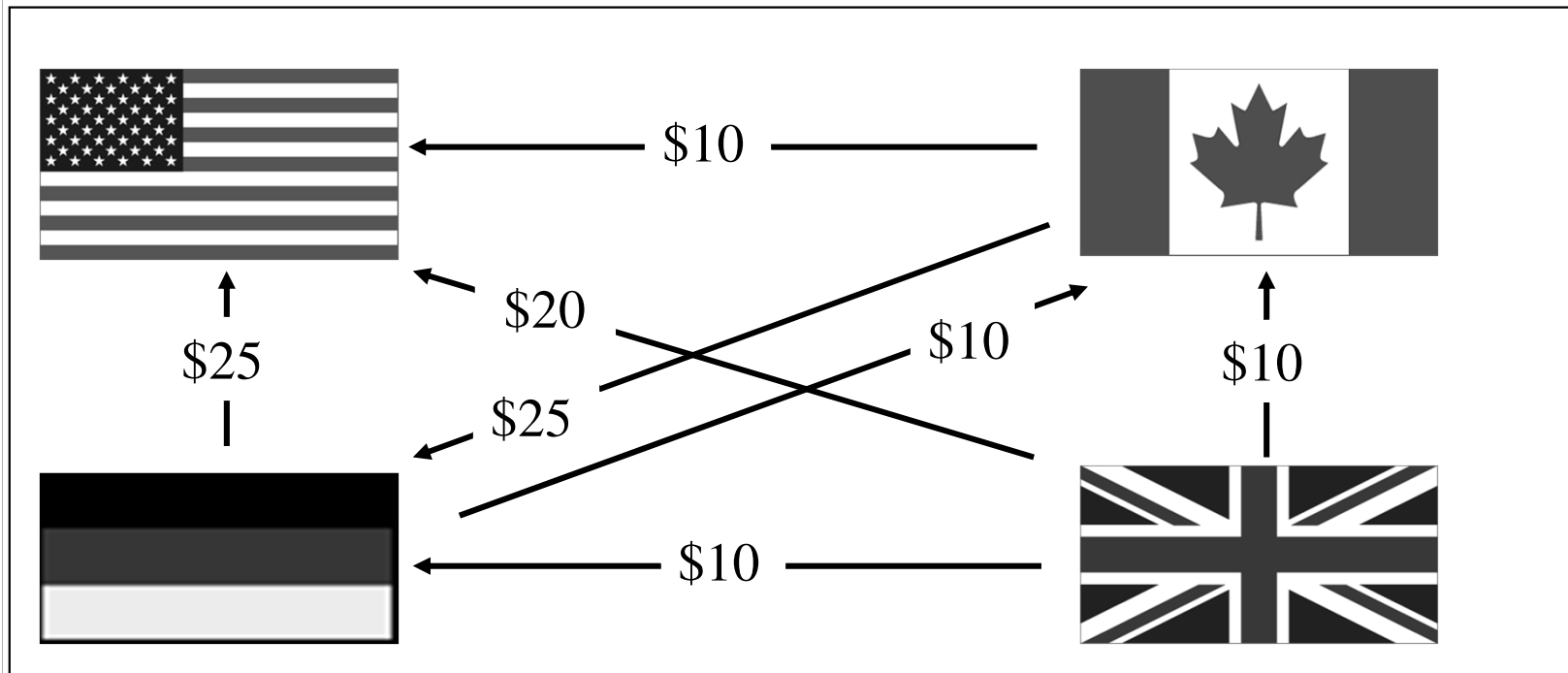
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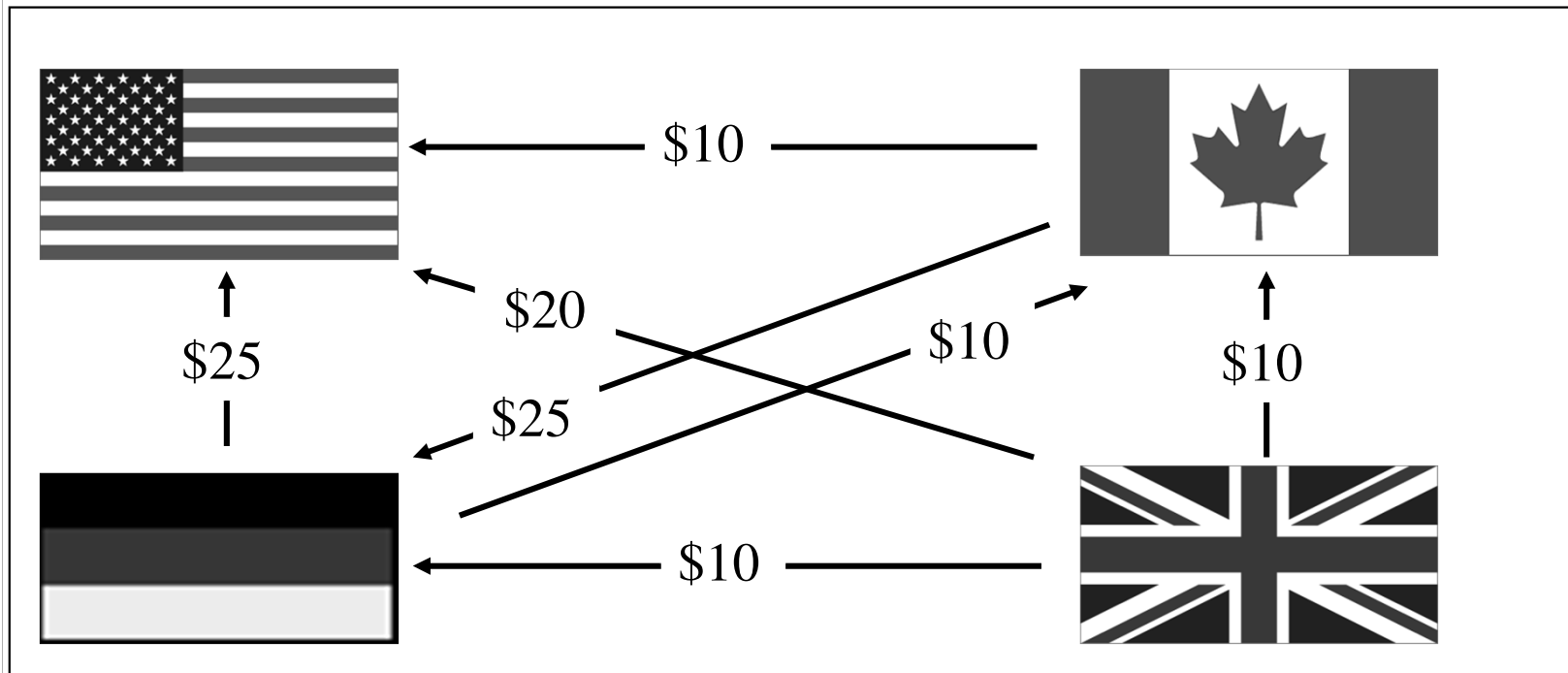
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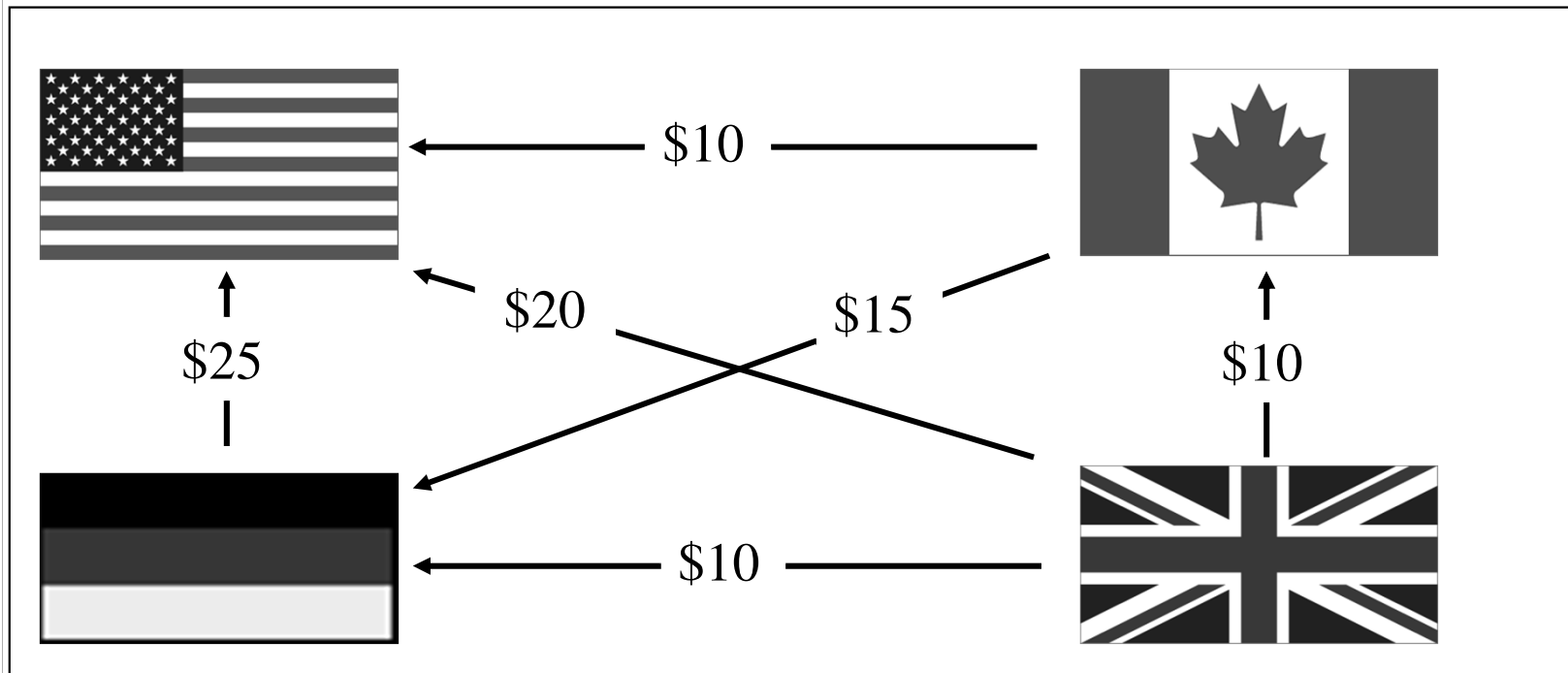
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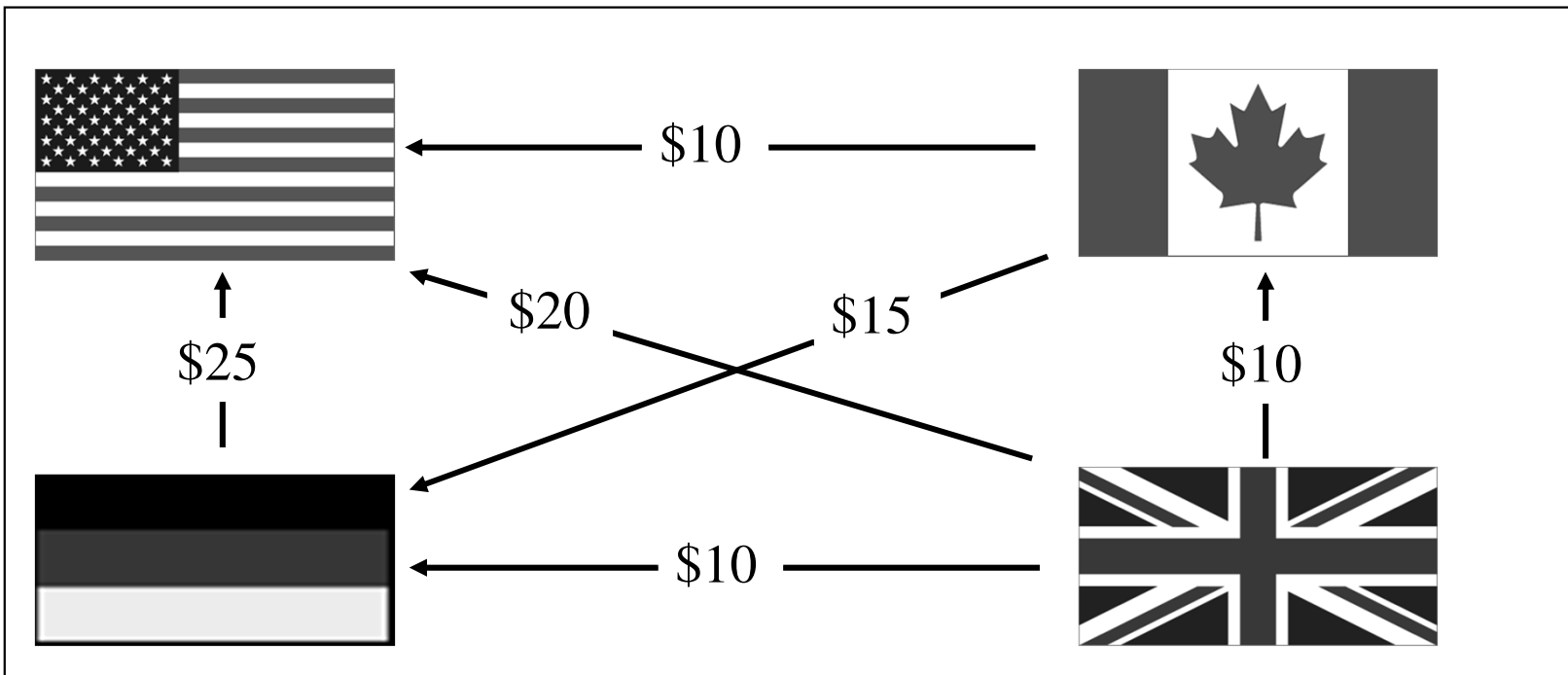
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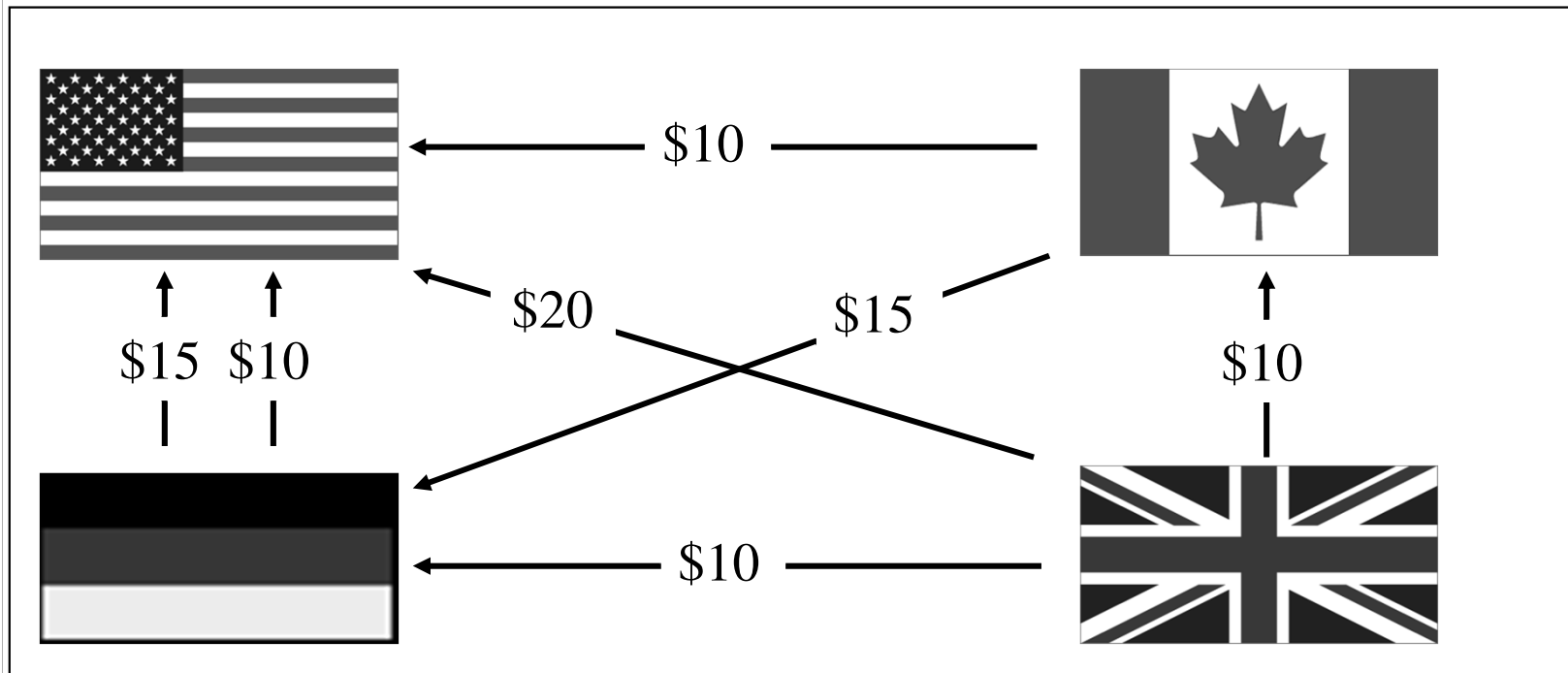
