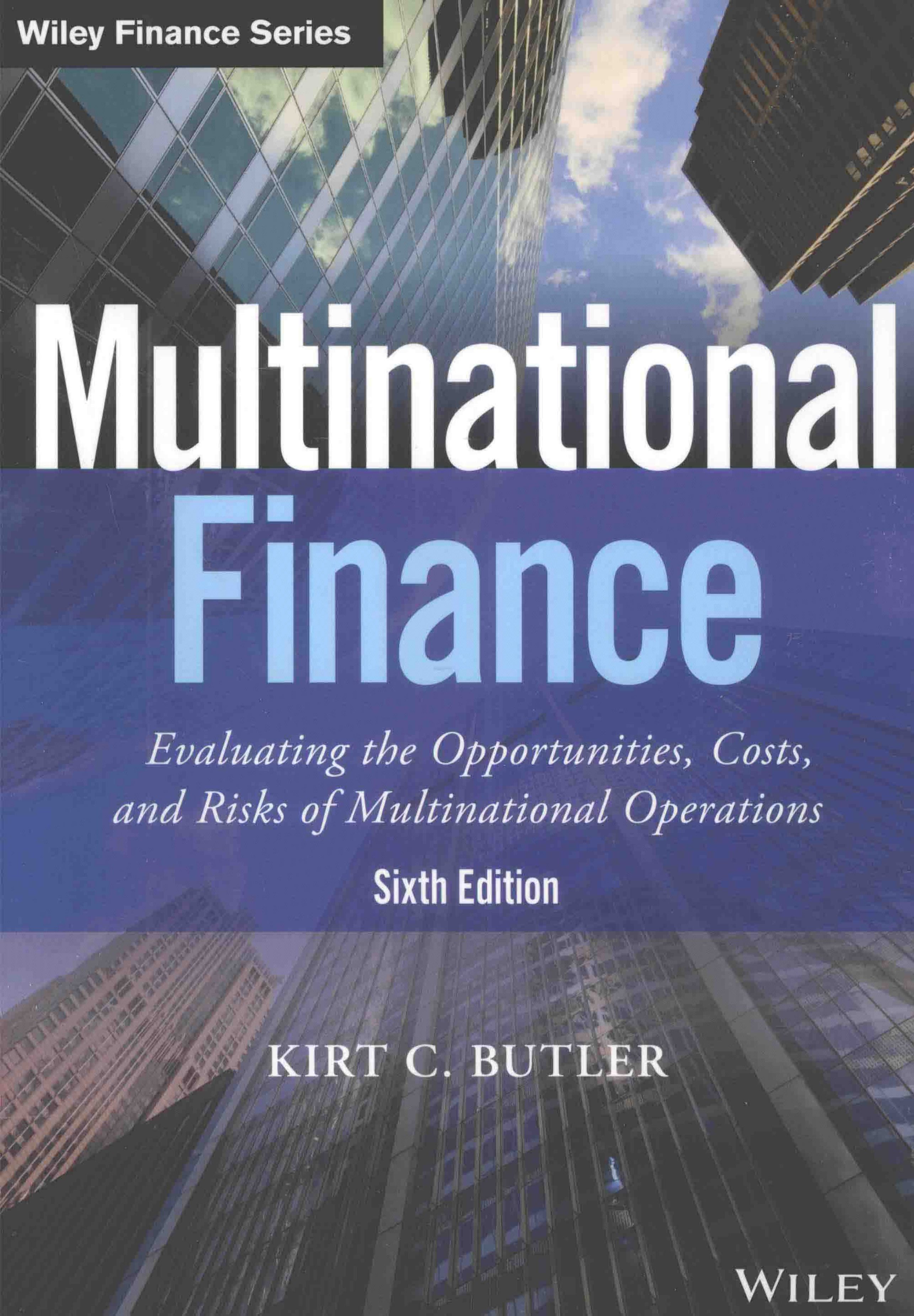

Wiley Finance Series

Multinational Finance

Evaluating the Opportunities, Costs, and Risks of Multinational Operations

Sixth Edition

KIRT C. BUTLER

WILEY

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Preface

Everything should be made as simple as possible, but not simpler.
— Albert Einstein

