

# International Economic Activities



**SILESIAN  
UNIVERSITY**  
SCHOOL OF BUSINESS  
ADMINISTRATION IN KARVINA

**Ing. Jana Šimáková, Ph.D.**

simakova@opf.slu.cz



**??? What do you consider as a multinational corporation???**

**???What is the most common aim of any company???**

# Multinational Corporation

---



**SILESIAN  
UNIVERSITY**  
SCHOOL OF BUSINESS  
ADMINISTRATION IN KARBINA

- multinational corporation (MNC) can be defined as a corporation engaged in any form of international economic activities (Madura, 2017).
- The main goal of MNC
  - Maximization of the MNC's value
  - for MNC operating as stock company traded on stock exchanges - the goal of maximizing the value of MNC while maximizing shareholder assets, thus maximizing share prices.
- Basis of the international financial management
  - successfully develop business and financial strategies in more than one national business environment

Note: For purposes of this course, we abstract from other possible targets of MNC, such as meeting the needs of governments, lenders, employees etc. MNC will be seen as a stock company traded on the stock exchange. Therefore the MNC's goal can be specified as maximizing the shareholder property. MNC management is supposed to make decisions followed by maximization of the share price.

---

# Questions and Applications

---



**SILESIA**  
**UNIVERSITY**  
SCHOOL OF BUSINESS  
ADMINISTRATION IN KATOWICE

**Two years ago, Seattle Co. (based in the United States) established a subsidiary in Singapore so that it could expand its business there. It hired a manager in Singapore to manage the subsidiary. During the last two years, the sales generated by the subsidiary have not grown. Yet, the manager of the subsidiary has hired several employees to do the work that he was assigned. The managers of the parent company in the United States have not closely monitored the subsidiary because they trusted the manager of the subsidiary and because the subsidiary is so far away. Now they realize that there is an agency problem. The subsidiary is experiencing losses every quarter, so they need to more closely monitor the management of the subsidiary.**

**???What is the agency problem? How can be agency problem solved???**

# Agency Problem

---



- conflict between goals of managers and goals of shareholders
- based on information asymmetry in the MNC
  - managers have an access to information from the operational business of the company/subsidiary
  - shareholders have very limited access to it
- managers tend to maximize their own benefit not the goal of the company
  - for example, through maximizing the size of the company, increasing managerial responsibilities and powers, securitization of their positions, growth management benefits and rewards to promote its own social objectives, growth in prestige, etc.
- agency costs
  - the costs of ensuring that managers maximize shareholder wealth
  - normally larger for MNCs than for purely domestic firms

# Prevention of the Agency Problem

---



**SILESIAN  
UNIVERSITY**  
SCHOOL OF BUSINESS  
ADMINISTRATION IN KATOWICE

- suitable method of control
  - proper governance
  - clear communication of MNC goals
  - compensation plans for managers (reward, options to buy the MNC stock)
  - setting regular business and control processes in MNC
  - effect of stock market



## **Solution of the Seattle Co.:**

**When Seattle Co. recognized the agency problems with its Singapore subsidiary, it created incentives for the manager of the subsidiary that were aligned with the parent's goal of maximizing shareholder wealth. Specifically, it set up a compensation system so that the annual bonus paid to the manager would be based on the level of earnings at the subsidiary.**

