

GLOBAL  
EDITION



# Multinational Business Finance

SIXTEENTH EDITION

David K. Eiteman • Arthur I. Stonehill • Michael H. Moffet



# Multinational Business Finance

Sixteenth Edition  
Global Edition

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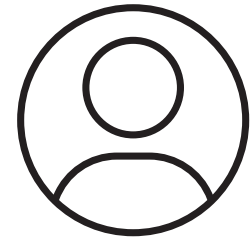
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# Preface

## New to This Edition

Our continuing challenge is to strike a balance between being one of the very first textbooks in this field (and therefore in many ways defining the field) and introducing the many new concepts and components in global business today, from digital currencies to global fintech. We have hopefully found some balance between what is valued by continuing adopters and the valued insights of selected reviewers—the *innovator's dilemma*. Surveys of adopters were extremely useful in this revision, and a number of specific recommendations were included.

- **Corporate Governance, Activists, and Stakeholder Capitalism.** Chapter 4 on corporate governance, including elements of ownership, financial objectives, and the growing role of activist investors, has been revised and expanded. Of special note is the growth of stakeholder capitalism and its multiple objective framework as compared to stockholder wealth maximization.
- **The Impossible Trinity.** A core international financial principle, the *Impossible Trinity's* use as a unifying theoretical link across multiple subjects—whether it be Iceland's financial crisis or choices made by the European Union on capital flows—is increasingly leveraged.
- **The Foreign Exchange Market and Digital Trade.** New material in this edition explores in depth how the changing structure of the global foreign exchange market—trading, communication, and settlement—is posing challenges for private players and public regulators and overseers.
- **Currency Manipulation.** This is a politically charged topic between the U.S. and China, and we explore in depth the motivations, methods, and metrics associated with currency manipulation. Included is a new mini-case that seeks to determine whether China is or is not a currency manipulator.
- **Emerging Market Regimes.** The sixteenth edition offers new insights into the currency and capital regime choices of many emerging market countries; many recognizing that they are trade-dependent economies in search of currency stability in lieu of attracting other capital account elements such as foreign direct investment.
- **International Taxation.** Integrally linked to a world of digital commerce, multinational tax management continues to rise in its significance in multinational financial management. We have expanded our coverage of this critical determinant of global finance, with emphasis on the constantly changing U.S. tax rates and rules.
- **Political Risk and Financial Losses.** The chapter on foreign direct investment and political risk has been revised to reflect the growing use of restrictions on convertibility, transferability, and the possibility of repudiation or expropriation.

## Solving Teaching and Learning Challenges

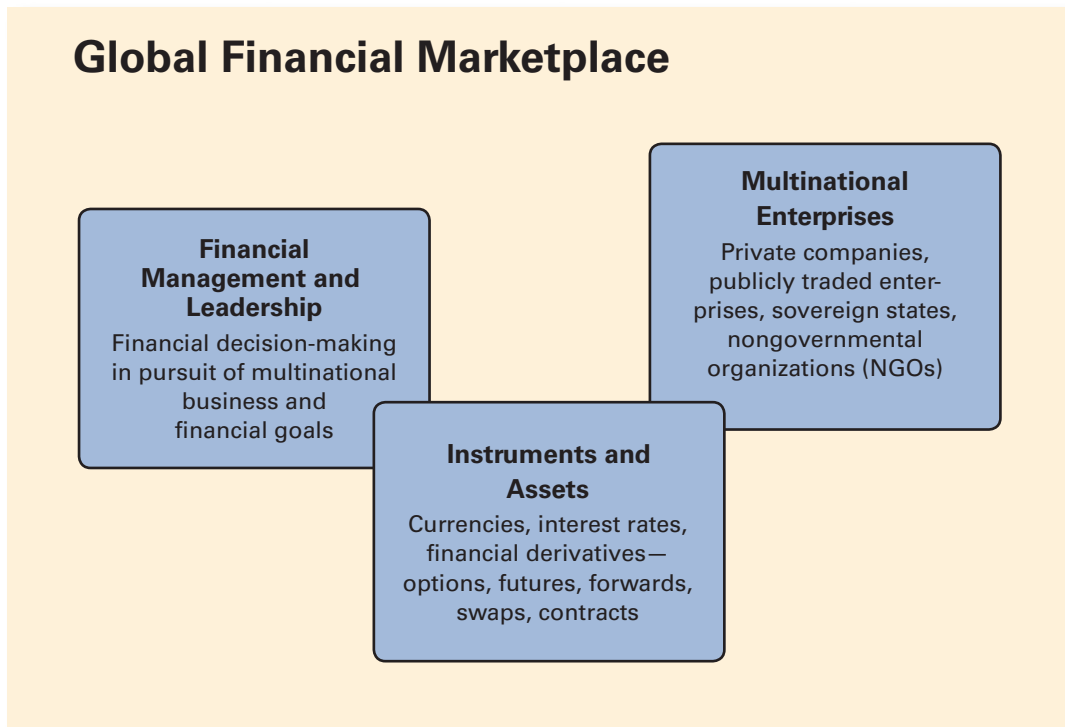
**Multinational Business Finance** is the financial management of multinational enterprises (MNEs)—*multinational financial management*. MNEs are firms and organizations of all kinds and sizes—for-profit companies, family-owned businesses, sovereign states, and nongovernmental organizations (NGOs), among others—that have operations in more than one country and conduct their activities through a multitude of structures and contracts from wholly owned foreign subsidiaries to joint ventures with local or global partners to host governments.

