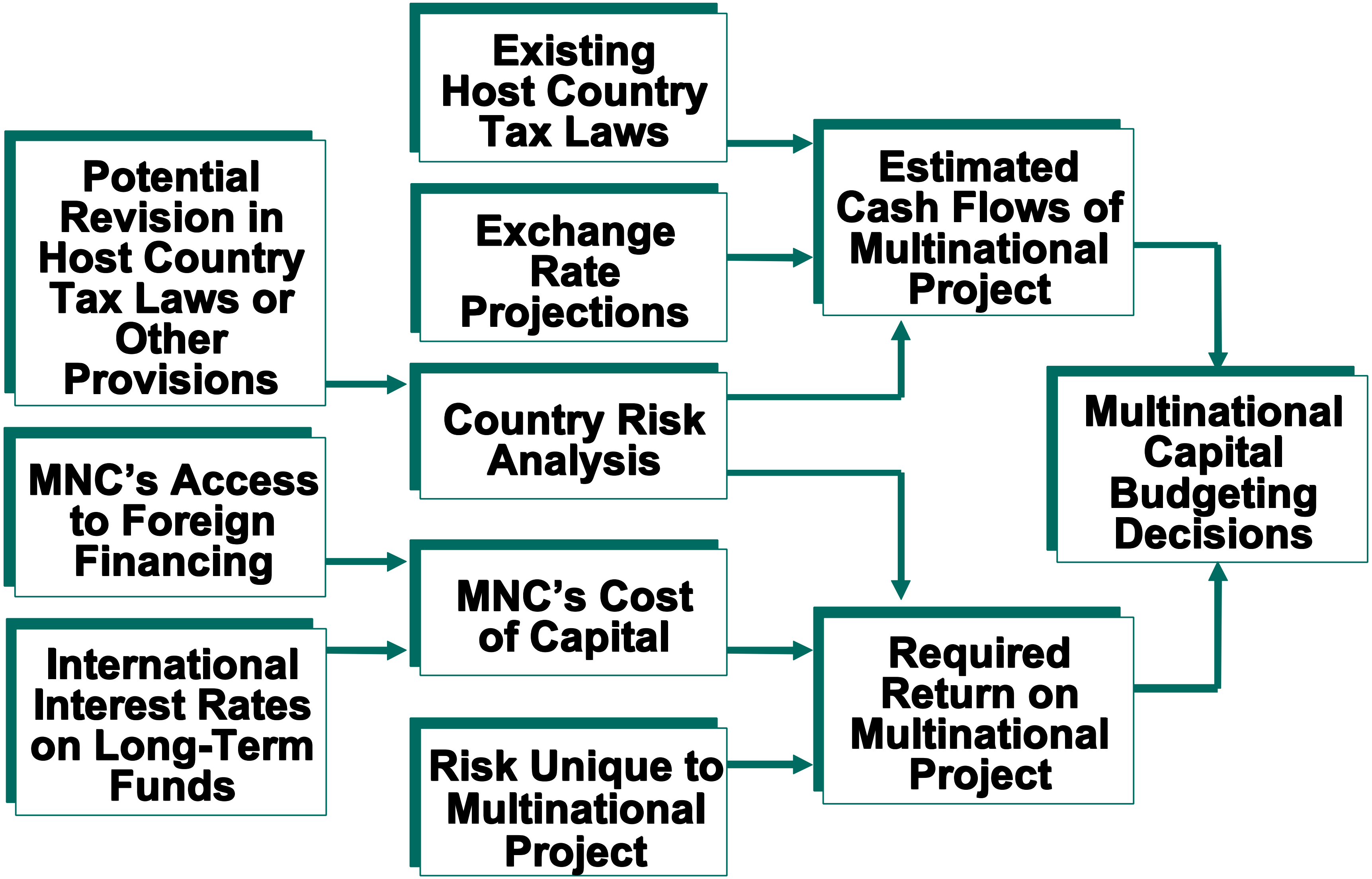
Part IV
Long-Term Asset and Liability Management



Investing in Foreign Enterprises Directly

9

Chapter Nine

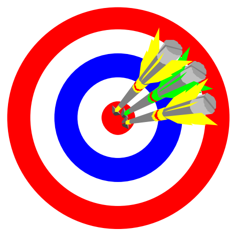
Chapter Objectives:

To describe common motives for initiating direct foreign investment (DFI); and

To illustrate the benefits of international diversification.

Motives for DFI

- MNCs commonly consider DFI because it can improve their profitability and enhance shareholder wealth.
- In most cases, MNCs engage in DFI because they are interested in boosting revenues, reducing costs, or both.



Revenue-Related Motives for DFI

Motives	Means of Achieving Benefit
❶ Attract new sources of demand.	Establish a subsidiary or acquire a competitor in a new market.
❷ Enter profitable markets.	Acquire a competitor that has controlled its local market.
❸ Exploit monopolistic advantages.	Establish a subsidiary in a market where competitors are unable to produce the identical product.
❹ React to trade restrictions.	Establish a subsidiary in a market where trade restrictions will adversely affect export volume.
❺ Diversify internationally.	Establish subsidiaries in markets with different business cycles.