# Structure of the Multinational Financial Management

---



**SILESIAN  
UNIVERSITY**  
SCHOOL OF BUSINESS  
ADMINISTRATION IN KARVINA

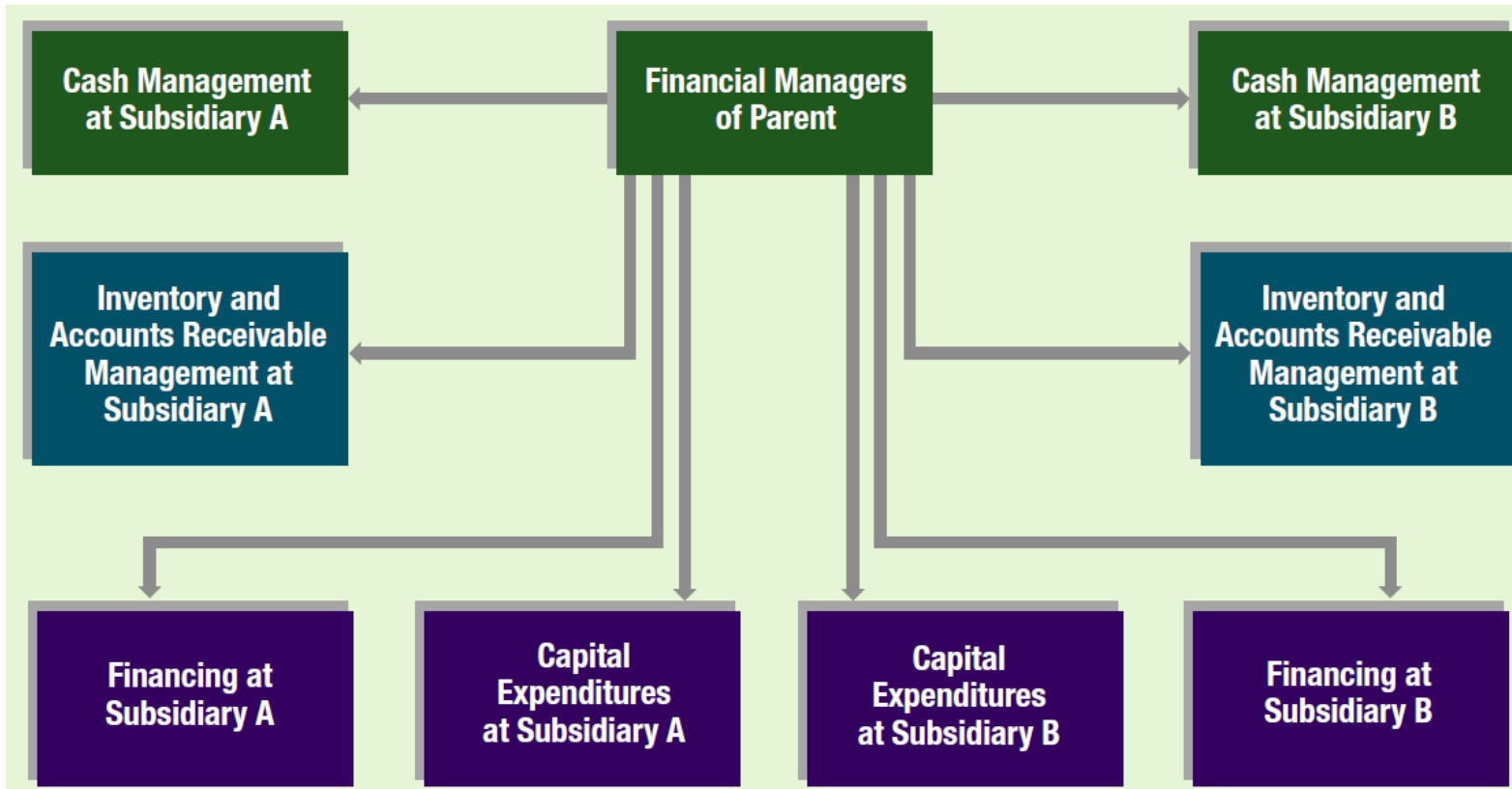
- Centralized management
- Decentralized management
- A combination of centralized and decentralized management