Multinational Finance assumes the viewpoint of the financial manager of a multinational enterprise with operations in more than one country. The enterprise could be a multinational corporation, a large financial institution, or a small partnership or proprietorship. The book provides a framework for evaluating the many opportunities, costs, and risks of multinational operations in a manner that allows readers to see beyond the algebra and terminology to general principles. The text is organized into five parts:

- **Part I: The International Financial Environment.** The text begins with an introduction to the international financial environment, currency and Eurocurrency markets, and the international parity conditions. Chapters 3 and 4 on currency and Eurocurrency markets are necessary prerequisites for most of the chapters that follow.
- **Part II: Derivative Securities for Financial Risk Management.** Chapters 5 to 7 cover currency derivatives—futures, options, and swaps—because of the importance of these derivative instruments in financial risk management.
- **Part III: Managing the Risks of Multinational Operations.** Part III covers the multinational treasury and the multinational corporation's management of transaction, operating, and translation exposures to currency risk.
- **Part IV: Valuation and the Structure of Multinational Operations.** Valuing and structuring the corporation's international assets is the heart of the text. Chapter 13 on cross-border capital budgeting has far more depth than competing texts, covering the international parity case as well as disequilibrium situations in which the international parity conditions do not hold. Additional chapters cover country risk, multinational financing, taxation, real option valuation, and corporate governance.
- **Part V: International Portfolio Investment and Asset Pricing.** The text supplements the multinational corporate finance material in earlier chapters with separate chapters on international capital markets, portfolio diversification, and asset pricing.

Readers with an interest in corporate finance will find that Parts I, III, and IV provide a comprehensive coverage of these topics with a managerial focus throughout.

Readers with an interest in financial markets will find that Part II provides a thorough coverage of currency derivatives and their use in financial risk management. Readers with an interest in international investments will find that Part V provides a rich insight into investors' required returns and the corporation's cost of capital.

KEY FEATURES

This edition of *Multinational Finance* retains the classic features developed in earlier editions, as well as new material on topics of interest to practitioners.

- **Comprehensive and up-to-date coverage of traditional topics.** Intended for advanced undergraduate and MBA classes in international financial management, the text requires only a single preparatory course in finance. Chapters that extend material from the first course begin with a brief review of the fundamentals. Numerous graphs and figures assist the reader in understanding key financial concepts and techniques. Real-world updates, applications, and examples are used to illustrate how the financial concepts and techniques are used in practice. Advanced material is placed in chapter appendices, so that study can be tailored to each individual's objectives.
- **Distinctive chapters on key topics.** Distinctive chapters are devoted to topics of special interest to practitioners of multinational finance.
  - Chapters 5 to 7 provide detailed treatments of futures, options, and swaps. These specialized chapters are appropriate for students desiring a deep understanding of the financial tools available for currency risk management.
  - Appendix 8A develops the valuation consequences of currency risk management for the firm's stakeholders. This allows a deeper understanding of the motives of the firm's stakeholders in managing currency risks.
  - Chapter 16 takes a real options approach to valuing flexibility in cross-border investments.
  - Chapter 17 describes differences in national corporate governance systems and their implications for the international market for corporate control. The chapter provides a survey of the rich and ongoing academic research into corporate governance and corporate control.
  - Chapter 19 applies the classic mean-variance algebra to an internationally diversified portfolio of assets, including a discussion of home asset bias.
  - Chapter 20 on international asset pricing provides an up-to-date treatment of this interesting and important topic, including a presentation of state-of-the-art international asset pricing models.
- **Exciting new material on topics of contemporary interest.** The text includes information on the best practices of multinational corporations, as well as the current thinking of top scholars in the field:
  - *Concepts*: Project valuation under both equilibrium and disequilibrium conditions, time-varying expected returns and volatilities, private equity, agency costs, moral hazard, behavioral finance, home bias, the legal environment and investor protections, asset allocation styles, the success of politically connected CEOs, and the impact of the 2008 financial crisis on the theory and practice of multinational finance.

- *Tools*: The no-arbitrage condition, exchange rate forecasting, volatility estimation, all-in costs, currency option pricing, capital budgeting, cost of capital, taxation of foreign-source income, real option valuation, asset pricing, international size and value premia, and international momentum strategies.

