

Contents in Brief

PART ONE Foundations of International Financial Management

- 1 Globalization and the Multinational Firm, 4
- 2 International Monetary System, 26
- 3 Balance of Payments, 58
- 4 The Market for Foreign Exchange, 74
- 5 International Parity Relationships and Forecasting Foreign Exchange Rates, 99

PART TWO World Financial Markets and Institutions

- 6 International Banking and Money Market, 130
- 7 International Bond Market, 157
- 8 International Equity Markets, 176
- 9 Futures and Options on Foreign Exchange, 200
- 10 Currency and Interest Rate Swaps, 227
- 11 International Portfolio Investment, 247

PART THREE Foreign Exchange Exposure and Management

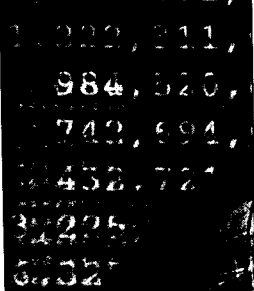
- 12 Management of Economic Exposure, 282
- 13 Management of Transaction Exposure, 303
- 14 Management of Translation Exposure, 330

PART FOUR Financial Management of the Multinational Firm

- 15 Foreign Direct Investment and Cross-Border Acquisitions, 352
- 16 International Capital Structure and the Cost of Capital, 380
- 17 International Capital Budgeting, 406
- 18 Multinational Cash Management, 423
- 19 Exports and Imports, 446
- 20 International Tax Environment, 456
- 21 Corporate Governance around the World, 472

