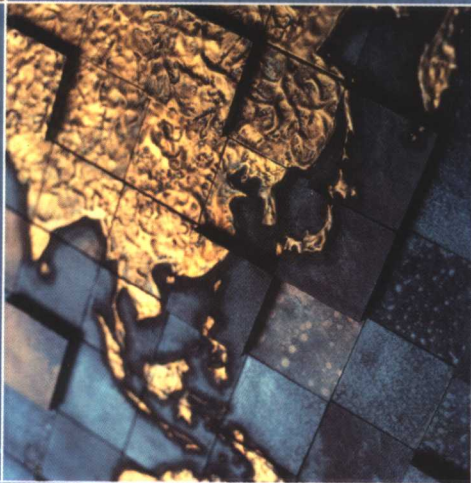


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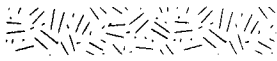


About the Author

James C. Baker is Professor of Finance and International Business at Kent State University where he has taught since 1971. He has M.B.A. and D.B.A. degrees in International Business from Indiana University and has held full-time appointments at the University of Maryland and San Francisco State University as well as part-time appointments at George Washington University, University of Hawaii, Catholic University in Puerto Rico, Madrid Business School in Spain, and Hiram College. He was international financial adviser at Federal Deposit Insurance Corporation from 1975–77. His teaching and research specialties are international financial management, international financial institutions and markets, international banking, and international business.

His books include *International Business Expansion into Less-Developed Countries*—a definitive study of the International Finance Corporation, *Foreign Influence in Korean Banking* (with Y. D. Euh), *International Business Classics* (with Donald Howard and J. K. Ryans), *International Bank Regulation*, and *The German Stock Markets*—the only English-language study of these markets. His articles have appeared in such journals as *Accounting and Business Research*, *The Banker*, *California Management Review*, *Columbia Journal of World Business*, *International Journal of Finance*, *International Trade Journal*, *Journal of Business Ethics*, *Journal of World Trade Law*, and *Managerial Finance*.

Dr. Baker currently serves on the editorial review boards of *Advances in Competitiveness Research*, *Global Finance and Business Review*, *Journal of Asia-Pacific Business*, *Journal of Emerging Markets*, *Journal of Global Business*, and *Multinational Business Review*. He serves as Membership Committee Chair for the Academy of International Business and on the Globalization Committee of the Financial Management Association International. His next project is a study of agencies that facilitate and encourage foreign direct investment in developing countries, e.g., Multilateral Investment Guarantee Agency (MIGA) and International Centre for Settlement of Investment Disputes (ICSID).



Preface

In 1963, the term “multinational corporation” (MNC) became a household term after a cover story about the institution in *Business Week*. In the following three decades, global business prospered as a result of the need for poor countries to develop, the end of the cold war and breakup of the Union of Soviet Socialist Republics, privatization of business and banking, and the burgeoning economic power of the global triad—Asia, the United States, and Europe. The latter phenomenon has created a market of nearly a billion people and, if East Europe and Latin America become part of the triad, the global economic village is even larger. The world is becoming more and more a borderless world for economic transactions as a result of GATT negotiations to reduce trade restrictions, the continuing move by the European Union toward a true United States of Europe with one currency, and trading arrangements such as the North American Free Trade Agreement uniting Canada, the United States, and Mexico into one large trading bloc.

Business operations in this borderless world need to be financed and managed with more attention to the most current methods available to financial managers. It is the purpose of this book to offer coverage of the most up-to-date methods for financial management of the international firms that carry out cross-border operations in this borderless world. The major emphasis is on instruction of undergraduate and beginning level MBA students.

Strategies of International Finance: Management, Markets, and Institutions

To achieve this purpose, a number of strategies have been formulated. First, the discussion of the book deals with management of the finance function from the viewpoint of the chief financial officer of the MNC. Second, the sources of funds to finance these MNCs are examined. Third, the markets for the financial instruments used to finance the MNC or to hedge its various risks are analyzed. Major concepts, analytical methods, and applications are incorporated.

International Finance: Management, Markets, and Institutions is organized into seven major areas. In Part I, Introduction, the student is introduced to international business finance and the cultural variables of international business that affect the international finance function. A birdseye view of international finance is presented. The chapter concludes with a discussion of readings highly recommended for the student of international finance.

