

# International Financial Management



Jeff Madura • 6th Edition

# INTERNATIONAL FINANCIAL MANAGEMENT

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6th Edition

JEFF MADURA  
Florida Atlantic University



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# ABOUT THE AUTHOR

Jeff Madura is presently the SunTrust Bank Professor of Finance at Florida Atlantic University. He has written several textbooks, including *Financial Markets and Institutions*. His research on international finance has been published in numerous journals, including *Journal of Financial and Quantitative Analysis*, *Journal of Money, Credit and Banking*, *Journal of Banking and Finance*, *Journal of International Money and Finance*, *Journal of Financial Research*, *Financial Review*, *Journal of Multinational Financial Management*, and *Global Finance Journal*. He has received awards for excellence in teaching and research, and has served as a consultant for international banks, securities firms, and other multinational corporations. He has served as a director for the Southern Finance Association and Eastern Finance Association, and also served as president of the Southern Finance Association.

# PREFACE

## OVERVIEW

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The international financial environment has experienced major changes in recent years. Many foreign countries in Asia, Eastern Europe, and Latin America that were previously governed by socialist policies and closed to the rest of the world have undergone a transition toward free enterprise and international integration. In particular, government-owned businesses have been privatized, companies have become publicly owned, and free trade agreements have been created. While the transition has created more efficient economies, it has had some adverse side effects. In particular, free enterprise can result in failure of the less competitive companies and can make a country more susceptible to economic crises experienced by other countries.

The transmission of economic crises across countries has created a volatile global marketplace. The multinational corporations (MNCs) that compete in the global marketplace must not only be properly managed to withstand the effects of crises in foreign countries, but must also have the flexibility to capitalize on these crises. While some events (such as the Asian crisis) have adversely affected the performance of MNCs, they also present some long-term opportunities. Crises in countries tend to reduce the value of assets such as land and businesses. Those MNCs with more astute management may be positioned to increase their investment when temporary crises result in lower asset prices within a specific country.

Furthermore, numerous countries around the world that have recently allowed more capital inflows into their country are now subjected to the threat of a local currency crisis if investors withdraw the funds they invested there. Consequently, MNCs are more exposed to abrupt declines in the currencies they use to conduct international business. The higher degree of exchange rate uncertainty places more pressure on MNCs to effectively manage exchange rate risk.

The inception of a single currency (the euro) among numerous western European countries in 1999 was another major event in the global marketplace. All MNCs need to recognize how the euro will not only affect exposure to exchange rate risk, but how it will change competition within Europe, the pricing of products in Europe, and the valuations of companies in Europe. Those MNCs with more astute management should benefit from the transition to the euro, while other MNCs could be adversely affected.

In general, the recent events have made international financial management more challenging. MNCs will respond by meeting the challenge rather than retreating. Those MNCs that are most capable of responding to changes in the international financial environment will be rewarded. The same can be said for the students today who may become the future managers of MNCs.

## INTENDED MARKET

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This text presumes an understanding of basic corporate finance. It is suitable for both undergraduate and master's level courses in international financial management. Some master's courses may attempt to maximize student comprehension by assigning the more difficult questions, problems, and cases in each chapter.

## ORGANIZATION OF THE TEXT

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This text is organized first to provide a background on the international environment and then to focus on the managerial aspects from a corporate perspective. Managers of MNCs must first understand the environment before they can manage within it. The first two parts of the text provide the macroeconomic framework for the text. Part I (Chapters 1 to 5) introduces the major markets that facilitate international business. Part II (Chapters 6 to 8) describes relationships between exchange rates and economic variables, and explains the forces that influence these relationships.

The remainder of the text provides a microeconomic framework, with a focus on the managerial aspects of international financial management. Part III (Chapters 9 to 12) explains the measurement and management of exchange rate risk. Part IV (Chapters 13 to 18) describes the management of long-term assets and liabilities, including motives for direct foreign investment, multinational capital budgeting, country risk analysis, and capital structure decisions. Part V (Chapters 19 to 21) concentrates on the MNC's management of short-term assets and liabilities, including trade financing, other short-term financing, and international cash management.

