
ALAN C. SHAPIRO



Foundations of Multinational Financial Management

2ND
EDITION

ECOND EDITION

Foundations of Multinational Financial Management

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Preface

APPROACH

The basic thrust of this second edition of *Foundations of Multinational Financial Management* is to provide a conceptual framework within which the key financial decisions of the multinational firm can be analyzed. As in the fourth edition of *Multinational Financial Management*, my more comprehensive book on this topic, the approach is to treat international financial management as a natural and logical extension of the principles learned in the foundations course in financial management. Thus, it builds on and extends the valuation framework provided by domestic corporate finance to account for dimensions unique to international finance.

Foundations focuses on decision making in an international context. Analytical techniques help translate the often vague rules of thumb used by international financial executives into specific decision criteria. The book offers a variety of real-life examples, both numerical and institutional, that demonstrate the use of financial analysis and reasoning in solving international financial problems. These examples have been culled from the thousands of illustrations of corporate practice that I have collected over the years from business periodicals and from my consulting experience. By scattering the best of these examples throughout the text, students can see the value of examining decision problems with the aid of a solid theoretical foundation. Seemingly disparate facts and events can then be interpreted as specific manifestations of more general financial principles.

All the traditional areas of corporate finance are explored, including working capital management, capital budgeting, cost of capital, and financial structure. However, this is done from the perspective of a multinational corporation, concentrating on those decision elements that are rarely, if ever, encountered by purely domestic firms. These elements include multiple currencies with frequent exchange rate changes and varying rates of inflation, differing tax systems, multiple money markets, exchange controls, segmented capital markets, and political risks such as nationalization or expropriation. Throughout the book, I have tried to demystify and simplify multinational financial management by showing that its basic principles rest on the same foundation as does corporate finance.

The emphasis throughout this book is on taking advantage of being multinational. Too often companies focus on the threats and risks inherent in venturing abroad rather than on the opportunities that are available to multinational firms. These opportunities include the ability to obtain a greater degree of international diversification than security purchases alone can provide as well as the ability to arbitrage between imperfect capital markets, thereby obtaining funds at a lower cost than could a purely domestic firm.

AUDIENCE

Foundations of Multinational Management is a briefer version of my other text, *Multinational Financial Management* (MFM). It emphasizes broad concepts and practices rather than extensive quantitative material. Compared to MFM, *Foundations* reduces the range and complexity of the subject matter covered. Although *Foundations* is intended primarily for an undergraduate audience, it is suitable for use in masters level courses where there is not enough time to cover the full range of topics dealt with in MFM or where the students do not have the necessary preparation for using MFM. It is also suitable for use in bank management and other executive development programs.

FEATURES

Foundations of Multinational Financial Management presumes a knowledge of basic corporate finance, economics, and algebra. However, it assumes no prior knowledge of international economics or international finance and is, therefore, self-contained in that respect. For those who are not familiar with *Multinational Financial Management*, here are some of the distinctive features that have led to its widespread adoption. These features have been incorporated and enhanced in *Foundations*.

Distinctive topic coverage includes the following:

- Role of expectations in determining exchange rates (Chapter 2)
- Use of the balance-of-payments framework to assess the economic links among nations (Chapter 4)
- Understanding of currency futures and options contracts (Chapter 6) and their use in exchange risk management (Chapter 9)
- Use of currency risk sharing in international contracts (Chapter 9)
- Identification of the economic, as opposed to accounting, aspects of foreign exchange risk (Chapter 10)
- Development of marketing and production strategies to cope with exchange risk (Chapter 11)
- Evaluation of foreign currency denominated debt (Chapter 12)
- Role of countertrade in financing international trade (Chapter 13)
- Costs and benefits of managing interaffiliate fund flows on a global basis (Chapter 15)
- Integration of tax management with financial management based on the Tax Reform Act of 1986 (Chapters 15 and 23)
- Understanding of the nature and consequences of international portfolio investment (Chapter 16)
- Development of global strategies of MNCs (Chapter 17)
- Assessment of the true profitability of a foreign operation (Chapter 18)
- Valuation of the growth options often associated with foreign investments (Chapter 18)
- Assessment of the cost of capital for foreign investments (Chapter 19)