# Centralized Multinational Financial Management



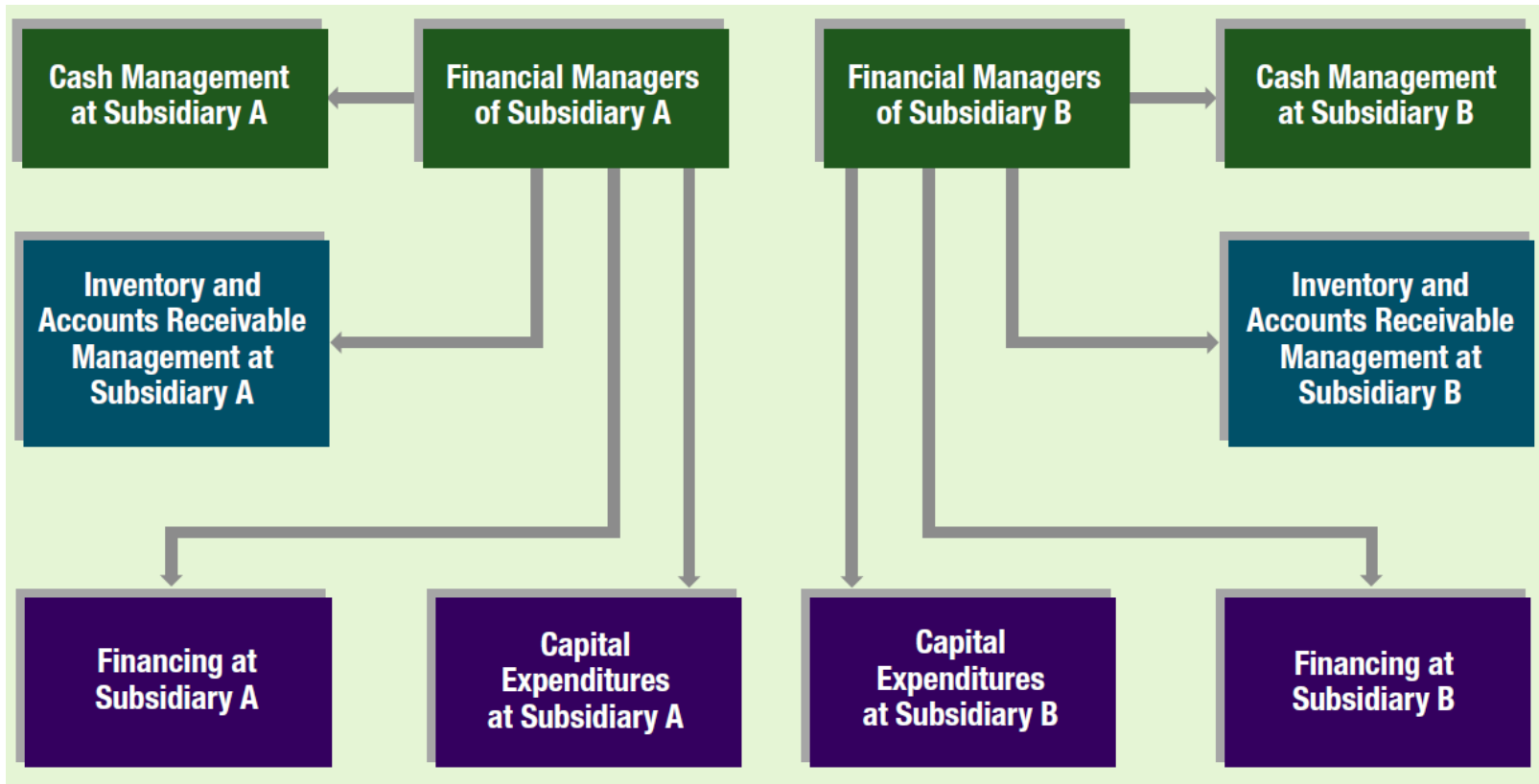
**SILESIAN  
UNIVERSITY**  
SCHOOL OF BUSINESS  
ADMINISTRATION IN KATOWICE



# Decentralized Multinational Financial Management



**SILESIAN  
UNIVERSITY**  
SCHOOL OF BUSINESS  
ADMINISTRATION IN KATOWICE





**???Which type of multinational financial management  
brings higher agency cost???**

**???Why???**

# MNC Pricing Model



- The basic model of the valuation of MNC is based on a model that works with

purely domestic income: 
$$V = \sum_{t=1}^n \left\{ \frac{E(CF_{d,t})}{(1+k)^t} \right\}$$

- Transfer of cash flow in foreign currency on the domestic currency units:

$\underbrace{\quad\quad\quad}_m$

$V$	Value of MNC
$E(CF_j)$	expected cash flow in given period ( $CF_{d,t}$ in domestic currency, $CF_{j,t}$
$n$	period of expected cash flow
$k$	the weighted average cost of capital (WACC), including the required rate of return for shareholders and creditors
$CF_j$	cash flow denominated in the relevant currencies $j$
$S_{j,t}$	expected exchange rate at which the currency can be converted into local currency at the end of period $t$

# Questions and Applications

---



**SILESIA**  
**UNIVERSITY**  
SCHOOL OF BUSINESS  
ADMINISTRATION IN KATOWICE

**Carolina Co. has expected cash flows of \$100 000 from local business and 1 million Mexican pesos from business in Mexico at the end of period  $t$ . Assuming that the peso's value is expected to be 0.09 USD/ MXN when converted into dollars, the expected dollar cash flows are:**

$m$



**??? What are the reasons of involvement of the company  
into international economic activities???**

# Factors Motivating MNC to Start International Activities

---



**SILESIAN  
UNIVERSITY**  
SCHOOL OF BUSINESS  
ADMINISTRATION IN KARVINA

- new resources
- new markets
- international diversification to reduce risk
- multinationality leading to profitability
- economies of scale
- flexibility
- effect of learning and acquiring specific assets
- ...