Each chapter is self-contained, so that professors can use classroom time to focus on the more comprehensive topics and rely on the text to cover the other concepts. Chapters can be rearranged without a loss in continuity. The chapters in this edition have been revised to place the MNC's management of long-term assets and liabilities (Part IV) ahead of the MNC's management of long-term assets and liabilities (Part V). This organization covers the strategic aspects such as motives for direct foreign investment and decisions on whether to conduct direct foreign investment before it covers the operational aspects such as short-term financing or investment. Yet, some professors prefer to cover the MNC's management of short-term assets and liabilities before the MNC's management of long-term assets and liabilities. The organization can be easily revised because the two parts are self-contained.

Furthermore, chapters within a part can be reorganized. This edition has organized Part IV to cover the management of long-term assets (with separate chapters on direct foreign investment, multinational capital budgeting, multinational restructuring, and country risk analysis) before the management of the long-term liabilities (chapters on capital structure and long-term financing). Yet, the text illustrates how management of long-term assets and long-term liabilities is integrated within the chapters.

## APPROACH OF THE TEXT

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The approach of the text is to reinforce the key concepts in the following ways.

1. **PART-OPENING DIAGRAM:** A diagram is provided at the beginning of each part to illustrate in general terms how the key concepts covered in that part are related. This offers some intuition about the organization of chapters in that part.

2. **OBJECTIVES:** The key concepts are identified within a bulleted list of objectives at the beginning of each chapter.
3. **EMPHASIS:** The key concepts are thoroughly described in the chapter and supported by examples and illustrations.
4. **NIKE PROBLEM:** Some of the key concepts are applied to Nike's international business near the end of the chapter to illustrate the reality of these concepts.
5. **VALUATION OF THE MNC:** Since the underlying objective of an MNC's managers is to maximize the value of the MNC, it is important to recognize how the concepts discussed in the text relate to the MNC's value. Some key concepts in the chapter are applied to the MNC valuation diagram near the end of each chapter to demonstrate how the concepts can affect the value of an MNC.
6. **SUMMARY:** The key concepts are summarized at the end of the chapter in a bulleted list that corresponds to the list of objectives at the beginning of the chapter.
7. **SELF-TEST:** A "Self-Test" at the end of the chapter challenges students on the key concepts. The answers to these questions are provided in Appendix A.
8. **QUESTIONS AND APPLICATIONS:** Many of the questions and other applications at the end of the chapter test the student's knowledge of the key concepts in the chapter. Near the end of this section is the "Internet Application" that identifies a specified Web site related to key concepts and requires students to access the Web site to answer questions about the concepts. There is also an application called "Running Your Own MNC" at the end of this section that allows students to apply the key concepts to a small business that they created at the beginning of the school term. This not only gives students practice in applying theory to practice, but also enhances their entrepreneurial skills.
9. **CONTINUING CASE:** At the end of each chapter, the continuing case allows students to use the key concepts to solve problems experienced by a firm called Blades, Inc. (a producer of roller blades). By working on cases from each chapter that relate to the same firm over a school term, students see how a firm can develop its international business over time and the rewards and challenges resulting from its growth in international business.
10. **SMALL BUSINESS DILEMMA:** The Small Business Dilemma at the end of each chapter places students in a position where they must use concepts introduced in the chapter to make decisions about a dilemma experienced by one particular small business called Sports Exports Company.
11. **INTEGRATIVE PROBLEM:** The Integrative Problem at the end of each part integrates the key concepts across chapters within that part.
12. **FOCUS ON AN MNC:** The "Focus on an MNC" application in Appendix D and on-line at the text's Web site enables students to apply many of the chapter concepts to a specific MNC of their choice. It also gives students experience in retrieving an annual report on-line, on reviewing an annual report, and in recognizing the link between theory provided by the text and practice.  
Students can copy the on-line assignments onto a file and infuse their responses to each chapter over the school term. By the end of the term, the file will contain a consolidated set of their response across all assigned chapters.
13. **SUPPLEMENTAL CASES:** Supplemental cases (called Case Problems in previous editions) allows students to apply chapter concepts to a specific situation of an MNC. All Supplemental Cases are located in Appendix B at the end of the text.