- Understanding of political risk measurement and management (Chapter 20)
- Use of interest rate and currency swaps and LDC debt-equity swaps (Chapter 22)
- Design of a global financing strategy (Chapter 23)
- Discussion of new perspectives on the international debt crisis and country risk analysis (Chapter 25)
- Analysis of the August 1993 European currency crisis (Appendix A at the back of the book)

CHANGES TO THE SECOND EDITION

Changes that have been made to the second edition include the following:

- Extensive discussion of the September 1992 and August 1993 currency crises in the European Monetary System
- Extensive discussion of the changes in Mexico, including the North American Free Trade Agreement, and Latin America in recent years
- Addition of several cases including a comprehensive case on the financing and analysis of Euro Disneyland
- Update on Japanese banking and international risk-based capital standards
- Additional discussion of currency swaps
- Deletion of Chapter 20 on international tax planning
- Comparison of the cost of capital in Japan and the United States
- Discussion of how the Japanese financial system helps to reduce the costs of financial distress

The book also contains many new charts and illustrations of corporate practice that are designed to highlight specific techniques or teaching points. Again, the emphasis is on reinforcing and making more relevant the concepts developed in the body of each chapter. To make the text more suitable as a teaching vehicle, I have added numerous questions and problems at the ends of the chapters, most of which are based on up-to-date information and real-life situations.

PEDAGOGY

The pedagogical thrust of the book is greatly enhanced by including the following learning and teaching aids:

1. *Focus on Corporate Practice.* Throughout the text, there are numerous real-world examples and vignettes that provide actual applications of financial concepts and theories. They show how the issues, tools, and techniques discussed in the book are being applied to day-to-day financial decision making.

2. *Extensive Use of Examples and Illustrations.* Numerous short illustrations and examples of specific concepts and techniques are scattered throughout the body of most chapters.

3. *Lengthier Illustrations of Corporate Practice.* There are seven, longer illustrations of actual company practices, at the end of key chapters, that are designed to demonstrate different aspects of international financial management.

4. *Problems and Discussion Questions.* There are hundreds of realistic end-of-chapter questions and problems that offer practice in applying the concepts and theories being taught. Many of these questions and problems relate to actual situations and companies.

5. *Learning Objectives.* Each chapter opens with a statement of its action-oriented learning objectives. This statement enhances learning by previewing and guiding the reader's understanding of the materials that will be encountered in the chapter.

6. *Key Terms.* The introduction to each chapter also contains a list of key terms. Placing these terms at the beginning of the chapter gives readers added preparation for what is to come.

7. *Key Concepts.* Most pages contain one or two key ideas in the margins next to the point where these ideas appear in the text. Highlighting these key ideas serves as an effective study and review tool for students.

8. *Glossary.* The back of the book contains a Glossary that defines all the key terms appearing in the text.

9. *Supplements.* A complete set of ancillary materials is available for adopters of *Foundations* to supplement the text. These include the following:

- An *Instructor's Manual* with *Testbank* contains detailed solutions to the end-of-chapter questions and problems and tips for teaching each chapter. The *Testbank* contains over 160 additional questions and problems suitable for use in multiple choice exams. The *Testbank* is also available in computerized form as *The A & B Test Manager*.
- The *Lotus 1-2-3 Templates* are designed to solve a wide variety of international financial management problems. Problems in the text that can be solved using these templates are noted in the *Instructor's Manual*.
- A *Study Guide* written by Andrea L. DeMaskey, Villanova University, is available. The *Study Guide* contains detailed chapter outlines and a number of solved questions and problems.

THANKS

I have been greatly aided in developing *Foundations of Multinational Financial Management* by the helpful suggestions of the following reviewers: Robert Aubey, University of Wisconsin, Madison; James Baker, Kent State University; Donald T. Buck, Southern Connecticut State University; C. Edward Chang, Southwest Missouri State University; Jay Choi, Temple University; Robert C. Duvic, University of Texas at Austin; Janice Wickstead Jadow, Oklahoma State University; Steve Johnson, University of Texas at El Paso; Boyden C. Lee, New Mexico State University; Marc Lars Lipson, Boston University; Dileep Mehta, Georgia State Uni-

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A.C.S.

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