Glossary, 497

Index, 505



Contents

PART ONE

Foundations of International

CHAPTER 1 Globalization and the Multinational Firm, 4

What's Special about International Finance?, 5

Foreign Exchange and Political Risks, 5

Market Imperfections, 6

Expanded Opportunity Set, 7

Goals for International Financial
Management, 7

Globalization of the World Economy: Recent
Trends, 9

*Emergence of Globalized Financial
Markets, 9*

Advent of the Euro, 10

*Trade Liberalization and Economic
Integration, 11*

Financial Management

International Finance in Practice: Why We Believe in the Euro, 12

Privatization, 14

Multinational Corporations, 15

International Finance in Practice: Multinationals More Efficient, 17

Organization of the Text, 18

Summary, 21

MINI CASE: Nike's Decision, 23

Appendix 1A: Gains from Trade: The Theory of Comparative Advantage, 24

CHAPTER 2
International
Monetary
System, 26

Evolution of the International Monetary System, 26

Bimetallism: Before 1875, 27

Classical Gold Standard: 1875–1914, 27

Interwar Period: 1915–1944, 29

Bretton Woods System: 1945–1972, 30

The Flexible Exchange Rate Regime:
1973–Present, 33

The Current Exchange Rate
Arrangements, 34

European Monetary System, 38

The Euro and the European Monetary
Union, 40

A Brief History of the Euro, 40

*What Are the Benefits of the Monetary
Union?, 41*

Costs of Monetary Union, 43

International Finance in Practice: Mundell Wins Nobel Prize in Economics, 44

Prospects of the Euro: Some Critical Questions, 44

International Finance in Practice: The New World Order of Finance, 46

The Mexican Peso Crisis, 47

The Asian Currency Crisis, 48

Origins of the Asian Currency Crisis, 49

Lessons from the Asian Currency Crisis, 51

Fixed versus Flexible Exchange Rate Regimes, 52

Summary, 54

MINI CASE: Will the U.K. Join the Euro Club?, 57

CHAPTER 3

Balance of Payments, 58

Balance-of-Payments Accounting, 58

Balance-of-Payments Accounts, 59

The Current Account, 60

The Capital Account, 62

Statistical Discrepancy, 64

Official Reserve Account, 64

The Balance-of-Payments Identity, 65

Balance-of-Payments Trends in Major
Countries, 67

*International Finance in Practice: The Dollar
and the Deficit, 69*

Summary, 70

CONTENTS

MINI CASE: Mexico's Balance-of-Payments
Problem, 72

**Appendix 3A: The Relationship between
Balance of Payments and National Income
Accounting, 73**

CHAPTER 4
The Market
for Foreign
Exchange, 74

Function and Structure of the FOREX
Market, 75

FX Market Participants, 76

Correspondent Banking Relationships, 77

*International Finance in Practice: Fearless
Dealers, 78*

The Spot Market, 79

Spot Rate Quotations, 79

The Bid-Ask Spread, 81

Spot FX Trading, 82

Cross-Exchange Rate Quotations, 83

*International Finance in Practice: Young
Traders Run Currency Markets, 84*

*Alternative Expressions for the Cross-
Exchange Rate, 85*

The Cross-Rate Trading Desk, 86

Triangular Arbitrage, 87

Spot Foreign Exchange Market

Microstructure, 88

The Forward Market, 90

Forward Rate Quotations, 90

Long and Short Forward Positions, 91

Forward Cross-Exchange Rates, 92

Swap Transactions, 92

Forward Premium, 93

Summary, 94

MINI CASE: Shrewsbury Herbal
Products, Ltd. , 97

CHAPTER 5

International Parity Relationships and Forecasting Foreign Exchange Rates, 99

Interest Rate Parity, 99

Covered Interest Arbitrage, 101

Interest Rate Parity and Exchange Rate Determination, 104

Reasons for Deviations from Interest Rate Parity, 105

Purchasing Power Parity, 107

PPP Deviations and the Real Exchange Rate, 108

International Finance in Practice: Big MacCurrencies, 110

Evidence on Purchasing Power Parity, 110

The Fisher Effects, 113

Forecasting Exchange Rates, 114

Efficient Market Approach, 115

Fundamental Approach, 116

Technical Approach, 117

Performance of the Forecasters, 118

Summary, 121

MINI CASE: Turkish Lira and Purchasing Power Parity, 124

Appendix 5A: Purchasing Power Parity and Exchange Rate Determination, 126

CHAPTER 6**International
Banking and Money
Market, 130**

International Banking Services, 130

The World's Largest Banks, 131

Reasons for International Banking, 131

Types of International Banking Offices, 133

Correspondent Bank, 133

Representative Offices, 133

Foreign Branches, 134

Subsidiary and Affiliate Banks, 134

Edge Act Banks, 134

Offshore Banking Centers, 135

International Banking Facilities, 135

Capital Adequacy Standards, 136

International Money Market, 138

Eurocurrency Market, 138

Eurocredits, 140

Institutions

Forward Rate Agreements, 141

Euronotes, 143

Eurocommercial Paper, 143

International Debt Crisis, 143

History, 144

Debt-for-Equity Swaps, 145

International Finance in Practice: LDC

Lenders Should Have

Listened to David Hume, 146

The Solution: Brady Bonds, 147

Japanese Banking Crisis, 148

The Asian Crisis, 149

Summary, 149

MINI CASE: Detroit Motors' Latin American
Expansion, 152

Appendix 6A: Eurocurrency Creation, 155

CHAPTER 7
International Bond
Market, 157

The World's Bond Markets: A Statistical
Perspective, 157

Foreign Bonds and Eurobonds, 157

Bearer Bonds and Registered Bonds, 158

National Security Regulations, 159

Withholding Taxes, 159

Other Recent Regulatory Changes, 159

Global Bonds, 160

Types of Instruments, 160

Straight Fixed-Rate Issues, 160

Euro-Medium-Term Notes, 160

Floating-Rate Notes, 161

Equity-Related Bonds, 161

Zero-Coupon Bonds, 162

Dual-Currency Bonds, 162

Currency Distribution, Nationality, and Type
of Issuer, 163

International Bond Market Credit Ratings, 163

*International Finance in Practice: Sara Lee
Corp. Offers 3-Year Eurobonds at 6%, 164*