Part II covers the global environment of business finance. The major topics include the international monetary system, the balance of payments, foreign exchange, the management of foreign exchange risk, and the measurement and management of political risk.

Planning for foreign investment and operations is the topic of Part III. The major areas covered are foreign direct investments, capital budgeting, cost of capital, financial structure of the MNC, and planning and organization of the international finance function.

The focus of Part IV is on the role of banks in global finance. International banks play a major role in the development and nurturing of MNC operations. Thus, the functions of international banks are examined.

Part V is a discussion and analysis of the non-bank financial institutions and international financial markets that represent an inventory of financial resources for the MNC. The latter coverage includes treatment of financial derivatives used in hedging financial risks, including exchange-traded and over-the-counter derivatives.

The day-to-day management of international financial operations is examined in Part VI. The coverage includes working capital management; accounting, control and auditing of international operations; and taxation of these operations.

The book concludes with coverage of special issues in chapter 18 that affect the financial management of MNCs. This chapter is devoted to payment systems, global custody, and settlement of cross-border transactions, activities that are becoming more and more important in global finance as we approach the 21st century.

Distinctive Characteristics of the Book

International Finance: Management, Markets, and Institutions has incorporated some distinctive characteristics. First, the book is shorter in length and number of chapters than most books in international business finance. Most books in this area have seven to ten or more chapters and are difficult to complete in one semester. Second, the book emphasizes the role of the chief financial officer (CFO) of the MNC and contains several caselets that examine CFOs and financial institutions' executives in real-life situations. Third, coverage of the three major foreign exchange exposures are treated in one chapter. Fourth, major functions of international banks are covered in one chapter. Fifth, an inventory of financial resources has been constructed in Part V, with an analysis of major sources of financing and hedging for MNCs. Finally, the area of global custody and settlement is covered in chapter 18. These areas have become more important for international firms and investors during the past decade.

Pedagogical Materials

The book includes a number of pedagogical aids to enhance the learning process by students. These include the following:

1. 33 management applications (brief cases) that cover examples of techniques, institutions, functions, and personalities in international financial management;
2. key objectives and terms to be learned in each chapter that are listed at the beginning of each chapter;
3. study aids placed throughout each chapter that suggest to the student additional readings or problems to facilitate his/her critical thinking and understanding of the material;
4. end-of-chapter lists of additional readings, discussion questions, and problem exercises;
5. a glossary of terms of significance to the area of international financial management;
6. a comprehensive Instructor's Manual that contains solutions to end-of-chapter discussion questions and problems as well as chapter outlines and synopses; overhead transparency masters; test banks of true/false, multiple choice, and essay questions and answers; and other sources of information of value to the instructor using this textbook.

Guidelines for the Instructor

The book is designed to be a less-rigorous examination of international business finance for undergraduate and beginning MBA students. It can be used as a textbook for the upper-level undergraduate international business finance course or as a supplement for an advanced financial management course, using the sections that discuss financial management concepts, such as Parts II, III, and VI. It can be used as a supplement for the financial institutions and markets course using Parts IV and V. It can also be used as a supplement for an International Business course whose primary textbook is trade- or marketing-oriented.

Recommended Readings

Several outside readings can be recommended for a course in global finance that will supplement the textbook and classroom experience for students. Most of the materials discussed in this section should be found in any university library.

Before international finance periodicals are recommended, it must be noted that the subject of culture should be among the background subjects covered by a student of global finance. Unfortunately, few students are required to take an introductory course in international business in which the subject of cultural variables in international business is covered. The student can develop sufficient background in cultural aspects by reading just two books: *The Cultural Environment of International Business* by Terpstra and David and *The Silent Language* by Edward Hall.¹

Several international business periodicals of a general nature are helpful, including: (1) *Journal of International Business Studies*, the quarterly refereed journal of the Academy of International Business, that occasionally contains excellent scholarly material on such subjects as foreign investment theory and empirical studies on various functional aspects of international financial management; (2) *Management International Review*, a refereed scholarly general international business journal with occasional pieces on international financial management; (3) *Journal of World Business*, formerly *Columbia Journal of World Business*, a quarterly refereed journal covering international business issues; (4) *International Trade Journal*, the refereed journal of the International Trade and Finance Association, covers international trade and finance issues bordering on the theoretical that have economic implications; (5) *The International Executive*, a bimonthly refereed journal aimed at advancement and dissemination of research in the field of international business.