Moreover, global business and finance, all the way down to the trading of currencies, has been revolutionized by digital platforms from electronic trading to the coming introduction of digital currencies, all adding to the complexity of international business.

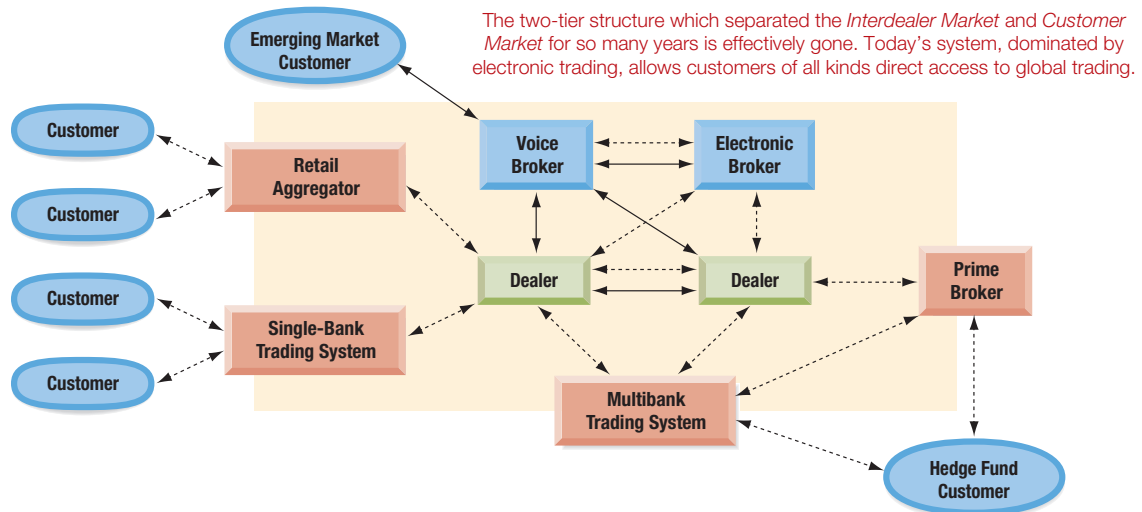
*Multinational Business Finance*, Sixteenth Edition, is aimed at university-level courses in international financial management, international business finance, international finance, and similar titles. It can be used either at the graduate level or in executive education and corporate learning courses.

A prerequisite course or experience in corporate finance or financial management would be ideal. However, we review the basic finance concepts before we extend them to the multinational case. We also review the basic concepts of international economics and international business.

Over many years and many editions, as we ourselves have used the book in courses from Hyderabad to Helsinki to Honolulu, we have observed an ever-widening audience for this book. We continue to try to service this greater global audience with multicountry companies, markets, and challenges, whether in theoretical applications, practice boxes, mini-cases, or end-of-chapter problems.