LEARNING AIDS FOR STUDENTS

Several learning aids are used to highlight the main points in each chapter and assist the student in learning the material:

- Callouts in the text highlight key concepts and definitions.
- Market Updates and Applications appear as boxed essays and provide real-world examples and practical applications of the conceptual material.
- Key Terms appear in boldface the first time they are used. Key terms are listed at the end of each chapter and defined in a comprehensive Glossary.
- End-of-chapter Conceptual Questions summarize the key ideas and allow readers to test their understanding of the material.
- End-of-chapter Problems provide practice in applying the concepts, techniques, and strategies.
- Excel templates for many of the models in the text are available from Wiley's website.

SUPPLEMENTS FOR INSTRUCTORS

The following supplements are available to adopting instructors:

- More than 600 **PowerPoint slides** review the key elements in each chapter and illustrate how to apply the material. The accompanying Notes Pages provide additional anecdotes, insights, and examples for classroom use.
- A **Solutions Manual** provides answers to all of the end-of-chapter questions.
- A **Test Bank** contains more than 1,000 questions and solutions, including true–false and multiple-choice questions, numerical problems, and short essays.

Great care is taken in providing these supplements in order to reduce instructors' burden of preparation and allow them to spend their time where it is most needed—in helping students to understand the domain of multinational finance.

Acknowledgments

At my karate dojo in Michigan, we begin and end each class with the Japanese phrase *onegai shimasu,* or, "Please teach me." This is appropriate for both students and teachers. Although I have learned a great deal from my own colleagues, I have learned at least as much from my students. Their varied approaches to learning have enriched my life and made me a better teacher, scholar, and student.

I am particularly grateful to the following scholars, whose thoughtful comments and suggestions over the years have helped to make my work on multinational finance both interesting and enjoyable.

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Finally, I wish to thank my family—my wife, Erika, and our children, Rosemarie and Vincent—for their love and tolerance. Erika—you are my life partner as we dance to the end of time.

About the Author

Kirt C. Butler is an associate professor in the Department of Finance at Michigan State University, where he teaches multinational finance and global strategy in MSU's Eli Broad College of Business. He joined the faculty in 1985 after completing his doctorate in Finance at MSU. He also holds an MBA in Finance from the College of Business, an MS in Computer Science from the College of Engineering, and a BA in Psychology from the Honors College at Michigan State University.

Professor Butler's research has appeared in a variety of academic and practitioner journals, including the *Journal of Finance, Journal of Accounting Research, Financial Analysts Journal, Journal of Portfolio Management, Journal of International Money and Finance,* and the *Journal of International Business Studies,* among others. His academic research has been profiled in the *New York Times, Time* and *Money* magazines, and on the CNN and CNBC websites.

Professor Butler also is a sensei of Okinawan Shido-kan (Shorin Ryu) Karate, with more than 40 years of experience and a rank of eighth-degree black belt.

Contents

PART One

The International Financial Environment

Even if you're on the right track, you'll get run over if you just sit there.
—Will Rogers

CHAPTER 1

An Introduction to Multinational Finance

The notes I handle no better than many pianists, but the pauses between the notes—ah, that is where the art resides!

—Artur Schnabel

This book assumes the viewpoint of the financial manager of a *multinational corporation (MNC)* with investment or financial operations in more than one country. Managers encounter new opportunities as they extend their operations into international markets, as well as new costs and risks. The challenge facing the multinational financial manager is to successfully develop and execute business and financial strategies in more than one culture or national business environment.

1.1 THE GOALS OF THE MULTINATIONAL CORPORATION

Exhibit 1.1 presents the ownership and control structure that is typical of companies in market economies. In these countries, the primary goal of the firm is to maximize shareholder wealth. However, shareholder wealth maximization is far from the only objective of the MNC. Many other *stakeholders* have an interest in the firm, including suppliers, customers, debtholders, managers, business partners, employees, and society at large. The objectives of these other stakeholders often are in conflict with shareholder wealth maximization, especially during periods of financial distress.

Stakeholders include those with an interest—or stake—in the firm.

Exhibit 1.2 represents the value of the various claimants on the firm's revenues. In this view, the value of revenues is allocated to operating expenses, governments, suppliers of debt and equity capital, and other potential claimants such as domestic or foreign litigants, in proportion to their claims on the firm.