In addition to these scholarly periodicals, some other more general publications are mentioned for their value to scholars in international business and finance. These include *The Economist* and *Business Week*, two weeklies containing some international business material. *Fortune* and *Business* are two periodicals published less frequently than weekly that have occasional case studies of MNCs and their operations. Finally, daily business newspapers such as the *Wall Street Journal*, *Investor's Business Daily*, and the *Financial Times* contain valuable information about international financial markets and news of international business that is very current.

Journals and periodicals devoted to international finance topics can be divided between those that are practice oriented and those that are scholarly in nature. Among

¹ Vern Terpstra and Keith David, *The Cultural Environment of International Business* (Cincinnati, OH: South-Western, 1991) and Edward T. Hall, *The Silent Language* (New York: Doubleday & Co., 1959).

the former, *Euromoney*, subtitled *The Journal for International Money and Capital Markets*, should be singled out for its valuable material. This monthly periodical contains many articles on international financial institutions and markets and material about the personalities and issues in the field of international finance.

Other practical periodicals include: (1) *International Financial Law Review*, a monthly magazine that examines the technical and regulatory side of international finance; (2) *International Currency Review*, a bimonthly periodical devoted to analyses of leading currencies that can be used by MNC management; and (3) *Global Finance*, a monthly magazine, covering the major issues in international finance.

A number of scholarly journals have been published during the past few years, including the following: (1) *Journal of International Money and Finance*, the most rigorous of the international finance refereed journals, is devoted to highly theoretical research in this area; (2) *Global Finance Journal*, a refereed journal devoted to high-level international financial management issues; (3) *Journal of International Financial Management and Accounting*, a refereed journal that examines research in international financial management and accounting; (4) *Journal of Multinational Financial Management*, another refereed journal devoted to international financial management issues; (5) *International Review of Economics and Finance*, a quarterly refereed journal; (6) *Multinational Finance Journal*, the quarterly publication of the Multinational Finance Society.

A few books that are closely related to the international finance area fill important niches and are important reference works. These include: (1) John Pippenger, *Fundamentals of International Finance* (Englewood Cliffs, NJ: Prentice Hall, 1984), a book that concentrates on the international financial economics underlying much of international financial management. This book could be used as a supplement in the international financial management course; (2) J. Orlin Grabbe, *International Financial Markets* (Englewood Cliffs, NJ: Prentice-Hall, 1996), a book that specializes in the narrow aspect of international financial markets and their operations; (3) Bruno Solnik, *International Investments* (Reading, MA: Addison-Wesley, 1996) is a book similar to those by Grabbe, Evans, and Madura et al. in that it can be used as a supplement in an international financial management course, but Solnik concentrates on the investment side of international financial markets; (4) Ian H. Giddy, *Global Financial Markets* (Lexington, MA: D.C. Heath & Co., 1994), covers international financial markets; (5) international finance casebooks that can be used as supplements in an international financial management course, particularly the second edition of Gunter Dufey and Ian H. Giddy, *Cases in International Finance* (Reading, MA: Addison-Wesley, 1993); Harvey A. Poniachek, *Cases in International Finance* (New York: John Wiley, 1993), and W. Carl Kester and Timothy A. Luehrman, *Case Problems in International Finance* (New York: McGraw-Hill, 1993).

Finally, several publications are available as research data tools for the international finance scholar. Among these are (1) *International Financial Statistics*, a monthly publication of the International Monetary Fund (IMF) that includes several types of statistical data about the international financial aspects of member countries of the IMF; (2) *Balance of Payments Yearbook*, a publication of the IMF that includes periodical information regarding the balance of payments of IMF member countries; (3) *The Dow Jones Guide to the World Stock Market*, a reference book that includes information on the 2,500 biggest stocks in 20 of the key equity markets around the globe that make up the Dow Jones World Stock Index.



Acknowledgments

This book is the result of teaching international financial management for 25 years. My interest in this topic was sparked by Lee Nehrt in his first graduate course, International Finance, at Indiana University in 1962. During the ensuing years, I have used all major texts in the field and owe a debt of gratitude to their authors, including Zwick and Zenoff, Eiteman/Stonehill/Moffett, Shapiro, Madura, Abdullah, Eng/Lees/Mauer, Kim/Kim, Butler, and others. Their concepts and discussion of the issues in this field have broadened my knowledge of the area.