Cost-Related Motives for DFI

Motives	Means of Achieving Benefit
❶ Fully benefit from economies of scale.	Establish a subsidiary in a new market where products produced elsewhere can be sold. This allows for increased production and greater production efficiency.
❷ Use foreign factors of production.	Establish a subsidiary in a market that has lower costs of labor or land. Sell the products elsewhere.
❸ Use foreign raw materials.	Establish a subsidiary in a market where raw materials are cheap and accessible. Sell the products in that market and elsewhere.

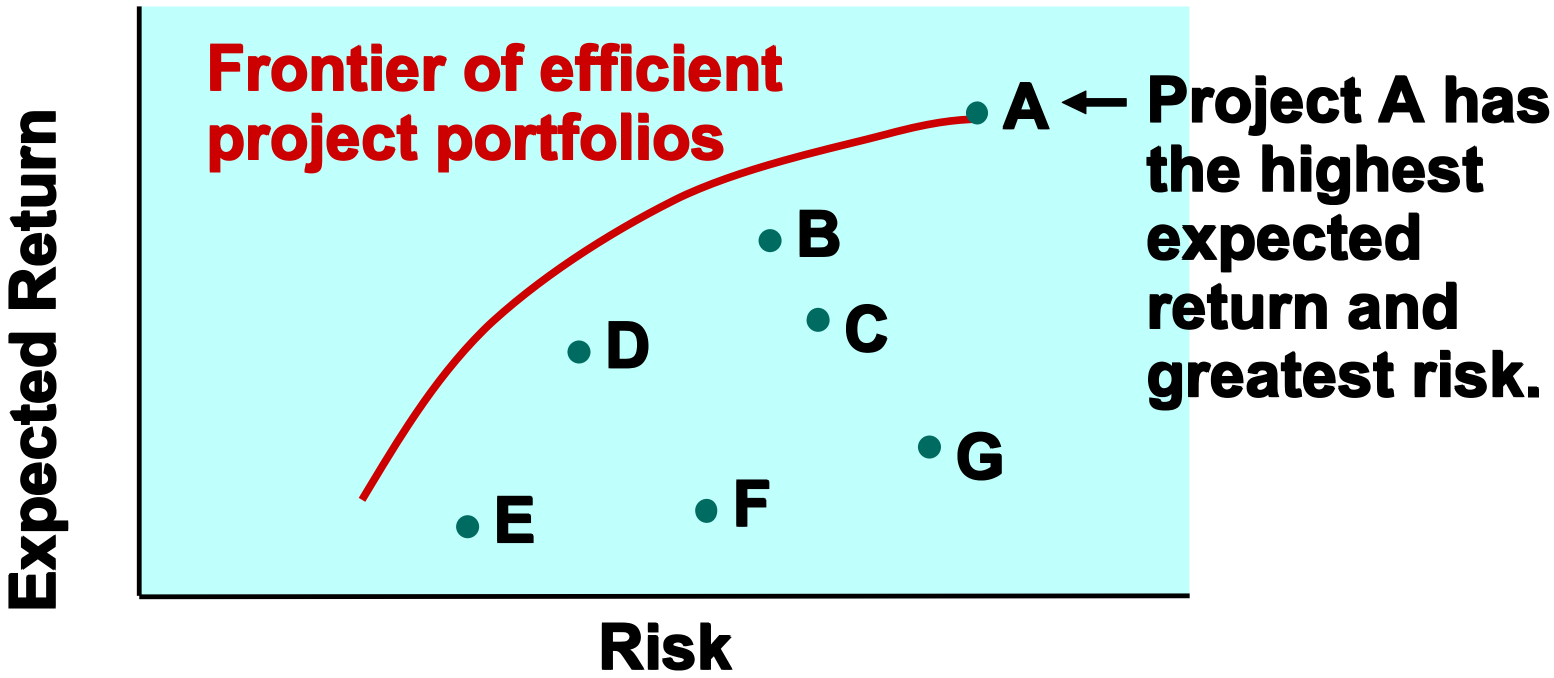
Cost-Related Motives for DFI

Motives	Means of Achieving Benefit
❹ Use foreign technology.	Participate in a joint venture or acquire an existing overseas plant to learn about foreign production processes, so as to improve its own operations.
❺ React to exchange rate movements.	Establish a subsidiary in a new market where the local currency is weak but is expected to strengthen over time.

Diversification Analysis of International Projects

- Like any investor, an MNC with projects positioned around the world is concerned with the risk and return characteristics of the projects.
- The portfolio of all projects reflects the MNC in aggregate.

