Notes

Chapter 1

- ^{1.} We use the term *international business* to refer to the cross-border business activities of individual firms, while economists use *international trade* to refer to aggregate cross-border flows of products and services between nations. While international business describes an enterprise-level phenomenon, international trade describes the macrophenomenon of aggregate flows between nations.
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Chapter 2

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^{6.} The word *trade* comes from the Anglo-Saxon term *trada*, which means to walk in the footsteps of others. Ancient trade routes were the foundation for a high level of crosscultural exchange of ideas that led to the development of religion, science, economic activity, and government. The phrase "all roads lead to Rome" is not so much a metaphorical reference to Rome's dominance of the world 2,000 years ago, but to the fact that Rome's territorial colonies were constructed as commercial resource centers to serve the needs of the Roman Empire and increase its wealth. In an empire that stretched from England to Israel and from Germany to Africa, the Romans created more than 300,000 kilometers of roads. Roman roads were the lifeblood of the state that allowed trade to flourish. The Roman Empire was so concerned with the interruption of its shipping lanes for imported goods that it dispatched army legions to protect those lanes.

In the middle ages, the Knights Templar acted as guardians for pilgrims making the hazardous journey to pay homage to the birthplace of the Christian religion. In addition to protecting tourists, this warrior order created the first international banking system with the use of rudimentary traveler's checks, eliminating the need for travelers to carry valuables on their person.

In 1100, Genghis Khan not only united the Mongols but created an empire beyond the Chinese border that included Korea and Japan in the East, Mesopotamia (modern day Iraq and Syria), Russia, Poland, and Hungary. He instituted common laws and regulations over his domain, most notably the preservation of private property, to enhance and protect international trade.

Arab merchants traded in spices along land routes reaching from northern Arabia across modern day Turkey, through Asia Minor, and finally reaching China. By concealing the origins of cinnamon, pepper, cloves, and nutmeg, traders gained a monopoly and controlled prices. Europeans came to believe that the spices came from Africa, when in fact they had merely changed hands in the region. Under the traditional trading system, spices, linen, silk, diamonds, pearls, and opium-based medicines reached Europe via indirect routes over land and sea. Representing one of the earliest systems of international distribution, the products passed through many hands on their long voyage. At every juncture, prices increased several fold. (This discussion is based on Lawrence Beer, Arizona State University.)

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- ^{18.} Here is an example of how transfer pricing works. Consider an MNE with a subsidiary in three countries. Suppose that subsidiary A operates in country A with high corporate income taxes, and subsidiary B operates in country B, a tax haven. One way to minimize taxes is for subsidiary A to sell merchandise to subsidiary B for a low transfer price. Subsidiary B then resells the merchandise to subsidiary C in the third country at a high transfer price. This results in lower overall taxes for subsidiary A because of its low profits, for subsidiary B because of country B's low tax rates, and for subsidiary C because the high cost of its purchase reduces its profits.
- ^{19.} While this approach to transferring funds within the MNE is quite common, transfer pricing has some drawbacks. First, while transfer pricing between members of the corporate family is legal when carried out within reasonable limits, governments strongly disapprove of the practice of avoiding tax obligations. Thus, many governments impose policies that restrict transfer pricing. Coca-Cola's Japan subsidiary was fined 15 billion yen (\$145 million) for making royalty payments from trademarks and products to its U.S. parent that Japan's National Tax Administration judged as too high. Second, transfer pricing can distort the financial results of foreign subsidiaries. For instance, a subsidiary that is required to charge low prices for its exports

may experience unusually low profitability, which harms its performance and can demoralize local staff. Third, some MNEs use artificial transfer prices to hide the poor results of a badly performing subsidiary, or achieve other goals aimed at concealing the true performance of the firm.

^{20.} Timor Mehpare and Seyhan Sipahi, "Fast-Food Restaurant Site Selection Factor Evaluation by the Analytic Hierarchy Process," *The Business Review* 4 (2005): 161–67.

^{21.} Here is an illustration of net present value analysis. A U.S.-based MNE is considering an expansion project through its subsidiary in Mexico. The project requires an initial investment of 220 million Mexican pesos (MXP) and has an economic life of 5 years. The project is expected to generate annual after-tax cash flows of MXP120 million, MXP125 million, MXP150 million, MXP155 million, and MXP200 million, which will be remitted to the parent company during the next 5 years. The current spot exchange rate is MXP11/\$ and the spot rates are expected to be MXP11.10/\$, MXP11.25/\$, MXP11.50/\$, MXP11.55/\$, and MXP11.75/\$ for the next 5 years. Assuming that the appropriate discount rate for this project is 10 percent, what is the NPV of the project from the parent company's perspective? Should the MNC accept this project based on its NPV? Let's analyze.