## EXHIBIT 5.4 The Foreign Exchange Market Today



Constructed by authors based on a number of sources including "Foreign Exchange Market Structure, Players and Evolution," Michael R. King, Carol Osler and Dagfinn Rime, Norges Bank, Working Paper, Research Department, 2011, 10, p. 21, and "The anatomy of the global FX market through the lens of the 2013 Triennial Survey," by Dagfinn Rime and Andreas Schrimpf, *BIS Quarterly Review*, December 2013.

### Organization

*Multinational Business Finance* has been redesigned and restructured for tightness—critical elements of the field but in a much shorter delivery framework. This has been accomplished by integrating a number of previous topics along financial management threads. The book is in five parts, the parts unified by the common thread of the globalization process by which a firm moves from a domestic to a multinational business orientation.

- Part 1 introduces the global financial environment.
- Part 2 explains foreign exchange theory and markets.
- Part 3 explores foreign exchange rate exposure.
- Part 4 details the financing of the global firm.
- Part 5 analyzes international investment decisions.

### Pedagogical Tools

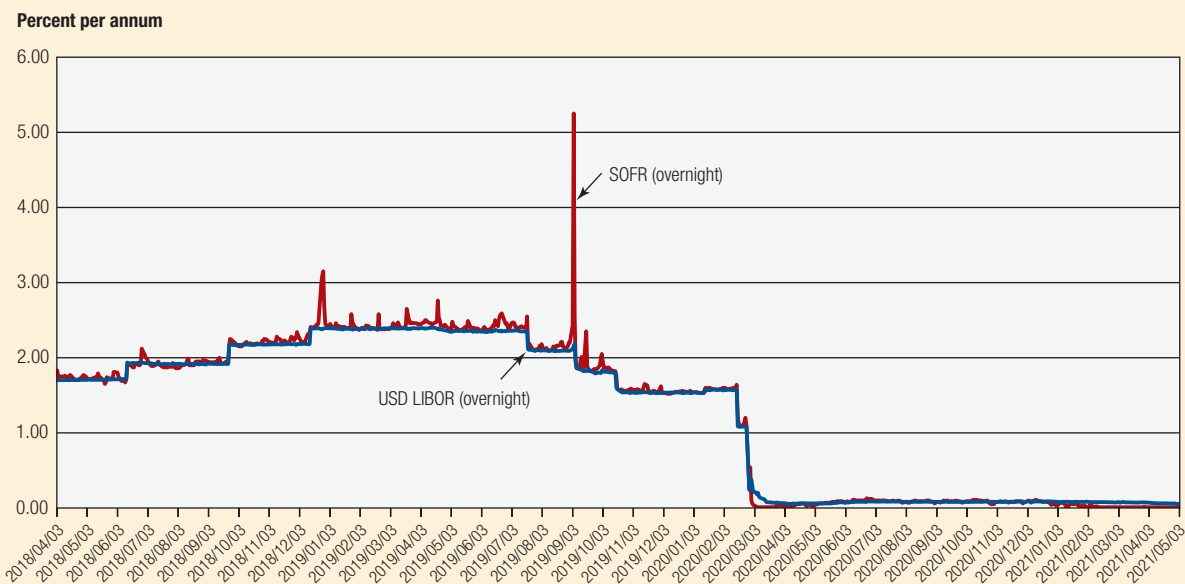
To make the book as comprehensible as possible, we use a large number of proven pedagogical tools. Again, our efforts have been informed by the detailed reviews and suggestions of a panel of professors who are recognized individually for excellence in the field of international finance, particularly at the undergraduate level. Among these pedagogical tools are the following:

- A student-friendly writing style combined with a structured presentation of material, beginning with *learning objectives* for each chapter and ending with a summarization of how those learning objectives were realized.



- A wealth of *illustrations and exhibits* to provide a visual parallel to the concepts and content presented.
- A running case on a hypothetical Ireland-based firm, *Aidan Corporation*, provides a cohesive framework for the multifaceted globalization process and is reinforced in several end-of-chapter problems.
- A *mini-case* at the end of each chapter illustrates the chapter content and extends it to the multinational financial business environment.

