



Executive Education: Mini MBA Program

International Business

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Learning objectives

- Understanding interdependencies of world economies – Globalization
- To explore various reasons for firms to move beyond the home country – Theory of Trans-national Corporation
- To understand the basics exchange rate mechanism
- How firms raise money for overseas projects

Globalization

- Shift towards a more integrated and interdependent world economy, which is manifested by:
 - Increase in trade of goods and services
 - Dispersion of production of goods
 - Integration of financial markets

World Trade Statistics for 2000

(in million U.S. dollars)

Country	Import		Export		Difference
China - Mainland	(4)	225,094	(4)	249,203	24,109
China - Hong Kong	(5)	212,805	(5)	201,860	-10,945
Germany	(2)	495,450	(2)	550,222	54,772
Japan	(3)	379,490	(3)	479,227	99,737
United States	(1)	1,259,300	(1)	781,918	-477,382
World		6,531,331		6,365,024	-166,307

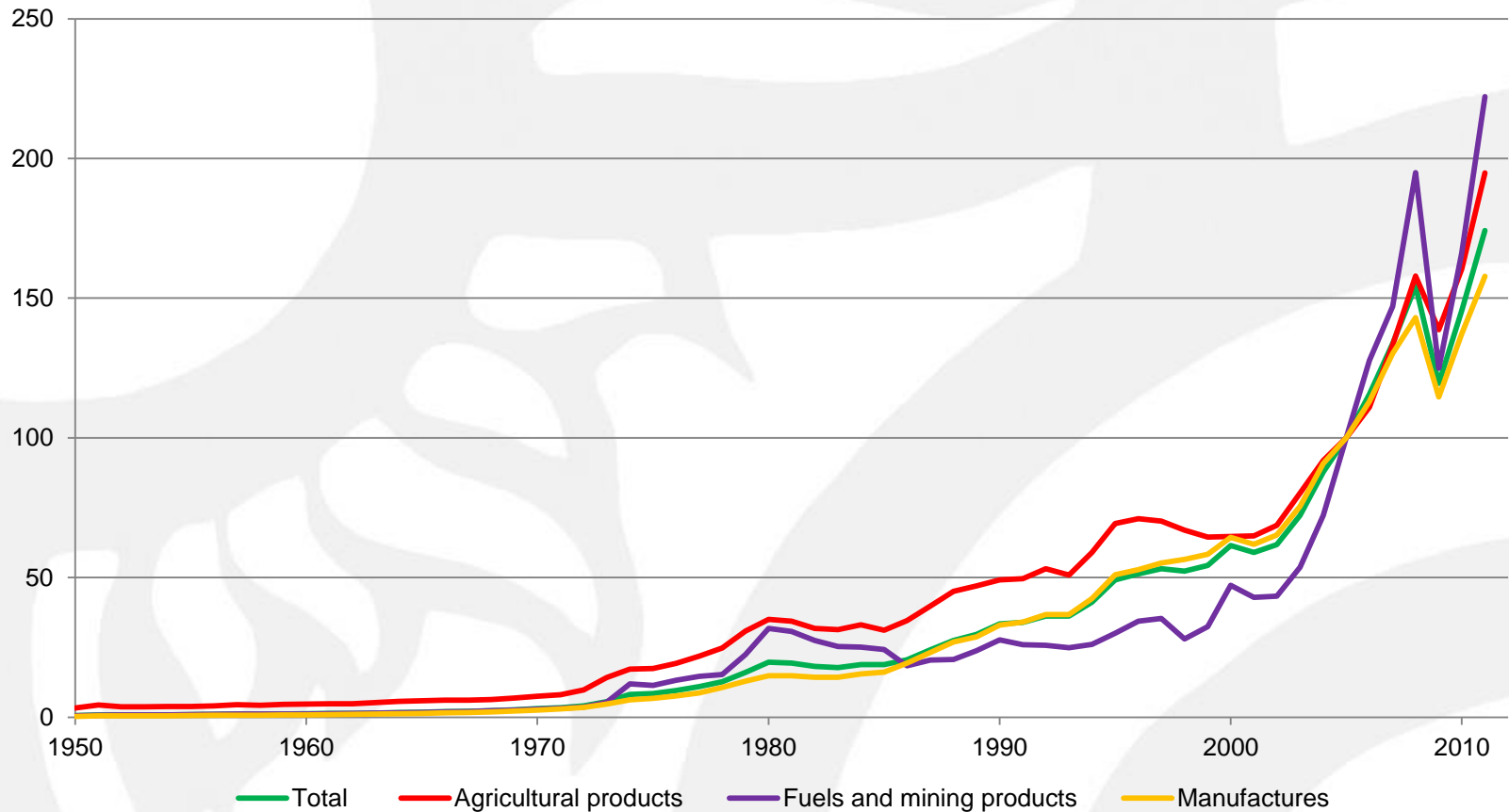
World Trade Statistics for 2011

(in million U.S. dollars)