**???What forms of engaging MNC in international business  
do you know???**

**???Can you order them according to the risk???**



# Forms of International Economic Activities

---



**SILESIAN  
UNIVERSITY**  
SCHOOL OF BUSINESS  
ADMINISTRATION IN KARVINA

- International trade
- Licensing
- Franchising
- Joint ventures
- Acquisitions of existing operations
- Establishing new foreign subsidiaries



- International trade is a relatively conservative approach that can be used by firms to penetrate markets
  - by exporting – to penetrate markets
  - by importing - to obtain low-cost or unavailable supplies
- This approach entails minimal risk because the firm does not place any of its capital abroad. (in comparison to other international economic activities)
- If the firm experiences a decline in its exporting or importing, it can normally reduce or discontinue this part of its business at a relatively low cost.

# Licensing

---



- Licensing obligates a firm to provide its technology (copyrights, patents, trademarks, or trade names) in exchange for fees or some other specified benefits.
  - Licensing allows firms to use their technology in foreign markets without a major investment in foreign countries and without the transportation costs that result from exporting.
  - A major disadvantage of licensing is that it is difficult for the firm providing the technology to ensure quality control in the foreign production process.
- Examples:
  - Starbucks has licensing agreements with SSP (an operator of food and beverages in Europe) to sell Starbucks products in train stations and airports throughout Europe.
  - Sprint Nextel Corp. has a licensing agreement to develop telecommunications services in the United Kingdom.
  - IGA, Inc. has a licensing agreement to operate supermarkets in China and Singapore.

# Franchising

---



- Franchising obligates a firm to provide a specialized sales or service strategy, support assistance, and possibly an initial investment in the franchise in exchange for periodic fees.
- Like licensing, franchising allows firms to penetrate foreign markets without a major investment in foreign countries.
- Examples:
  - McDonald's, Pizza Hut, Subway Sandwiches, Blockbuster Video, and Dairy Queen have franchises that are owned and managed by local residents in many foreign countries.

# Joint Ventures

---



- A joint venture is a venture that is jointly owned and operated by two or more firms.
  - Many firms penetrate foreign markets by engaging in a joint venture with firms that reside in those markets.
  - Most joint ventures allow two firms to apply their respective comparative advantages in a given project.
- Examples:
  - General Mills, Inc., joined in a venture with Nestlé SA so that the cereals produced by General Mills could be sold through the overseas sales distribution network established by Nestlé.
  - Xerox Corp. (USA) and Fuji Co. (Japan) engaged in a joint venture that allowed Xerox Corp. to penetrate the Japanese market and allowed Fuji to enter the photocopying business.
  - Sara Lee Corp. and AT&T have engaged in joint ventures with Mexican firms to gain entry to Mexico's markets.

# Acquisitions of Existing Operations

---



**SILESIAN  
UNIVERSITY**  
SCHOOL OF BUSINESS  
ADMINISTRATION IN KARWINA

- Firm acquire other firm in foreign countries as a way to penetrate abroad
  - acquisitions allow firms to have full control over their foreign businesses and to quickly obtain a large portion of foreign market share.
- An acquisition of an existing corporation is subject to the risk of large losses.
  - the large investment required
  - if the foreign operations perform poorly, it may be difficult to sell it at a reasonable price.
- Some firms engage in partial international acquisitions in order to obtain a stake in foreign operations.
  - requires a smaller investment than full international acquisitions => less risk.
  - the firm will not have complete control over foreign operations that are only partially acquired.
- Example – Google, Inc. - acquisitions to expand business and improve technology
  - Australia and Brazil (search engines), Canada (mobile browser), Finland (micro-blogging), Germany (mobile software), Russia (online advertising), South Korea (weblog software), Spain (photo sharing), etc.

# Establishing New Foreign Subsidiaries

---



**SILESIAN  
UNIVERSITY**  
SCHOOL OF BUSINESS  
ADMINISTRATION IN KARVINA

- Firms can penetrate foreign markets by establishing new operations in foreign countries to produce and sell their products.
  - This method requires a large investment (the risk of large losses).
  - Establishing new subsidiaries may be preferred to foreign acquisitions because the operations can be tailored exactly to the firm's needs.
  - a smaller investment may be required than would be needed to purchase existing operations.
- The firm will not reap any rewards from the investment until the subsidiary is built and a customer base established.



**???What are examples of presented methods of penetration to foreign markets in your home country???**

**Find other examples of international trade, licencing, franchising, joint venture, acqizition of foreign operations, and establishing new foreign subsidiary. Explain, why firms use these methods for the foreign market.**





**SILESIAN  
UNIVERSITY**  
SCHOOL OF BUSINESS  
ADMINISTRATION IN KARVINA

---

***THANK YOU FOR YOUR  
ATTENTION***