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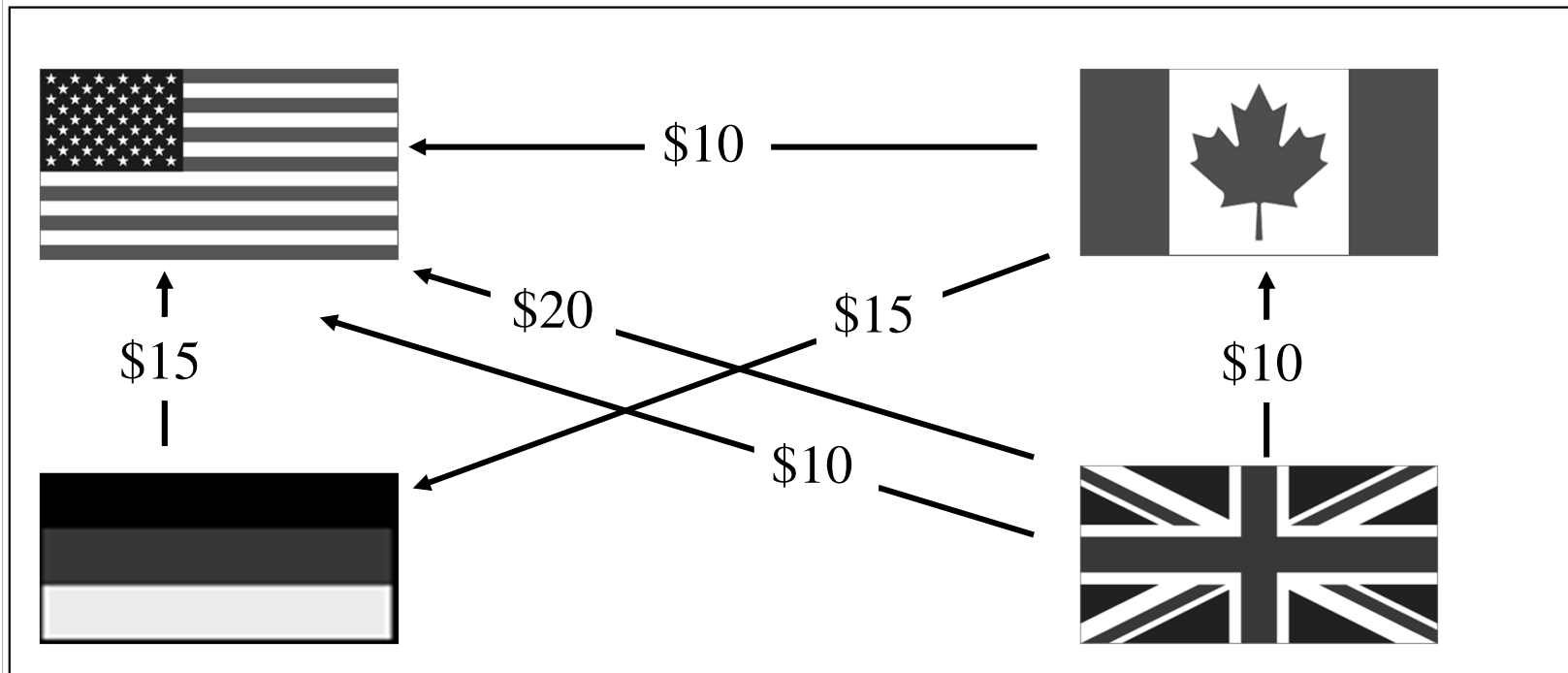
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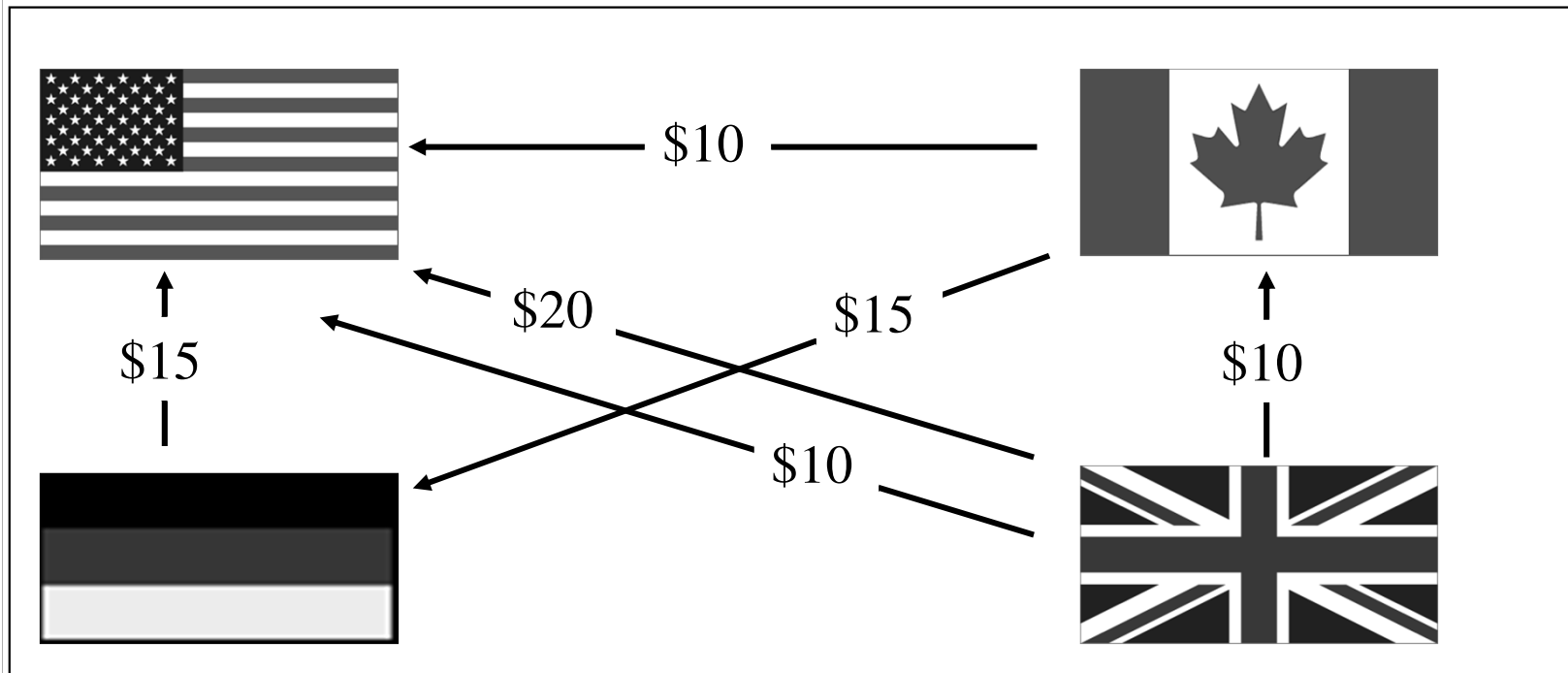
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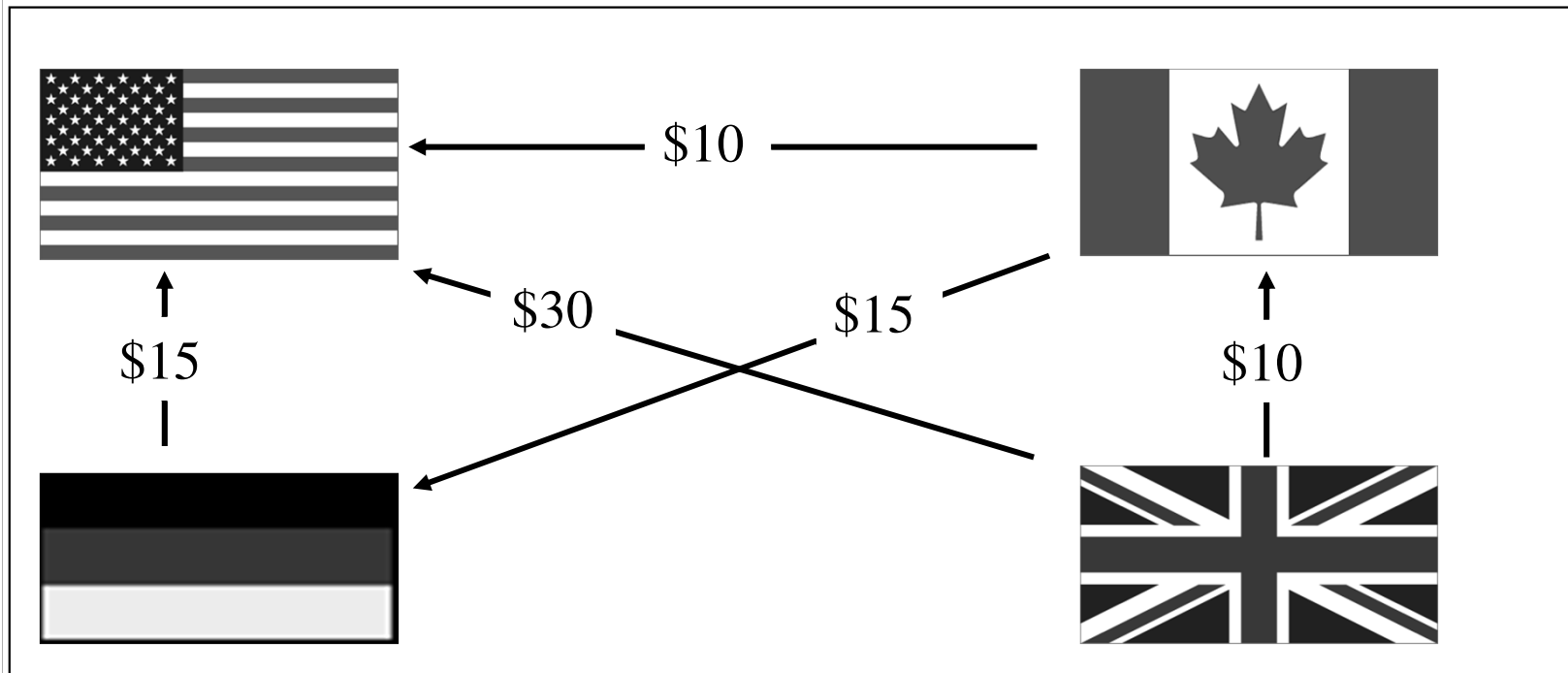
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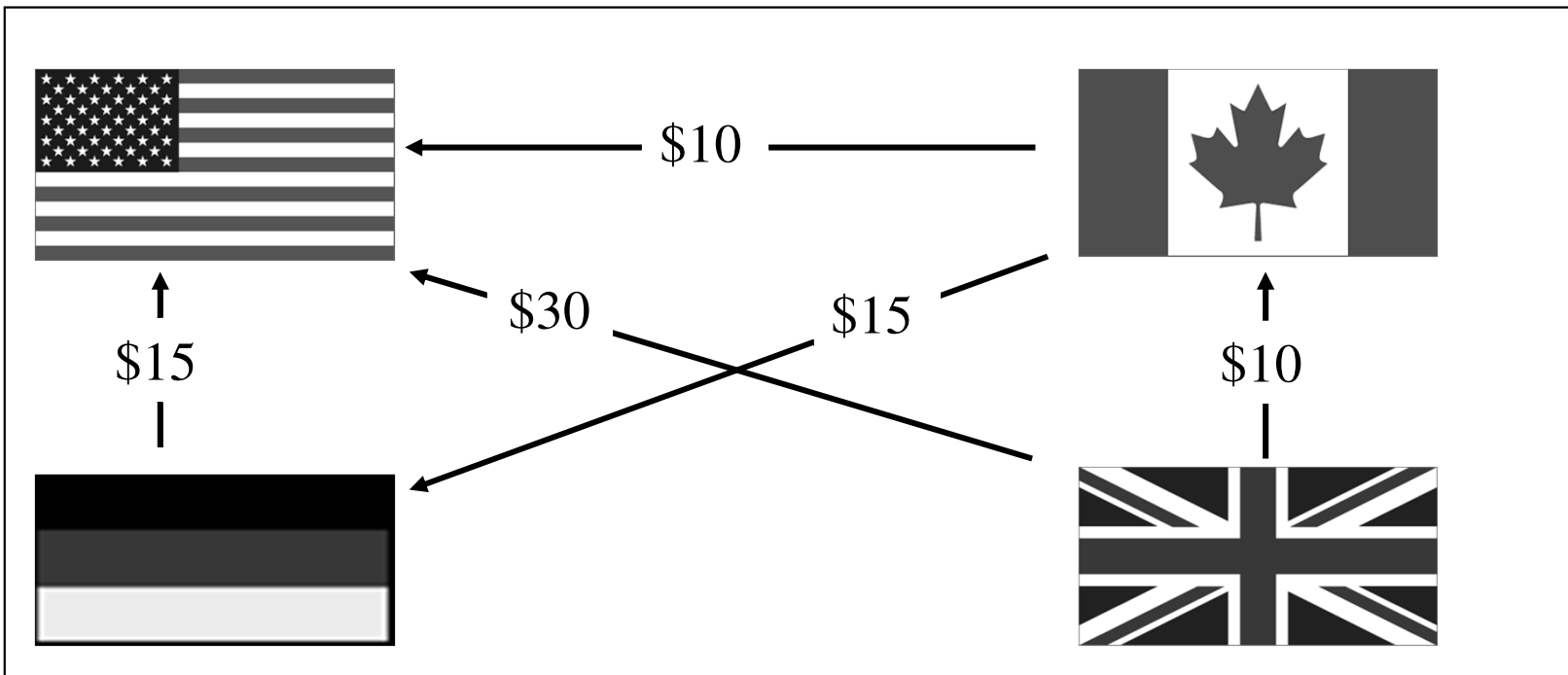
