

Chapter

1

Globalization and the Multinational Corporation

QUESTIONS

1. **Define globalization. How has it proceeded in trade in goods and services versus capital markets?**

Answer: Globalization refers to the increasing connectivity and integration of countries and corporations and the people within them in terms of their economic, political, and social activities. Because of globalization, multinational corporations dominate the corporate landscape.

2. **Describe four ways that a company can supply its products to a foreign country. How do they differ?**

Answer: An MNC can supply a foreign market through exports, by licensing local firms abroad to manufacture the company's products, by setting up a joint venture with a foreign company, or by foreign direct investment.

3. **What is a *greenfield investment*?**

Answer: MNCs engage in *greenfield investments* when they enter foreign markets by simply establishing new operations in these countries without having a local partner and without acquiring a local company.

4. **What percentage ownership typically defines FDI?**

Answer: Foreign direct investment (FDI) occurs when a company from one country makes a significant investment that leads to at least a 10% ownership interest in a firm in another country.

5. **What is agency theory? How does corporate governance address the issues raised by agency theory?**

Answer: Agency theory explores the problems that arise because the owners of the firm do not typically manage the firm, and it devises ways to resolve these problems. This is often called the separation of ownership and control. A manager of a firm, in particular the chief executive officer (CEO), is viewed as an agent who contracts with various principals—most importantly the firm’s shareholders but also the firm’s creditors, suppliers, clients, and employees. The principals must design contracts that motivate the agent to perform actions and make decisions that are in the best interests of the principals.

6. Why is ownership more concentrated in developing countries than in developed countries?

Answer: In many developed countries, the rule of law is strong enough to discipline managers through legal means, for example by takeovers and proxy contests or through contractual compensation plans. Concentrated ownership is one way in which agency problems are mitigated in developing countries. A block of stock is held by either a wealthy investor, a family, or a financial intermediary, which might be a bank, a holding company, a hedge fund or a pension fund. The large shareholder clearly has a vested interest in monitoring management and has the power to implement changes in management. Negative aspects of this approach include possible collusion between the large shareholder and the management to expropriate wealth from smaller shareholders and the fact that the stock may be more difficult to trade on the stock market if a substantial block of shares is withdrawn from the market but is still available to be sold should the large shareholder want to sell.

7. What is the IMF? What is its role in the world economy?

Answer: The International Monetary Fund (IMF) is an international organization of 187 member countries, based in Washington, DC, which was conceived at a United Nations conference convened in Bretton Woods, New Hampshire, in 1944. The main goal of the IMF is to ensure the stability of the international monetary and financial system—the system of international payments and exchange rates among national currencies that enables trade to take place between countries, to help resolve crises when they occur, and to promote growth and alleviate poverty. To meet these objectives, the IMF offers *surveillance* and *technical assistance*. Surveillance is the regular dialogue about a country’s economic condition and policy advice that the IMF offers to each of its members. Technical assistance and training are offered to help member countries strengthen their capacity to design and implement effective policies, including fiscal policy, monetary and exchange rate policies, banking and financial system supervision and regulation, and statistics.

8. What is the World Bank? What is its role in the world economy?

Answer: The World Bank is an international institution created in 1944, as the

International Bank for Reconstruction and Development (IBRD) to facilitate postwar reconstruction and development. Over time, the IBRD's focus shifted toward poverty reduction, and in 1960, the International Development Association (IDA) was established as an integral part of the World Bank. Whereas the IBRD focuses on middle-income countries, the IDA focuses on the poorest countries in the world. Together they provide low-interest loans, interest-free credits, and grants to developing countries for investments in education, health, infrastructure, communications, and other activities. The World Bank also provides advisory services to developing countries and is actively involved with efforts to reduce and cancel the international debt of the poorest countries.