### EXHIBIT B Comparison of SOFR and Overnight USD LIBOR



The continuing popularity of our mini-cases has prompted us to introduce 11 new mini-cases in the sixteenth edition. The new topics, among others, include the following:

- **Global fintech.** Global fintech’s continuing role in opening the emerging world to global finance.
- **Digital currencies.** The rise of digital currencies like the Chinese eYuan.
- **Toshiba’s corporate governance challenges.**
- **International remittances.** The role international remittances may play in alleviating global income inequality and opportunity.
- **Replacing LIBOR.** The rationale and complexity of replacing the global financial system’s interest rate centerpiece—LIBOR.
- **Currency volatility.** The rise and fall of currency volatility during the year of COVID.
- **Google tax.** The U.S. development of what many term “the Google tax.”
- **Saudi Aramco.** The initial public offering of the world’s most profitable company, Saudi Aramco.

- **Hostile acquisitions.** A detailed exploration of one of the world’s most hostile international acquisitions, Mittal’s acquisition of Arcelor.
- *Global Finance in Practice* boxes in every chapter highlight how real firms and real managers deal with the never-ending complexity of executing global business deals in a changing marketplace, from the mundane accounts payable to the exceptional expropriation. These applications extend the concepts without adding to the length of the text itself.

## GLOBAL FINANCE IN PRACTICE 13.1

### Brexit and the Cost of Capital

The decision for the United Kingdom to leave the European Union is resulting in more and more companies having a higher cost of capital on both sides of the Channel. A restructuring of the banking sectors in both regions involves direct costs as well as more segmented markets, all at a time when global interest rates—dollar, pound, and euro—are expected to start rising as the post-COVID stimulus programs fall further and further into the past.

**Impacts on Banks.** Banks in the UK are already incurring sizeable restructuring costs. A number of London banks have been moving quickly to move large portions of their operations and jobs to the Continent in an effort to retain clients and market share. London banks are estimating that restructuring costs alone may range between \$200 million and \$400 million. The costs of capital for banks themselves are expected to rise at least 4%, and many are looking to increase their capital bases by more than 30% as they establish European banks to retain Continental clients.

**Impacts on Borrowers.** One of the unintended results is a multitude of banks are reducing their lines of credit and increasing their fees to many of the small to medium-sized enterprises. Companies with annual revenue of up to €10 million

are defined as *small businesses*, and firms with revenue between €10 and €50 million are *medium-sized* according to the European Union. This segment of borrowers is particularly sensitive to these changes as many of these firms use only one bank for the majority of their financial services. Without alternative banks, offering either alternative services or competitive rates, they are starting to feel the impacts of reduced services and increased costs. As a result of rising bank fees and fewer alternatives, borrowers have experienced rising costs of debt.

How this will ultimately impact business activity is hard to say, but early signs from these segments are not encouraging. Some experts, including Professor Aswath Damodaran of New York University’s Stern School of Business, have been encouraging companies to focus on the three drivers of business valuation—cash flows, growth rates, and discount rates—and not fall victim to pessimism. He has characterized Brexit as a “garden variety crisis” that most businesses should endure. A number of firms, however, have cut back on new investment projects. Rising capital costs make fewer prospective investments financially viable. A number of borrowers have noted that their firms will intentionally now work to increase their cash balances—a form of precautionary source of funds—as they fear reduced access to affordable debt.

- A multitude of end-of-chapter questions and problems assess the students’ understanding of the course material. All end-of-chapter problems are solved using spreadsheet solutions. Selected end-of-chapter problem answers are included at the back of this book.
- Numerous mathematical derivations, such as parity conditions, foreign currency option pricing, and complex option products, are placed in appendices. This allows selective use as the student or faculty member feels appropriate.

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# Global Financial Environment

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**Multinational Financial Management:  
Opportunities and Challenges**

## CHAPTER 2

**International Monetary System**

## CHAPTER 3

**The Balance of Payments**

## CHAPTER 4

**Financial Goals, Corporate Governance, and the  
Market for Corporate Control**



# Multinational Financial Management: Opportunities and Challenges

*The objects of a financier are, then, to secure an ample revenue; to impose it with judgment and equality; to employ it economically; and, when necessity obliges him to make use of credit, to secure its foundations in that instance, and forever, by the clearness and candor of his proceedings, the exactness of his calculations, and the solidity of his funds.*

—Edmund Burke, *Reflections on the Revolution in France*, 1790, p. 467.