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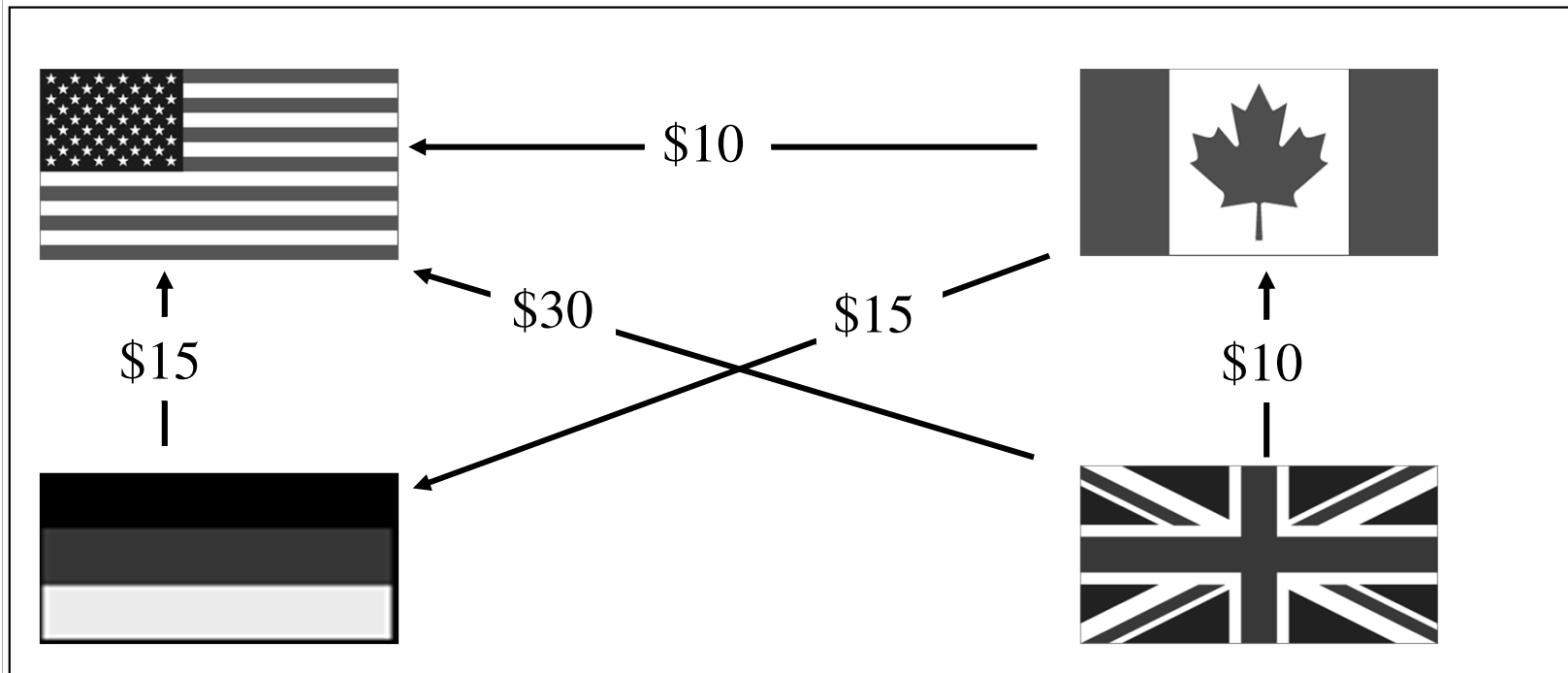
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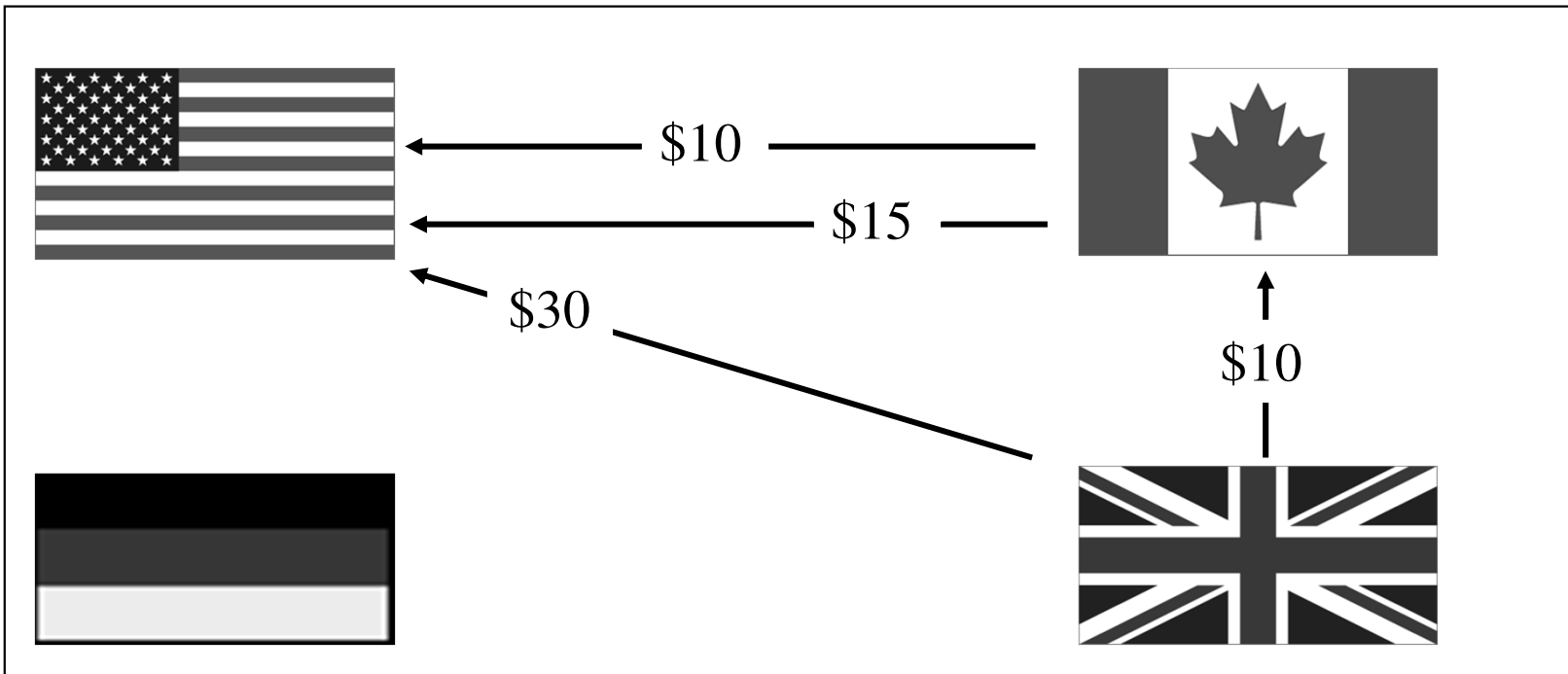
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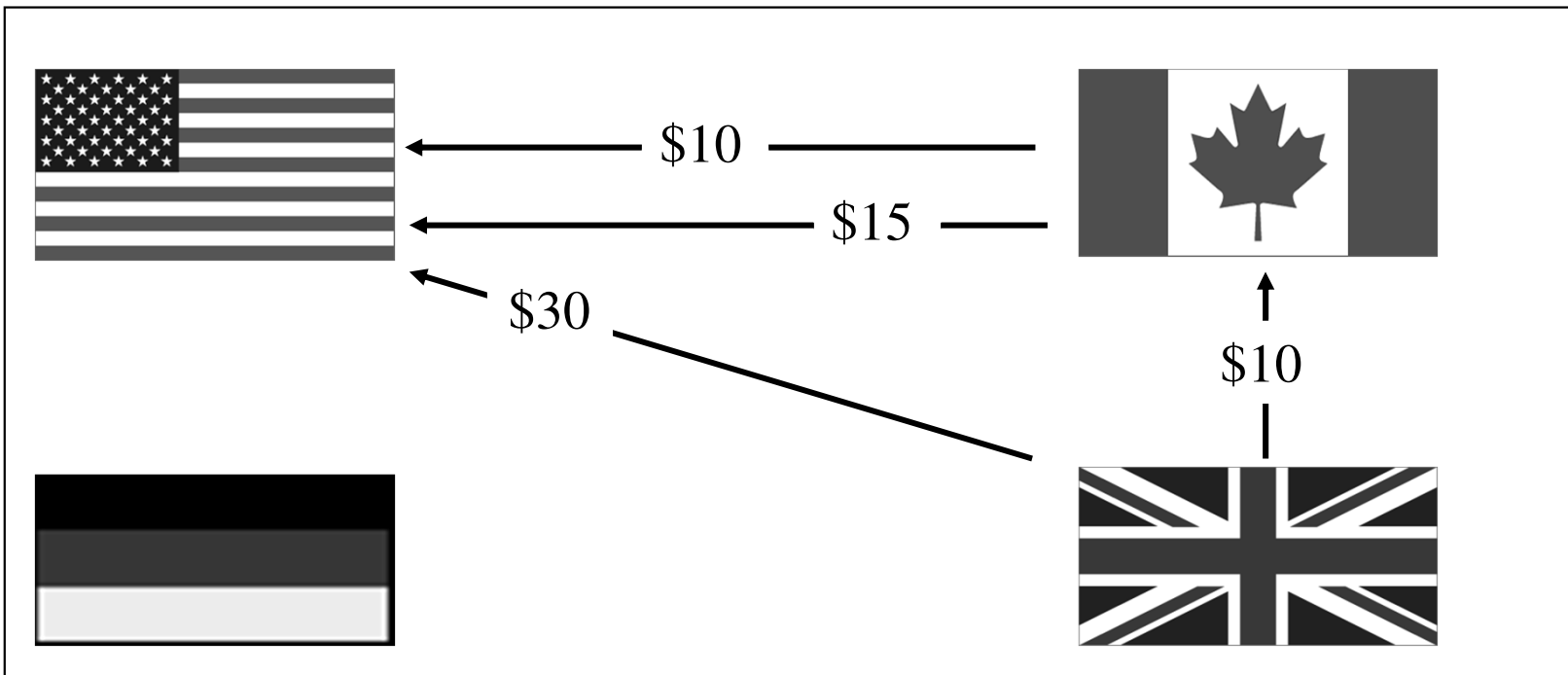
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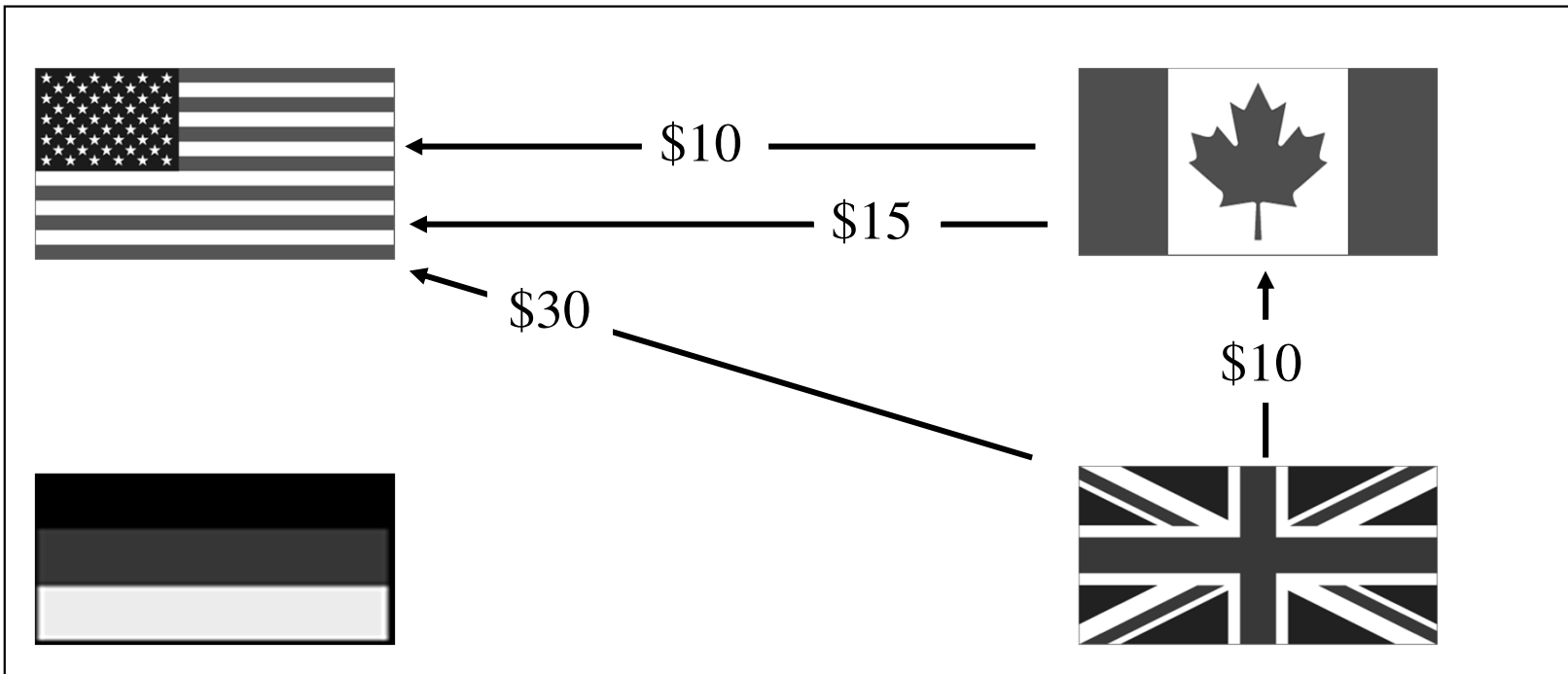