9. What are the major multilateral development banks?

Answer: The term typically refers to the World Bank Group and four regional development banks: the African Development Bank, the Asian Development Bank, the European Bank for Reconstruction and Development, and the Inter-American Development Bank. These banks have a broad membership that includes both developing countries (borrowers) and developed countries (donors), and their membership is not limited to countries from the region of the regional development bank. While each bank has its own independent legal and operational status, their similar mandates and a considerable number of joint owners lead to a high level of cooperation among MDBs. The MDBs provide financing for development in three ways. First, they provide long-term loans at market interest rates. To fund these loans, the MDBs borrow on the international capital markets and re-lend to borrowing governments in developing countries. Second, the MDBs offer long-term loans (often termed *credits*) with interest rates set well below market rates. These credits are funded through direct contributions of governments in donor countries. Finally, grants are sometimes offered mostly for technical assistance, advisory services, or project preparation.

10. What is the WTO? What is its role in the world economy?

Answer: The World Trade Organization (WTO) was founded in 1995. It is headquartered in Geneva, Switzerland, and had 153 member countries in 2010. Whereas GATT was a set of rules, the WTO is an institutional body. The WTO expanded its scope from traded goods to trade within the service sector and intellectual property rights. Various WTO agreements set the legal ground rules for international commerce to hopefully ensure that the multilateral trading system operates smoothly. They are negotiated and signed by a large majority of the world's trading nations, and the agreements are ratified in the parliaments of the member countries. If there is a trade dispute between countries, the WTO's dispute settlement process helps interpret the agreements and commitments, and it ensures that countries' trade policies conform to them.

11. What is an institutional investor? Along with individual investors, what do they determine?

Answer: Institutional Investors are organizations that invest pools of money on behalf of individual investors or other organizations. Examples include banks, insurance companies, pension funds, mutual funds, and university endowments. Institutional investors, together with individual investors, determine the prices of bonds and stocks implicitly determining the expected rates of return on these assets thereby setting the MNC's cost of capital. The cost of capital, in turn, affects project valuations, which determines a company's investments.

12. What are anti-globalists?

Answer: Anti-globalization is an umbrella term encompassing separate social movements, united in their opposition to the globalization of corporate economic activity and the free trade with developing nations that results from such activity. Anti-globalists generally believe that global laissez-faire capitalism is detrimental to poor countries and to disadvantaged people in rich countries. Anti-globalists also criticize global financial institutions such as the World Bank, the IMF, and the WTO. Especially under attack is the so-called Washington consensus model of development, which, as promoted by international financial institutions (especially the IMF), is interpreted as requiring macroeconomic austerity, privatization, and a relatively laissez-faire approach to economic management. Anti-globalists believe that these policies exacerbate unemployment and poverty.

13. Who are Ante and Freedy Handel? How do their views on the world economy differ?

Answer: Ante and Freedy Handel are two brothers who discuss various international financial management problems and controversial issues in international finance in *Point-Counterpoint* features. The brothers are enrolled in an international finance class. Ante typically rails against free trade and free markets as he believes financial markets are inefficient and that prices do not necessarily correctly reflect information about a firm's prospects. Freedy believes more in the power of the capitalist system to allocate resources efficiently, and he consequently believes that financial markets by and large get things right.

PROBLEMS

- 1. Go to the Web site of your favorite multinational firm and determine where it operates throughout the world. How many employees does it have worldwide? Has it done any interesting cross-border mergers and acquisitions during the last year?**

Answer: As an example, Siemens, <http://www.siemens.com/investor/en/index.htm>, has an investor relations section in which you can find the current annual and quarterly reports.

Doing a Google search for acquisition will allow you to find the most current acquisitions that the company has done. The company operates in over 190 countries around the world listed on its Web site. There are over 340,000 employees.

2. **Go to UNCTADstat at <http://unctadstat.unctad.org>. Update the data in Exhibit 1.6 on cross-border mergers and acquisitions for the most recent years.**

Answer: UNCTAD provides lots of interesting data on FDI. As of publication of the book in 2011, Exhibit 1.6 was as current as we could get.

3. **Go to the IMF's Web site at www.imf.org and download the 2011 *World Economic Outlook*. Pick your favorite country and determine if this is a good time to invest in it or not.**

Answer: On the IMF's Web site, click on Data and Statistics to find the WEO.

4. **Go to the WTO's Web site at www.wto.org and determine which goods or services are the sources of trade disputes between countries this year.**

Answer: In May 2011, China was appealing the resolution of a dispute with the United States over passenger vehicle and light truck tires, and the Ukraine accused Moldova of protectionism because of certain environmental regulations.