My visits to several international financial institutions have resulted in contacts and materials that have been invaluable in formulating parts of the book. These include: Chicago Mercantile Exchange, Chicago Board of Trade, World Bank, International Monetary Fund, London International Financial Futures Exchange, Amsterdam Stock Exchange, London Stock Exchange, Madrid Stock Exchange, the German stock exchanges, stock exchanges in Zurich and Geneva, and several Edge Act banks in the United States. In addition, my visits to MNCs, such as Goodyear, Rubbermaid, Sherwin-Williams, BP, Timken, Babcock-Wilcox, and others, for discussion with their financial executives, as well as to foreign exchange trading rooms in Chicago and Cleveland have brought me in contact with many generous executives whose assistance has embellished several areas of this book.

I have had several doctoral students who have sharpened my conceptual knowledge of various areas of international finance and they should be acknowledged. They include Raj Aggarwal, Thomas Stuhldreher, Ezra Byler, Andrea DeMaskey, M. Anaam Hashmi, Sharif Ahkam, Daniel Borgia, David Rayome, and William Roberts. These and others have kept the juices flowing with the continuation of their research.

Many of the topical areas in this book have been sharpened by the many students who have taken the numerous courses and seminars in the areas of international financial management, international financial markets, and international banking which I have given during the past 25 years at the University of Maryland, San Francisco State University, Kent State University, Catholic University of Puerto Rico, University of Hawaii, George Washington University, Madrid Business School, and the Kent State University Geneva Semester program. These students have kept me current in this fast moving field.

Numerous reviews of international financial management research that I have done have furnished examples of financing techniques as the papers were published. Such journals include *Journal of International Business Studies*, *Global Finance Journal*, *Multinational Business Review*, *Journal of Emerging Markets*, *Global Finance and Business Review*, and *Journal of Asia-Pacific Business*. In addition, publications such as *Euromoney* and *Global Finance* have furnished real-world examples of many operations in this area.

I owe deep gratitude to the various reviewers of several drafts of the manuscript. These include Shirley Love of Idaho State University, Swapen Sen of Michigan Technological University, John M. Simms, Jr., of the University of North Carolina-Greensboro, Inayat U. Mangla of Western Michigan University, A. Sam Ghanty of University of Wisconsin-Green Bay, Michael E. Solt of San Jose State University, Ravi Vaidyanathan of Northeastern State University, Keqian Bi of the University of San Francisco, and Mark A. White of the University of Virginia. Their suggestions have im-

proved this book in many ways and I am forever grateful for the time they spent improving the manuscript.

In addition to the major reviewers, numerous other people have assisted me in the preparation of this book. Teresa Cohan of Simon & Schuster guided the various drafts to reviewers and was very cooperative in the methodical process resulting in a final product. Paul Donnelly of Prentice-Hall was instrumental in pushing the project along to completion. Mary Beth Sanok of Simon Schuster/Prentice-Hall took the project down the homestretch. Helen Powers and Gladys Soto were meticulous in their editorial work on the final draft. The editing that they performed greatly improved the final product. I am grateful to Apple Computer Corporation for the simplicity of its Powerbook 160 that facilitated the editing of several drafts of the manuscript. I owe much to Bruce Campbell, a Kent State University doctoral student, who offered much assistance in the problem solutions and test bank for the *Instructor's Manual* during a time of his own family loss. Susan Edwards, another Kent State University doctoral student, has been helpful in various aspects of this project. I am grateful to those who gave permission to include items in this text. They are listed elsewhere.

Finally, I am grateful to my wife, Jean, who sacrificed several vacations during the past three years while I worked on the book, and to my son, Jeff, who kept the grass mowed, the leaves raked, and the snow off the walks and driveway and, thus, freed up my time. I must acknowledge Dr. Delos Cosgrove and his team of cardiac surgeons at the Cleveland Clinic who repaired my aortic valve during the early stage of the manuscript and whose results kept me healthy for the remainder of the project.

Reworking various drafts of the book has removed many errors and brought confidence that it is free from mistakes. However, gremlins always manage to subvert such a feeling. I will appreciate any comments, corrections, or suggestions from any reader. Until then, I accept the responsibility for any and all errors that have not been corrected.

James C. Baker
Kent, Ohio, U.S.A.



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