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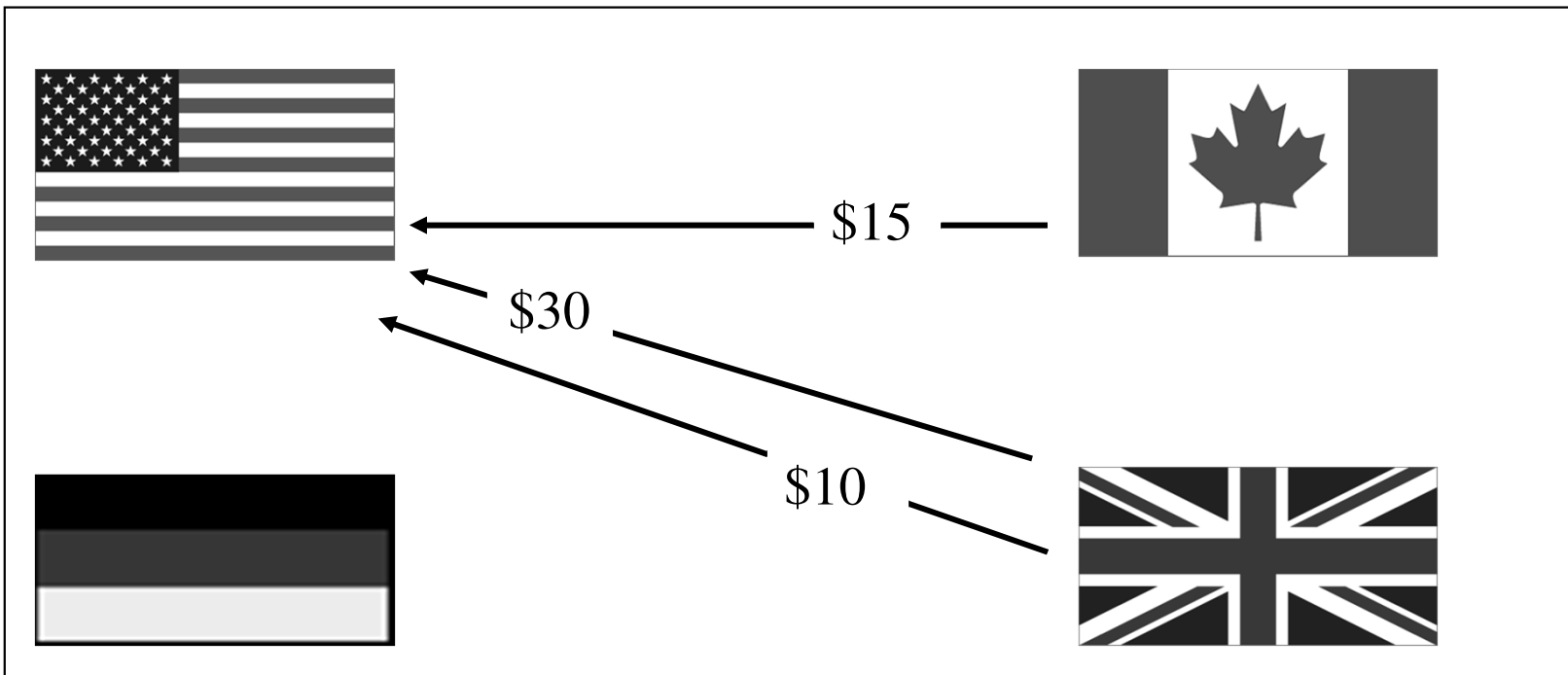
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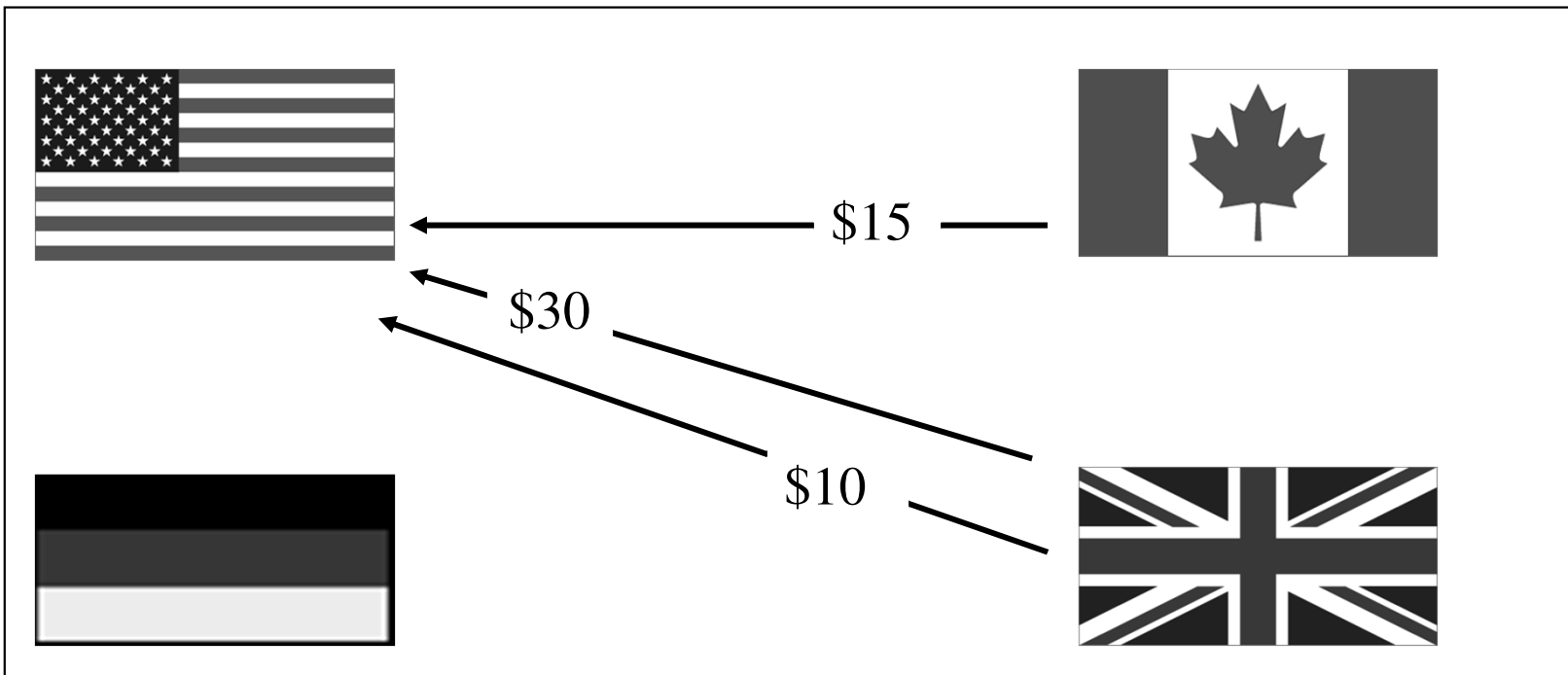
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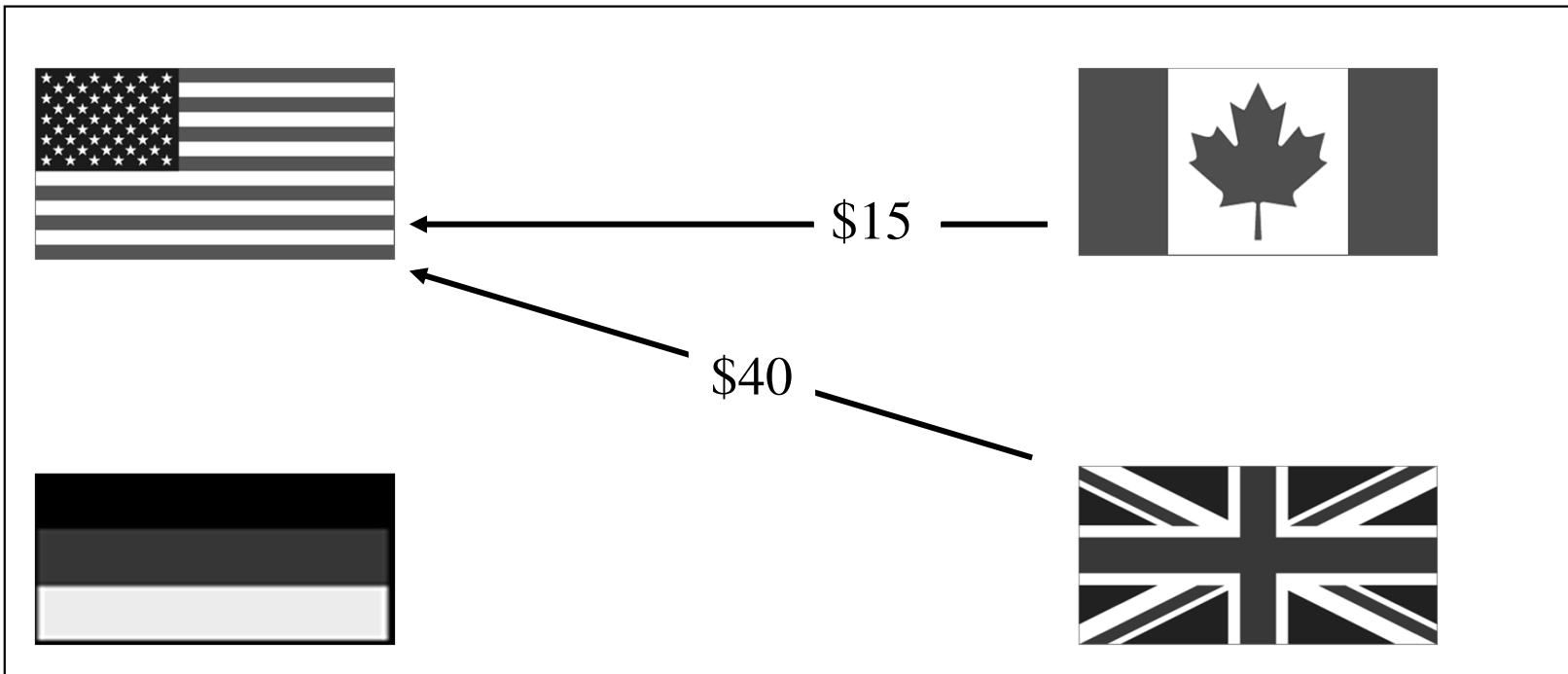
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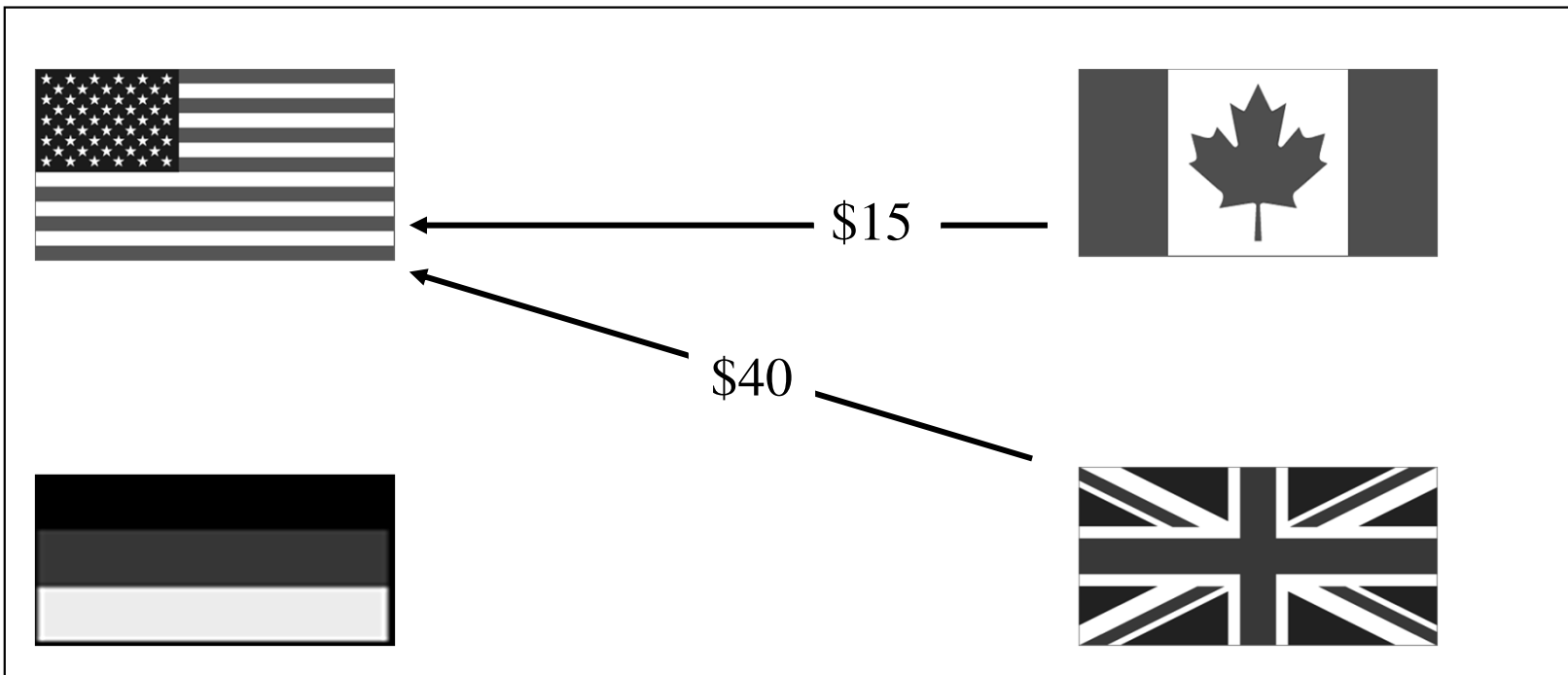
