

Solution Manual For

International Financial Management, 10th Edition © 2024 By Cheol Eun, Bruce Resnick and Tuugi Chuluun

Chapter 1-21

CHAPTER 1 GLOBALIZATION AND THE MULTINATIONAL FIRM

ANSWERS & SOLUTIONS TO END-OF-CHAPTER QUESTIONS AND PROBLEMS

QUESTIONS

1. Why is it important to study international financial management?

Answer: We are now living in a world where all the major economic functions, such as consumption, production, investment, and financing, are highly globalized. It is thus essential for financial managers to fully understand vital international dimensions of financial management. This global shift is in marked contrast to a situation that existed when the authors of this book were learning finance a few decades ago. At that time, most professors customarily (and safely, to some extent) ignored international aspects of finance. This mode of operation has become untenable since then.

2. How is international financial management different from domestic financial management?

Answer: There are three major dimensions that set apart international finance from domestic finance. They are:

1. foreign exchange and political risks,
2. market imperfections, and
3. expanded opportunity set.

3. Discuss the major trends that have prevailed in international business during the last two decades.

Answer: The 2000s brought a rapid integration of international capital and financial markets. Impetus for globalized financial markets initially came from the governments of major countries that had begun to deregulate their foreign exchange and capital markets. The economic integration and globalization that began in the eighties and nineties are picking up speed in the 2000s. Trade liberalization and economic integration continued to proceed at both the regional and global levels. Despite sovereign debt crisis in Europe, more EU member countries have adopted the common currency, the euro, that effectively became the second global currency after the U.S. dollar. In the last few years, however, economic nationalism has been gaining some popularity, as exemplified by the Brexit decision of the United Kingdom and the so-called “America First” policies of the Trump Administration. To the extent that economic nationalism is a populist response to the global financial crisis and Great Recession, it may subside as the world economy continues to recover.

4. How is a country's economic well-being enhanced through free international trade in goods and services?

Answer: According to David Ricardo, with free international trade, it is mutually beneficial for two countries to each specialize in the production of the goods that it can produce *relatively* most efficiently and then trade those goods. By doing so, the two countries can increase their combined production, which allows both countries to consume more of both goods. This argument remains valid even if a country can produce both goods more efficiently in absolute terms than the other country. International trade is not a ‘zero-sum’ game in which one country benefits at the expense of another country. Rather, international trade could be an ‘increasing-sum’ game from which all players become winners.

5. What considerations might limit the extent to which the theory of comparative advantage is realistic?

Answer: The theory of comparative advantage was originally advanced by the nineteenth century economist David Ricardo as an explanation for why nations trade with one another. The theory claims that economic well-being is enhanced if each country produces what it has a comparative advantage in producing relative to other countries, and then trade products. Underlying the theory are the assumptions of free trade between nations and that the factors of production (labor, technological know-how, and capital) are relatively immobile. To the extent that these assumptions do not hold, the theory of comparative advantage may not realistically describe international trade. In addition, free trade produces winners and losers and if the losers are not compensated, free trade may face political opposition from them.

6. What are multinational corporations (MNCs) and what economic roles do they play?

Answer: A multinational corporation (MNC) can be defined as a business firm incorporated in one country that has production and sales operations in many other countries. Indeed, some MNCs have operations in a few dozens of different countries. MNCs obtain financing from major money centers around the world in many different currencies to finance their operations. Global operations force the treasurer's office to establish international banking relationships, to place short-term funds in several currency denominations, and to effectively manage foreign exchange risk. By circumventing and also taking advantage of various market imperfections, such as barriers to trade and barriers to flow of people and capital across countries, MNCs contribute to greater integration of the world economy and more perfect functioning of global markets.

7. Ross Perot, a former Presidential candidate of the Reform Party, which was a third political party in the United States, had strongly objected to the creation of the North American Trade Agreement (NAFTA), which nonetheless was inaugurated in 1994. Perot feared the loss of American jobs to Mexico where it is much cheaper to hire workers. What are the merits and demerits of Perot's position on NAFTA? Considering the recent economic developments in North America, how would you assess Perot's position on NAFTA?

Answer: Since the inception of NAFTA, many American companies indeed have invested heavily in Mexico, sometimes relocating production from the United States to Mexico. Although this might have temporarily caused unemployment of some American workers, they were eventually rehired by other industries often for higher wages. At the same time, Mexico has been experiencing a major economic boom. It seems clear that both Mexico and the U.S. have benefited from NAFTA. Perot's concern appears to have been ill founded.

8. In 1995, a working group of French chief executive officers was set up by the Confederation of French Industry (CNPF) and the French Association of Private Companies (AFEP) to study the French corporate governance structure. The group reported the following, among other things: "The board of directors should not simply aim at maximizing share values as in the U.K. and the U.S. Rather, its goal should be to serve the company, whose interests should be clearly distinguished from those of its shareholders, employees, creditors, suppliers and clients but still equated with their general common interest, which is to safeguard the prosperity and continuity of the company". Evaluate the above recommendation of the working group.

Answer: The recommendations of the French working group clearly show that shareholder wealth maximization is not a universally accepted goal of corporate management, especially outside the United States and possibly a few other Anglo-Saxon countries including the United Kingdom and Canada. To some extent, this may reflect the fact that share ownership is not wide spread in most other countries.