Country	Import		Export		Difference
China - Mainland	(2)	1,743,000	(1)	1,898,000	155,000
China - Hong Kong	(10)	511,000	(12)	456,000	-55,000
Germany	(3)	1,254,000	(3)	1,472,000	218,000
Japan	(4)	855,000	(4)	823,000	32,000
United States	(1)	2,266,000	(2)	1,480,000	-486,000
World		18,438,000		18,255,000	-173,000

Trends in World

(Base year 2005 = 100)



Basic Definitions

- Foreign Direct Investment (FDI)
- Transnational Corporation (TNC)
- Outsourcing
- Off-shoring

Types of Foreign Expansion

- Export/Import
- Original Equipment Manufacturing (OEM)
- Outsourcing
- Foreign Direct Investment

Theory of comparative advantage

“If a foreign country can supply us with a commodity than we ourselves can make it, better buy it of them with some part of the produce of our own industry employed in a way in which we have some advantage”

Adam Smith (1776)

What are the reasons for comparative advantage

- Natural resources
- Human resources

Theory of Multinational Corporation

- Internalization Theory
- Product Cycle Model
- Market Power Theories
- Competing International Industries
- Eclectic Paradigm

The world's top 100 non-financial TNCs, ranked by foreign assets, 2011

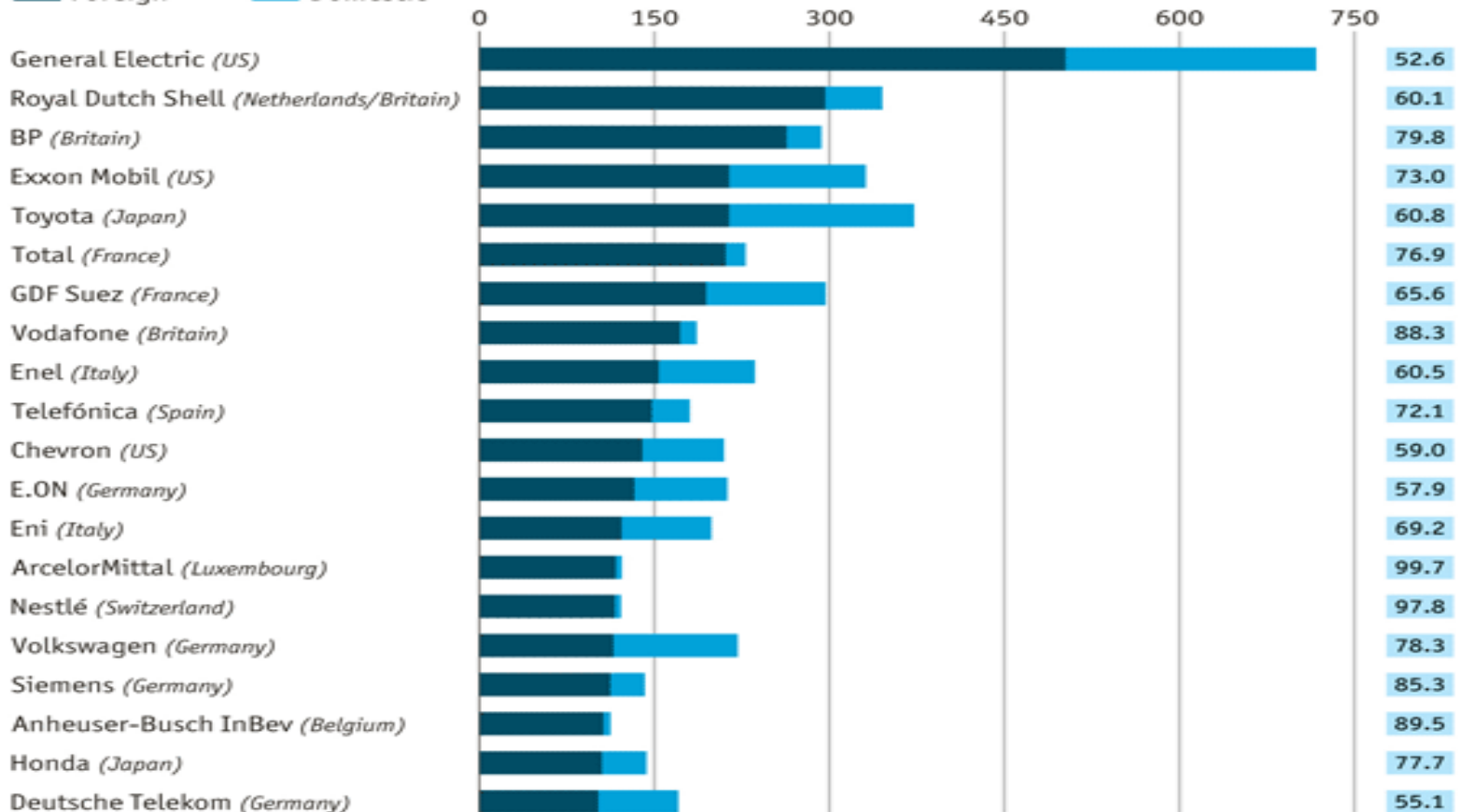
Biggest transnational companies

By foreign assets, 2011, \$bn

Foreign

Domestic

Foreign sales as a % of total



Source: UNCTAD

Process of overseas expansion

- Exporting
- Sales subsidiaries
- Licensing/Service facilities
- Distribution system
- Production facilities

Choosing the Country for FDI

- Market size
- Real Income
- Infrastructure Facilities
- Incentives
- Economic and Political Stability

Foreign Direct Investment

- Types of foreign direct investment
 - Joint ventures
 - Subsidiaries
- Foreign project evaluation and capital budgeting

The main difference between the foreign projects and domestic project is that the cash flows from foreign projects should be converted into domestic currency.