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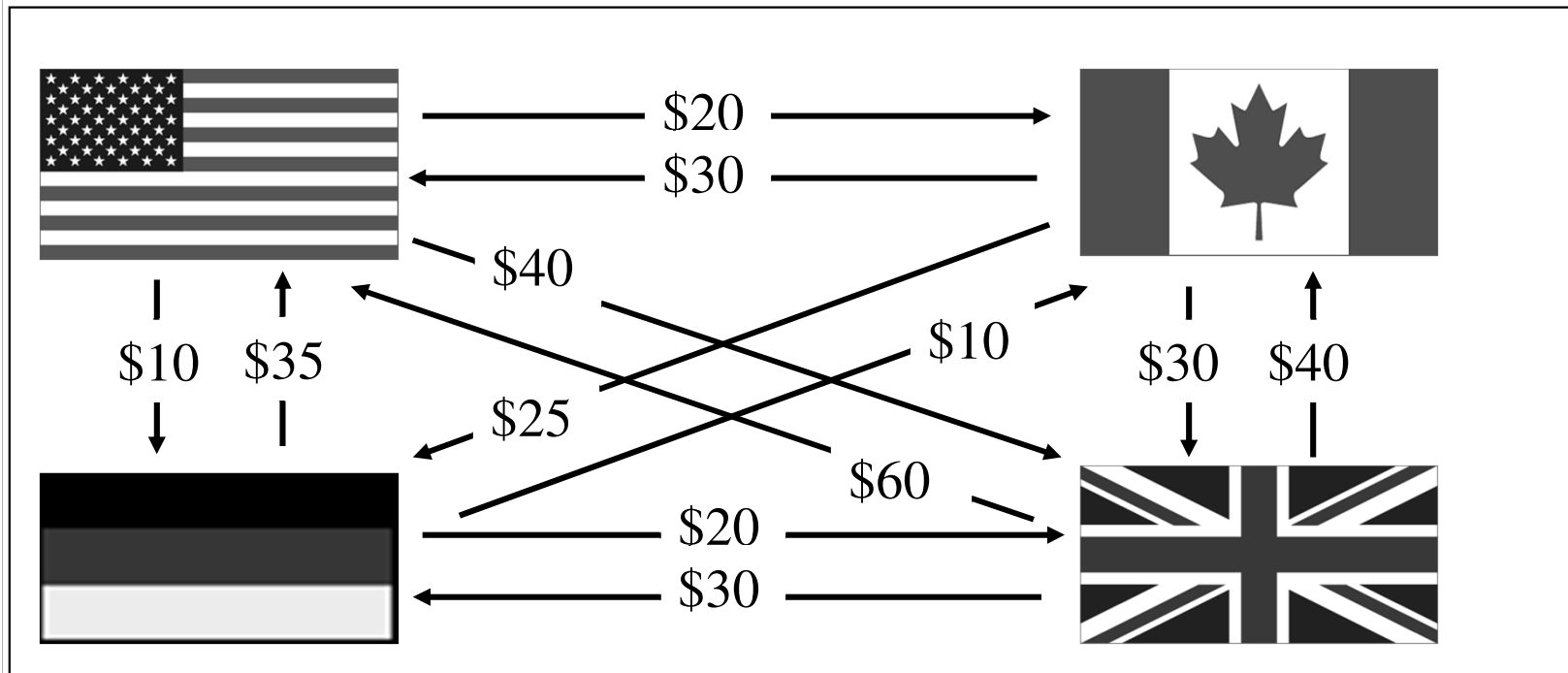
Multilateral Netting

Clearly, multilateral netting can simplify things greatly.



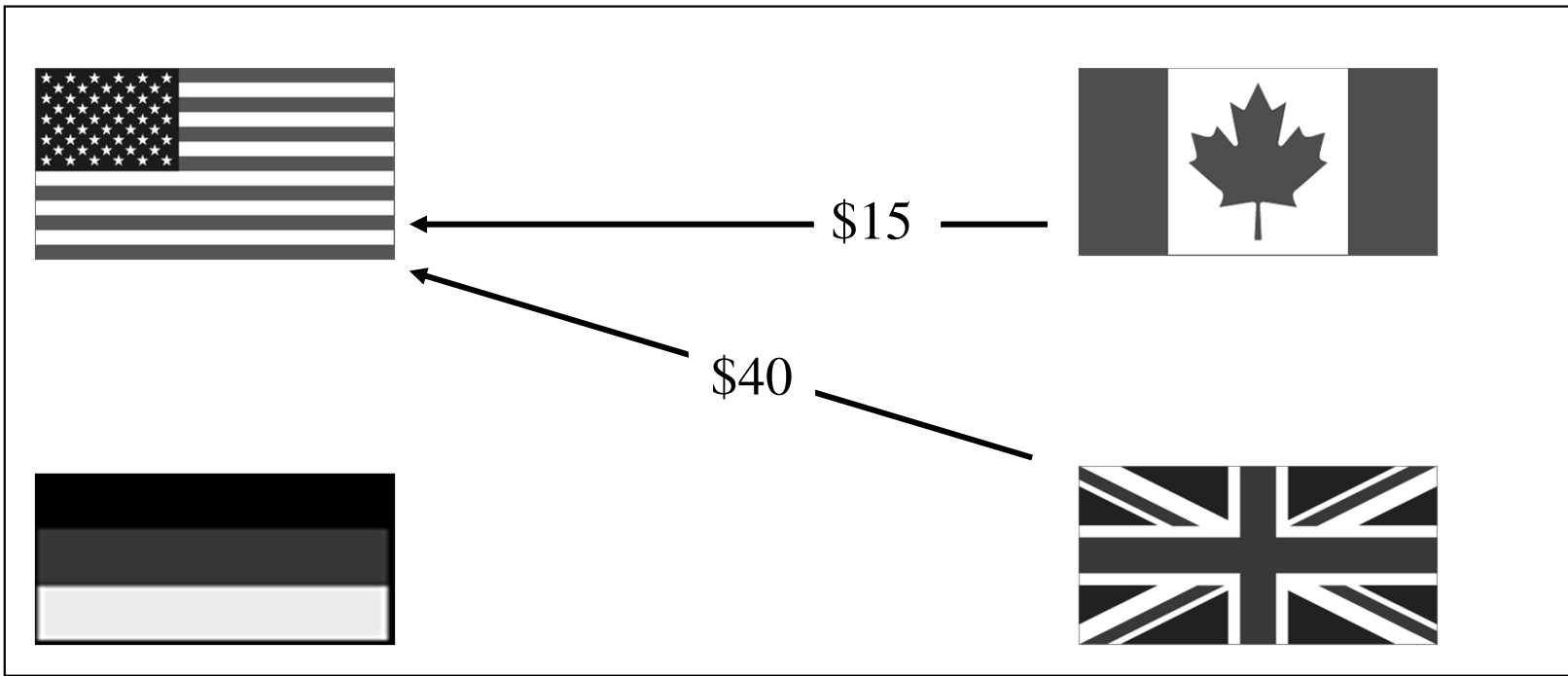
Multilateral Netting

Compare this:



Multilateral Netting

With this:



Transfer Pricing & Related Issues

- The Transfer Price is the price that for accounting purposes, is assigned to goods and services flowing from one division of a firm to another division.
- Controversial for a domestic firm
 - Consider the example of a firm that has one division that mills lumber and another that makes furniture. The transfer price of the lumber is a political as well as economic and accounting issue.

Transfer Pricing & Related Issues

- For MNC, there exists the added complications of:
 - Differences in tax rates.
 - Import duties and quotas.
 - Exchange rate restrictions on the part of the host country.

Blocked Funds

- A form of political risk is the risk that the foreign government may impose exchange restrictions on its own currency.
- Several methods exist for moving blocked funds:
 - Transfer pricing
 - Unbundling services
 - Parallel and back-to-back loans
 - Swaps

Blocked Funds

- Additional strategies for unblocking funds:
 - Direct negotiation
 - Export creation
 - ◆ Using the blocked funds to buy goods and services for the MNC.
 - ◆ For example, use the National Airlines of the host country for travel of executives of the MNC, and pay for the tickets with the blocked funds.
 - ◆ Transfer local expatriates from home payroll to the local subsidiaries payroll.

End Chapter Eighteen