Eurobond Market Structure and Practices, 165

Primary Market, 165

Secondary Market, 168

Clearing Procedures, 170

International Bond Market Indexes, 170

Summary, 173

MINI CASE: Sara Lee Corporation's
Eurobonds, 175

CHAPTER 8
International Equity
Markets, 176

A Statistical Perspective, 176

*Market Capitalization of Developed
Countries, 176*

*Market Capitalization of Developing
Countries, 177*

Measures of Liquidity, 179

Measures of Market Concentration, 180

Market Structure, Trading Practices, and
Costs, 181

International Equity Market Benchmarks, 183

World Equity Benchmark Shares, 187

Trading in International Equities, 188

Cross-Listing of Shares, 188

Yankee Stock Offerings, 190

The European Stock Market, 190

American Depository Receipts, 191

Global Registered Shares, 193

Factors Affecting International Equity
Returns, 194

Macroeconomic Factors, 194

Exchange Rates, 194

Industrial Structure, 194

*International Finance in Practice: Buying
Foreign Stocks from U.S. Brokers Gets
Easier, 195*

Summary, 196

MINI CASE: San Pico's New Stock
Exchange, 198

CHAPTER 9

Futures and Options on Foreign Exchange, 200

Futures Contracts: Some Preliminaries, 200

Currency Futures Markets, 203

Basic Currency Futures Relationships, 204

Eurodollar Interest Rate Futures Contracts, 206

Options Contracts: Some Preliminaries, 209

Currency Options Markets, 209

Currency Futures Options, 210

International Finance in Practice:

*Commodities: Why Isn't Turmoil Sparking
Future Boom?, 211*

Basic Option-Pricing Relationships at Expiration, 212

American Option-Pricing Relationships, 216

European Option-Pricing Relationships, 216

Binomial Option-Pricing Model, 218

European Option-Pricing Formula, 220

Empirical Tests of Currency Options, 221

Summary, 221

MINI CASE: The Options Speculator, 225

CHAPTER 10

Currency and Interest Rate Swaps, 227

Types of Swaps, 227

Size of the Swap Market, 228

The Swap Bank, 228

*International Finance in Practice: The World
Bank's First Currency Swap, 229*

Interest Rate Swaps, 229

Basic Interest Rate Swap, 229

Currency Swaps, 231

Parallel Loans, 232

Back-to-Back Loans, 233

*Institutional Difficulties of Parallel and
Back-to-Back Loans, 234*

Basic Currency Swap, 234

Swap Market Quotations, 237

Variations of Basic Currency and Interest Rate
Swaps, 238

Risks of Interest Rate and Currency Swaps, 238

CONTENTS

*International Finance in Practice: Eli Lilly
and Company: The Case of the Appreciating
Yen, 239*

Is the Swap Market Efficient?, 240

Concluding Points about Swaps, 241

Summary, 241

MINI CASE: The Centralia Corporation's
Currency Swap, 246

CHAPTER 11

International Portfolio Investment, 247

International Correlation Structure and Risk
Diversification, 248

Optimal International Portfolio Selection, 250

Effects of Changes in the Exchange Rate, 256

International Bond Investment, 258

International Mutual Funds: A Performance
Evaluation, 259

International Diversification through Country
Funds, 261

International Diversification with ADRs, 265

International Diversification with WEBS, 265

*International Finance in Practice: Live Here,
Invest Abroad, 266*

Why Home Bias in Portfolio Holdings?, 266

Summary, 270

MINI CASE: Solving for the Optimal
International Portfolio, 274

Appendix 11A: International Investment with
Exchange Risk Hedging, 276

Appendix 11B: Solving for the Optimal
Portfolio, 278

CHAPTER 12

**Management of
Economic
Exposure, 282**

Three Types of Exposure, 283

How to Measure Economic Exposure, 284

*International Finance in Practice: U.S. Firms
Feel the Pain of Peso's Plunge, 286*

