Introduction to Multinational Financial Management

Guiding Principle for our Decision Making
- In this course the governing principle for decision making will be to Maximize risk adjusted after-tax dollar profits available to the stockholders.

How is a Multinational Corp. different from a purely domestic firm?
- Operating in more than one country.
  - introduces a variety of special concerns
- Exchange rate risk
  - Cost
    - Cash flows in more than one currency denomination
    - Dollar prices are constantly changing
  - Benefit
    - May be able to take advantage of mispricing

On currency Regimes
- Most countries (in terms of the overall number) fix - their currencies
- Most industrialized countries float theirs
- We will be concerned primarily with floating rate regimes

Types of Government Regulations
- Tax Arbitrage:
  - Shift costs to high tax countries and shift profits to low tax countries
- Expropriation/nationalization
  - The government takes control of the firm's overseas assets with or without compensation
- Blockage of funds:
  - Conflict of interest, company wants to send dividends to US, foreign governments block it.

How is a Multinational Corp. different from a purely domestic firm? Cont.
2. Different government regulations
  - Cost
    - Legally more complex and expensive to comply
  - Benefits
    - Loopholes are easier to find
3. **Access to cheap labor**
   - The labor costs must be productivity adjusted

   - **In country 1**
     - 1 unit of labor can make 10 units of output
     - 1 unit of labor cost $20
   - **In country 2**
     - 1 unit of labor can make 5 units of output
     - 1 unit of labor costs $15
   - Even though country 2 has the lower wage, its productivity adjusted wage is higher (5 units/$15) vs (10 units/$20)

<table>
<thead>
<tr>
<th>Country A</th>
<th>Country B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Productivity Adjusted Compensation = $10</td>
<td>Productivity Adjusted Compensation = $8</td>
</tr>
<tr>
<td>Move from B to A</td>
<td>Move from B to A</td>
</tr>
<tr>
<td>Productivity Adjusted Compensation Falls = $9</td>
<td>Productivity Adjusted Compensation Falls = $9</td>
</tr>
</tbody>
</table>

Possible Impediments to Labor Mobility

- Legal Restrictions (visas)
- Language and Cultural
- Home bias

4. **Access to cheap capital:**
   - **Two Kinds**
     - (1) physical
     - (2) financial
   - Financial capital is much more mobile than labor.

<table>
<thead>
<tr>
<th>Country A</th>
<th>Country B</th>
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<tbody>
<tr>
<td>Expected Return = 4%</td>
<td>Expected Return = 2%</td>
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<tr>
<td>Capital flows from B to A</td>
<td>Capital flows from A to B</td>
</tr>
<tr>
<td>Expected Return Falls = 3%</td>
<td>Expected Return Falls = 3%</td>
</tr>
<tr>
<td>Expected Return Rises = 3%</td>
<td>Expected Return Rises = 3%</td>
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</tbody>
</table>
Possible Impediments to Capital Mobility
- Legal restrictions
- Perceived risk differences
- Information costs
- Home bias

Primary advantage of being an MNC
- The primary advantage of being an MNC is the ability to exploit market imperfections
- **Definition**
  - A market imperfection is any situation where the price is different than would be observed in a perfect competition, unregulated, full information environment.

Sources of imperfections
- Governments intervention
  - Price controls
  - Floors/ceilings
  - Price freezes - shortages
  - Wage controls
  - Minimum wage
  - Interest Rate Controls
  - Investment & capital flows Restrictions
  - Subsidies and taxes
- Information differences
- Monopoly (one seller) / Monopsony (one buyer) Power