Net FDI inflows, by region and economy, 2006-2012 (in million dollars)

	2006	2007	2008	2009	2010	2011	2012
Spain	41,429	83,393	77,884	19,427	45,382	32,206	36,214
Brazil	19,378	44,579	50,716	31,481	53,345	71,539	76,111
Russia	37,595	55,420	74,783	36,583	43,168	55,084	51,416
Canada	60,294	119,940	62,162	23,804	29,281	41,756	45,446
Hong Kong	44,902	62,121	67,035	54,276	82,709	96,135	
France	88,654	93,071	64,106	26,875	37,825	45,209	65,326
Belgium	58,828	96,588	184,842	65,835	86,909	102,001	-1,917
U.K.	215,059	240,540	261,535	4,059	61,326	36,244	55,562
China	124,082	156,249	171,535	131,057	243,703	280,072	253,475
U.S.	294,288	340,065	332,734	139,557	270,986	257,528	205,790
World	1,702,704	2,471,503	2,199,533	1,163,048	1,375,973	1,724,869	1,131,804

Foreign Exchange

- Foreign exchange is the rate at which one currency can be exchanged with another.
- Exchange rate regimes

Fixed rate regime

Under this regime rates are fixed, usually by benchmarking against a precious commodity like gold or silver.

Floating rate regime

Demand and supply determines the exchange rate.

Sources of demand:

- Exports
- Foreign investments in the country
- Tourism, etc.

Sources of supply:

- Imports
- Investments in foreign countries
- Tourism, etc.

Economic fundamentals that affect exchange rates

- Inflation

Inflation reduces the value of a currency and depreciates the exchange rate

- Interest rate

A country with high interest rates will loose value of its currency over time.

Foreign Exchange Risk

1. Transaction exposure

Changes in outstanding financial obligations due to changes in exchange rates

Example: On January 1, 2005 Olivier Imports of Orlando Florida imported 100 cases of French wine at a price of 60 Euros per case. The French Exporters allowed Olivier Imports three months to pay the amount. On January 1, 2005 the exchange rate was USD1.2000 to one euro. Olivier Imports fixed the selling price of wine in U.S. dollars by converting at this exchange rate and adding a 20% margin. The actual exchange rate on March 31, 2005 was USD1.3500.

Anticipated profit of Olivier Imports @ 1.2000 = $100 \times 60 \times 1.2 \times 0.2 = \text{USD}1,440$

Actual profit = $100 \times 60 \times 1.2 \times 1.2 - 100 \times 60 \times 1.35 = 8,640 - 8,100 = \text{USD}540$

2. Operating Exposure

Changes in the present value of the firm resulting from unexpected future changes in exchange rates

Example: In the year 1985 the exchange rate of Japanese yen was 250 to one U.S. dollar. Let us assume that a Japanese car manufacturer is selling a car in the U.S. for USD10,000, which translates into JPY2,500,000. In the year 1995, the Japanese yen was quoted at 80 to one U.S. dollar. If the same car is sold at the same price of USD10,000 in the U.S. then the revenue per car in Japanese yen will be only JPY800,000.

3. Accounting Exposure

Changes in owner's equity when the financial statements of the foreign affiliates are converted into domestic currency.

Sourcing of capital for foreign projects

- Debt Markets
 - Eurodollar markets
 - Eurobond markets
- Equity markets
 - Foreign equity markets
 - Depository receipt markets

International Indirect Investments

- Investing in foreign stocks

The main benefit of investing foreign stocks is the reduction of overall risk of the portfolio.

- Vehicles of international diversification
 - Country funds
 - American Depositary Receipts (ADRs)

International Financial Institutions

- International Monetary Fund (IMF)
Promote international monetary cooperation, exchange stability and orderly exchange arrangements.
- World Bank
International Bank for Reconstruction and Development (IBRD)
International Development Association (IDA)
International Finance Corporation (IFC)
- Bank for International Settlements

International Banking

- Import/Export Financing
 - Letters of credit
 - Export-Import Bank of United States
- International fund transfers
 - SWIFT
- Transfer pricing

Data and Information Sources

- <https://www.cia.gov/library/publications/the-world-factbook/>
- http://www.wto.org/english/ress_e/statistics_e/statistics_e.htm
- <http://data.worldbank.org/>
- <http://unctad.org/en/Pages/Statistics.aspx/>
- <http://www.bis.org/statistics/index.htm>
- <http://www.swift.com/index.page?lang=en>