This text is designed in recognition that each professor has his or her unique style for reinforcing the key concepts within a course. Numerous methods of reinforcing the key concepts are provided in this text so that professors can select the methods

that fit their style. Beyond the in-chapter applications within each chapter (such as the “Nike Problem” and “Valuation of an MNC”) and the traditional end-of-chapter questions, professors have a choice of assigning international applications to: (1) various large corporations (“Supplemental Cases”), (2) small businesses (“Small Business Dilemma”), (3) the same MNC throughout the term (“Continuing Case of Blades, Inc.”), (4) an MNC developed by each student (“Running Your Own MNC”), (5) a real MNC selected by each student (“Focus on an MNC”), and (6) related information on a specified Web site (“Internet Application”). While these methods vary in perspective, they all reinforce the key concepts in each chapter.

## MAJOR CHANGES TO THIS EDITION

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**Euro.** This edition has been completely revised to account for the inception of the euro, the single currency adopted by numerous western European countries in 1999. Although the individual currencies will still exist for some retail transactions for a few more years, the euro is now used for most commercial transactions in the participating European countries. The examples in this text using European currencies in the previous edition have been revised to use other currencies in this edition. In addition, the impact of the euro on the international financial management by MNCs is discussed in various chapters where appropriate.

**Asian Crisis.** The Asian crisis has not only had a major impact on the performance of MNCs, but on the lessons to be learned in international financial management. It is discussed in managerial chapters related to exchange rate risk, direct foreign investment, multinational restructuring, and country risk. It is also related to chapters on the behavior of exchange rates (Part II). In particular, it is closely related to Chapter 6 on central bank intervention because of all the intervention efforts by the Asian countries during the Asian crisis. For this reason, a comprehensive appendix on the Asian crisis has been created and is at the end of Chapter 6.

**Reorganization.** The part of the text focusing on the management of long-term assets and liabilities has been moved in front of the part on management of short-term assets and liabilities. This new organization reflects the outline of many corporate finance text books in which the long-term (strategic) decisions are discussed before the short-term (operating) decisions. The long-term decisions tend to be more complex, and therefore may receive more attention. Professors who prefer to cover the management of short-term assets and liabilities before the management of long-term assets and liabilities may reverse the order without a loss in continuity, because the chapters (and the parts) are still self-contained.

A new chapter called “Multinational Restructuring” has been created (Chapter 15). It follows the chapter on capital budgeting, and applies the capital budgeting framework to suggest how an MNC can assess various types of restructuring decisions, such as acquisitions, joint ventures, and divestitures. This chapter was created in response to the large amount of restructuring by MNCs in recent years.

The chapters related to long-term management of assets and liabilities have been reorganized as follows. The Part still leads off with a chapter on the motives for direct foreign investment (Chapter 13), followed by a chapter on multinational capital budgeting. The new chapter on multinational restructuring (Chapter 15) is inserted just after the chapter on multinational capital budgeting, since it applies the



capital budgeting framework. The next chapter is on country risk analysis (Chapter 16), as this chapter is closely tied to the investment decisions discussed in the previous three chapters. The chapter on multinational cost of capital and capital structure has been moved to Chapter 17, just after country risk analysis and just before the long-term financing chapter. This new arrangement reflects six chapters in this part; the first four chapters are focused on long-term investing, while the last two chapters are focused on long-term financing. The integration between long-term investing and financing is discussed in the chapters, where appropriate.

The chapter on taxation of MNCs (Chapter 21) from the previous edition has been converted to an appendix for the chapter on multinational capital budgeting (Chapter 14). This appendix describes how tax laws can vary among countries, and explains how differential tax laws among countries can affect the estimated cash flows of a proposed foreign project.