The U.S. cash flows of the project can be calculated as follows:

	0	1	2	3	4	5
Mexican peso cash flows	MXP 220 million	MXP 120 million	MXP 125 million	MXP 150 million	MXP 155 million	MXP 200 million
Prevail- ing spot exchange rate	MXP 11/\$	MXP 11.10/\$	MXP 11.25/\$	MXP 11.50/\$	MXP 11.55/\$	MXP 11.75/\$
U.S. dollar cash flows	\$20,000, 000	\$10,810, 811	\$11,111,1 11	\$13,043, 478	\$13,419, 913	\$17,021, 277

The NPV of the project can be calculated as follows: N P V = - $$20,000,000+$10,810,811/(1+0.10)^1+$11,111,111/(1+0.10)^2+$13,043,478/(1+0.10)^3+$13,419,913/(1+0.10)^4+$17,021,277/(1+0.10)^5 NPV=$28,545,359$

The MNC can accept the project because it has a positive NPV.

^{22.} The discount rate used in the NPV analysis of international projects may be higher due to a premium for additional risks involved in doing business internationally. Management may insist on a higher level of required return in the net present value calculation because higher country/political and currency risks indicate a higher probability of venture failure. A firm might apply a 7 percent discount rate to potential investments in Germany and Japan because those countries enjoy political and economic stability. But the same firm might use a 14 percent discount rate for similar potential investments in Pakistan and Russia because those countries experience political

- and economic turmoil. The higher the discount rate, the higher the projected net cash flows must be for the investment to have a positive net present value contribution. Occasionally, the discount rate for international projects can be lower than for domestic ones. Risk arises from various sources and management must systematically assess the range of potentially influential factors.
- ^{23.} Peter Drucker, *Management Challenges for the 21st Century* (New York: Harper Collins, 1999).
- ^{24.} Robert Aliber, *Exchange Risk and International Finance* (New York: Wiley, 1979).
- ^{25.} Donald R. Lessard, "Finance and Global Competition," *Midland Corporate Finance Journal* (Fall, 1987).
- ²⁶ Trade Fact of the Week, "Currency Trading Totals \$3 Trillion a Day," March 14, 2007.
- ^{27.} Ibid.
- ^{28.} Gordon Platt, "World's Best Foreign Exchange Banks 2005," *Global Finance* 19 (2005): 24–33.
- ^{29.} Adam Rombel, "The World's Best Internet Banks," *Global Finance* 16 (2002): 37–38.
- ^{30.} See Appendix for Chapter.
- ^{31.} Richard Rescigno, "At the Crossroads: Subaru Strives to Get Back Into Gear," *Barron's*, March 28, 1988, 15–19.

- ^{32.} Here is a simple example of an option transaction from a familiar context. Say you are in the market to buy a house. You find one that you like but you are not sure if you want to buy it. At this stage, you opt to put a deposit down to have the seller keep his for-sale house for you for two weeks. Later, if you buy the house, the deposit counts toward the purchase price. If you do not buy the house, you lose your deposit. You had the option to buy the house at an agreed-upon price but not the obligation to do so.
- ^{33.} W. Wallace and J. Walsh, "Apples to Apples: Profits Abroad," *Financial Executive* (May–June, 1995): 28–31.
- ^{34.} Hank Boerner, "Europe Faces Eagle Eye of US Financial Regulation," *European Business Forum* 21 (2005): 46–49.
- ^{35.} Robert Bruce, "Giant Step Is Taken Towards a Single Global Standard," *Financial Times*, May 3, 2007.
- ^{36.} Computershare, 2003 Annual Report, accessed at www.computershare.com, (2003).
- ^{37.} Alan J. Auerbach and Martin Feldstein, *Handbook of Public Economics*, 3rd ed. (Amsterdam: North-Holland, 2001).
- ^{38.} Brody Mullins, "Accenture Lobbyists Near Big Win On Securing Tax-Haven Status," *Wall Street Journal*, July 14, 2005, A2.