Risk-Return Analysis of International Projects

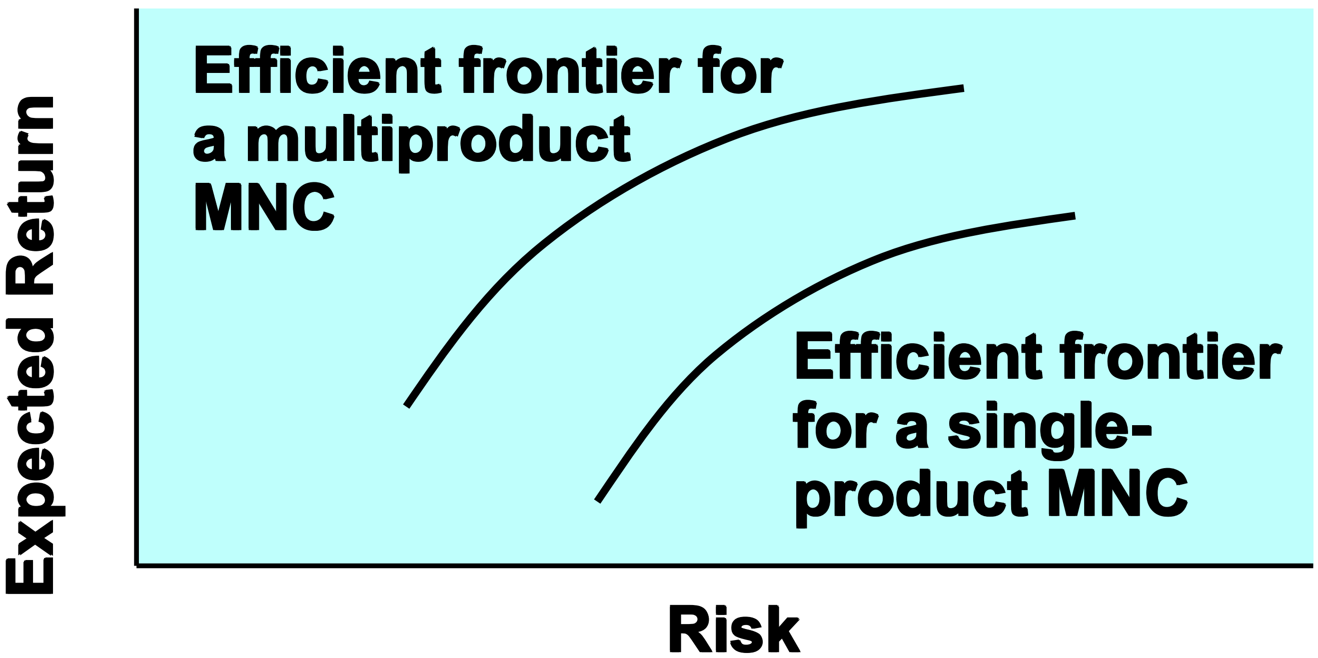


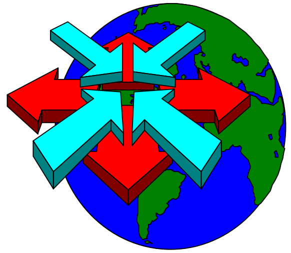
- **When the projects are combined appropriately, the project portfolio may be able to achieve a risk-return tradeoff exhibited by any of the points on the frontier of efficient project portfolios.**

Diversification Analysis of International Projects

- Project portfolios along the efficient frontier exhibit minimum risk for a given expected return.
- Of these efficient project portfolios, an MNC may choose one that corresponds to its willingness to accept risk.
- The actual location of the frontier of efficient project portfolios depends on the business in which the firm is involved.

- Some MNCs have frontiers of possible project portfolios that are more desirable than the frontiers of other MNCs.





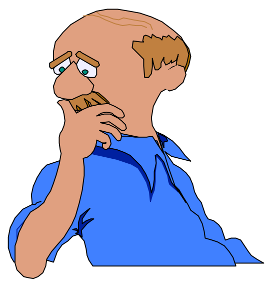
- Our discussion suggests that MNCs can achieve more desirable risk-return characteristics from their project portfolios if they sufficiently diversify among products and geographic markets.

Decisions Subsequent to DFI

- Some periodic decisions are necessary:
  - ¤ Should further expansion take place?
  - ¤ Should the earnings be remitted to the parent, or used by the subsidiary?
- These decisions should be analyzed on a case-by-case basis.

Host Government View of DFI

- Each government must weigh the advantages and disadvantages of DFI in its country.
- The government may provide incentives to encourage desirable forms of DFI, and impose preventive barriers or conditions on other forms of DFI.



Incentives to Encourage DFI

- The ideal DFI solves problems such as unemployment and lack of technology without taking business away from the local firms.
- Common incentives offered by host governments include tax breaks, discounted rent for land and buildings, low-interest loans, subsidized energy, and reduced environmental restrictions.

Barriers to DFI

- Governments are less anxious to encourage DFI that adversely affects local firms, consumers and the economy.
- DFI barriers include regulations governing mergers and acquisitions, restrictions on foreign ownership of local firms, red tape (procedural and documentation requirements), the political influence of local firms, and political instability.