**Nike Problem.** The “Nike Problem” in each chapter applies one or more key concepts in the chapter to Nike and requests opinions on related issues; this is designed to stimulate class discussion on key concepts as they relate to a large U.S.-based MNC.

**Valuation of an MNC.** The “Valuation of an MNC” section near the end of each chapter explains how each of the key chapter concepts can affect the value of the MNC. Since the underlying theme of international financial management is to maximize the value of the MNC, this section summarizes how the concepts covered in each chapter relate to the main managerial objective of maximizing the MNC’s value.

**Continuing Case.** A continuing case has been added to the end of every chapter. It allows students to use the key concepts to solve problems experienced by a firm called Blades, Inc. (a producer of roller blades). By working on cases from each chapter that relate to the same firm over a school term, students see how a firm can develop its international business over time, and the rewards and challenges resulting from its growth in international business.

The Supplemental Cases, which were called “Case Problems” in the previous edition, present short cases on different MNCs. The cases are now located in Appendix B.

**Internet Margin Notes.** Internet margin notes have been added to provide students with suggested Web sites containing materials pertinent to the topics being discussed. The text Web site at <http://madura.swcollege.com> contains links to all sites and is updated periodically to revise any changes in Internet addresses.

**Study Guide.** A new study guide, written by Jeff Madura and Oliver Schnusenberg, of St. Joseph’s University, now accompanies the text. This study guide focuses on helping students test their knowledge of the material.

## ON-LINE RESOURCES

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The following resources are available to students using this text:

- **Data Bank.** A data bank provides quarterly data on spot exchange rates, forward rates, interest rates, inflation rates, balance of trade data, and additional economic data for several countries since 1973.

- **References.** References to related readings are provided for every chapter.
- **Web Site Links.** Web site links related to the material in each chapter are provided.
- **Focus on an MNC.** The “Focus on an MNC” is available on-line to facilitate the consolidation of student responses to the assignments among chapters.

## SUPPLEMENTS

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The following supplements are available

### For the Student

- A **Study Guide**, written by Jeff Madura and Oliver Schnusenberg, of St. Joseph’s University, is a new addition to the text package. This study guide focuses on helping students test their knowledge of the material. It simulates test questions for key terms and key concepts, with numerous matching, multiple choice, and true/false questions for every chapter.
- **South-Western Finance Resource Center** (<http://finance.swcollege.com>). The South-Western Finance Resource Center provides unique features, customer service information, and links to book-related Web sites. Learn about valuable products and services to help with your finance studies, contact the finance editors, register for Thomson Investors Network, and more.

### For the Instructor

- An **Instructor’s Manual**, which contains the chapter theme, topics to stimulate class discussion, and answers to end of chapter Questions, Case Problems, Continuing Cases (Blades, Inc.), Small Business Dilemmas, Integrative Problems, and Supplemental Cases. An expanded **Test Bank** containing 880 questions in multiple choice or true/false format includes content questions as well as problems.
- **Thomson World Class Testing.** The *Thomson World Class Testing Tools*™ computerized testing program contains all of the questions in the printed test bank. *Thomson World Class Testing Tools*™ is an easy-to-use test creation software compatible with Microsoft Windows. Instructors can add or edit questions, instructions, and answers, and select questions by previewing them on the screen; selecting them randomly, or selecting them by number. Instructors can also create and administer quizzes online, whether over the Internet, a local area network (LAN), or a wide area network (WAN).
- **Transparency Masters.** A set of Transparency Masters selected from the key exhibits illustrated in the text are available to instructors.
- **PowerPoint Presentation Slides**, completely revised for this edition by Yee-Tien Fu of National Cheng-Chi University, are intended to enhance lectures and provide a guide for student note-taking. These can be downloaded from the text Web site.
- **South-Western Finance Resource Center** (<http://finance.swcollege.com>) The South-Western Finance Resource Center provides unique features, customer service information, and links to book-related websites. In particular, you may learn how to become an author with South-Western, request review copies, contact the finance editors, register for Thomson Investors Network, and more.

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*Jeff Madura*  
*Florida Atlantic University*

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