Operating Exposure: Definition, 288

Illustration of Operating Exposure, 289

Determinants of Operating Exposure, 292

Managing Operating Exposure, 294

Selecting Low-Cost Production Sites, 294

*International Finance in Practice: The
Strong Yen and Toyota's Choice, 295*

Flexible Sourcing Policy, 295

Diversification of the Market, 295

*R&D Efforts and Product
Differentiation, 296*

and Management

Financial Hedging, 296

ILLUSTRATED MINI CASE: Exchange Risk Management at Merck, 296

Step 1: Exchange Forecasting, 297

Step 2: Assessing Strategic Plan Impact, 297

Step 3: Deciding Whether to Hedge, 297

Step 4: Selecting the Hedging Instruments, 297

Step 5: Constructing a Hedging Program, 297

Summary, 298

MINI CASE: Economic Exposure of Albion Computers PLC, 301

CHAPTER 13
Management of
Transaction
Exposure, 303

- Forward Market Hedge, 304
- Money Market Hedge, 306
- Options Market Hedge, 307
- Cross-Hedging Minor Currency Exposure, 309
- Hedging Contingent Exposure, 310
- Hedging Recurrent Exposure with Swap Contracts, 311
- Hedging through Invoice Currency, 312
- Hedging via Lead and Lag, 313
- Exposure Netting, 313

International Finance in Practice: Riding Shifting Waves of Currency, 314

Should the Firm Hedge?, 314

International Finance in Practice: To Hedge or Not to Hedge, 316

What Risk Management Products Do Firms Use?, 318

Summary, 319

MINI CASE: Chase Options, Inc., 322

CHAPTER 14
Management of
Translation
Exposure, 330

Translation Methods, 330

Current/Noncurrent Method, 330

Monetary/Nonmonetary Method, 331

Temporal Method, 331

Current Rate Method, 331

Financial Accounting Standards Board
Statement 8, 333

Financial Accounting Standards Board
Statement 52, 333

*The Mechanics of the FASB 52 Translation
Process, 334*

Highly Inflationary Economies, 334

ILLUSTRATED MINI CASE: Consolidation of
Accounts according to FASB 52: The Centralia
Corporation, 337

Management of Translation Exposure, 341

Translation Exposure versus Transaction Exposure, 341

Hedging Translation Exposure, 342

Balance Sheet Hedge, 342

Derivatives Hedge, 343

Translation Exposure versus Operating Exposure, 344

Empirical Analysis of the Change from FASB 8 to FASB 52, 344

Summary, 344

MINI CASE: Sundance Sporting Goods, Inc., 346

CHAPTER 15

Foreign Direct
Investment and
Cross-Border
Acquisitions, 352

Global Trends in FDI, 353

Why Do Firms Invest Overseas?, 355

Trade Barriers, 356

Imperfect Labor Market, 356

Intangible Assets, 358

Vertical Integration, 359

Product Life Cycle, 359

*International Finance in Practice: Linear
Sequence in Manufacturing: Singer &
Company, 360*

Shareholder Diversification Services, 361

Multinational Firm

Cross-Border Mergers and Acquisitions, 362

Political Risk and FDI, 365

International Finance in Practice:

DaimlerChrysler: The First Global Car

Colossus, 366

International Finance in Practice: Stories

Past and Present, 371

Summary, 375

MINI CASE: Enron versus Bombay

Politicians, 377

CHAPTER 16

International Capital Structure and the Cost of Capital, 380

Cost of Capital, 380

Cost of Capital in Segmented versus Integrated Markets, 381

Does the Cost of Capital Differ among Countries?, 383

International Finance in Practice: The U.S. Welcomes the Alien Invasion, 384

ILLUSTRATED MINI CASE: Novo Industri, 387

Cross-Border Listings of Stocks, 389

Capital Asset Pricing under Cross-Listings, 392

The Effect of Foreign Equity Ownership
Restrictions, 394

Pricing-to-Market Phenomenon, 395

ILLUSTRATED MINI CASE: Nestlé, 395

*Asset Pricing under Foreign Ownership
Restrictions, 397*

The Financial Structure of Subsidiaries, 399

Summary, 401

Appendix 16A: Pricing of Nontradable Assets:
Numerical Simulations, 405

CHAPTER 17
International Capital
Budgeting, 406

Review of Domestic Capital Budgeting, 407

The Adjusted Present Value Model, 408

Capital Budgeting from the Parent Firm's
Perspective, 410

Generality of the APV Model, 412

*Estimating the Future Expected Exchange
Rate, 412*

ILLUSTRATED MINI CASE: The Centralia
Corporation, 413

Risk Adjustment in the Capital Budgeting
Analysis, 417

Sensitivity Analysis, 417

Real Options, 418

Summary, 419

MINI CASE: Dorchester, Ltd., 421

MINI CASE: Strik-It Rich Gold Mining
Company, 422

CONTENTS

CHAPTER 18 Multinational Cash Management, 423

The Management of International Cash
Balances, 423

ILLUSTRATED MINI CASE: Teltrex's Cash
Management System, 424

Netting Systems, 424

Centralized Cash Depository, 426

*Bilateral Netting of Internal and External
Net Cash Flows, 429*

*Reduction in Precautionary Cash
Balances, 429*

Cash Management Systems in Practice, 431

Transfer Pricing and Related Issues, 432

ILLUSTRATED MINI CASE: Intel Products
Transfer Pricing Strategy, 432

Low versus High Markup Policy, 432

Exchange Restrictions, 432

Differential Income Tax Rates, 433

*International Finance in Practice:
Disciplining European Cash: Currency
Volatility Spurs Proactive Cash
Management, 434*

Regulations Affecting Transfer Prices, 434

Import Duties, 436

Unbundling Fund Transfers, 437

Miscellaneous Factors, 438

Blocked Funds, 439

*International Finance in Practice: Taking
Shelter: As Congress Ponders New Tax
Breaks, Firms Already Find Plenty, 440*

Summary, 442

MINI CASE 1: Efficient Funds Flow at Eastern
Trading Company, 444

MINI CASE 2: Eastern Trading Company's
Optimal Transfer Pricing Strategy, 444

MINI CASE 3: Eastern Trading Company's
New MBA, 444

CHAPTER 19

Exports and Imports, 446

A Typical Foreign Trade Transaction, 447

Forfeiting, 449

Government Assistance in Exporting, 449

*The Export-Import Bank and Affiliated
Organizations, 450*

Countertrade, 451

Forms of Countertrade, 451

*Some Generalizations about
Countertrade, 452*

Summary, 453

MINI CASE: American Machine
Tools, Inc., 454

CHAPTER 20
International Tax
Environment, 456

The Objectives of Taxation, 456

Tax Neutrality, 456

Tax Equity, 457

Types of Taxation, 457

Income Tax, 457

Withholding Tax, 459

Value-Added Tax, 459

National Tax Environments, 461

Worldwide Taxation, 461

Territorial Taxation, 461

*International Finance in Practice: The Rise
and Rise of VAT, 462*

Foreign Tax Credits, 462

Organizational Structures for Reducing Tax Liabilities, 464

Branch and Subsidiary Income, 464

Payments to and from Foreign Affiliates, 465

International Finance in Practice: As Dot-Coms Go Bust In U.S., Bermuda Hosts an Odd Little Boomlet, 466

Tax Havens, 468

Controlled Foreign Corporation, 468

Summary, 469

MINI CASE: Sigma Corp.'s Location Decision, 470

CHAPTER 21
Corporate
Governance around
the World, 472

Governance of the Public Corporation: Key
Issues, 472

The Agency Problem, 474

Remedies for the Agency Problem, 476

Board of Directors, 476

*International Finance in Practice: When
Boards Are All in the Family, 477*

Incentive Contracts, 478

Concentrated Ownership, 478

Debt, 479

Overseas Stock Listings, 480

Market for Corporate Control, 480

Law and Corporate Governance, 481

Consequences of Law, 484

Ownership and Control Pattern, 484

Private Benefits of Control, 488

Capital Markets and Valuation, 488

Corporate Governance Reform, 489

Glossary, 497

Index, 505

Objectives of Reform, 489
Political Dynamics, 490
The Cadbury Code of Best Practice, 491
Summary, 492