## LEARNING OBJECTIVES

- 1.1 Explore the global financial marketplace—players and playing field
- 1.2 Consider how the theory of comparative advantage applies to multinational business
- 1.3 Examine how international financial management differs from domestic financial management
- 1.4 Discover the steps and stages of the globalization process

The subject of this book is the financial management of *multinational enterprises* (MNEs)—*multinational financial management*. MNEs are firms—both for-profit companies and not-for-profit organizations—that have operations in more than one country and conduct their business through branches, foreign subsidiaries, or joint ventures with host country firms.

It is a brave new world, a new world in which digital startups may become multinational enterprises in hours, where the number of publicly traded companies on earth is shrinking, where the most challenging competitors are arising from emerging markets, and where more and more value is being created by “idea firms.” The global marketplace is seeing change—radical, disruptive, rapid, whatever terminology you prefer—from the growing role of the Chinese currency, the *yuan*; the continuing recuperative efforts to economies following the global pandemic; or the possible sea change likely to come from the introduction of digital currencies. In 2021 the world even saw the first country, El Salvador, adopt a cryptocurrency, Bitcoin, as legal tender. In the following chapters we will explore everything from how the international financial community is in the process of changing its global benchmark (LIBOR) of the past 50 years, to the changes in currency volatility during the global pandemic, to the entry of the world’s most profitable company (Saudi Aramco) into the public security markets. Change is indeed the constant.

Multinational financial management requires managers and leaders all over the world to identify and navigate the prospective returns and risks of the global financial marketplace. These risks may all occur on the playing field of the global financial marketplace, but they are still a question of management—of navigating complexity in pursuit of the goals of the firm and all of its varied stakeholders.

This first chapter provides a brief overview of the global financial landscape including foreign currency markets and financial institutions—the ground rules and nomenclature of the game. We then explore the foundations of comparative advantage, those forces differentiating international from domestic finance. We conclude our introductory overview with the alternative paths firms may take in going global. The chapter concludes with a mini-case, *Global Fintech*, that examines how financial technology is changing all financial functions and services, how it offers the power to overcome barriers to access and inclusion across the globe, but also how its adoption faces many political and institutional barriers along the way.

## 1.1 The Global Financial Marketplace

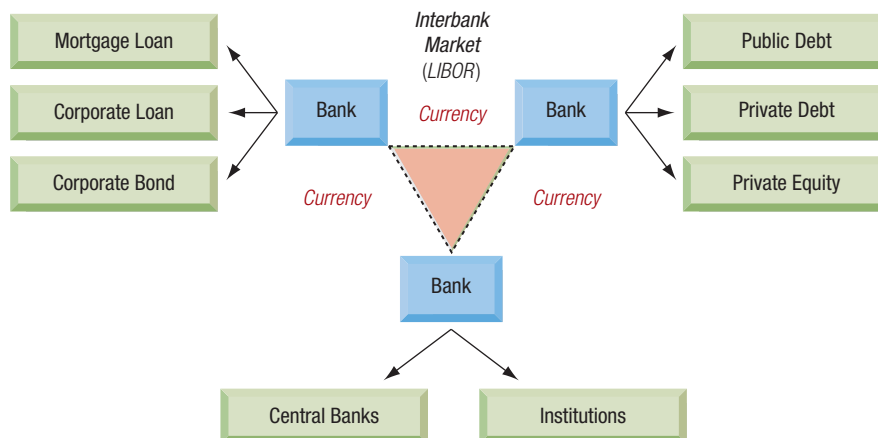
Business—domestic, international, global—involves the interaction of individuals and individual organizations for the exchange of products, services, and capital across markets. The global *capital markets* and business marketplace is in many ways the field of play. This is the landscape upon which the daily activities of global business play out. Like all institutions created by humans, it is constantly changing, yet certain fundamental components rarely change. We begin by exploring the institutional and behavioral landscape of global business—specifically, the organizations and assets that make up the global financial marketplace.

### Assets, Institutions, and Linkages

Exhibit 1.1 provides an overview of the global capital markets. One way to characterize the global financial marketplace is through its securities and institutions, all linked through the interbank market.

#### EXHIBIT 1.1 Global Capital Markets

The global capital market is a collection of institutions (central banks, commercial banks, investment banks, not-for-profit financial institutions like the IMF and World Bank) and securities (bonds, mortgages, derivatives, loans, etc.), which are all linked via a global network—the *Interbank Market*. This interbank market is the critical pipeline system for the movement of capital



The exchange of securities, the movement of capital in the global financial system, must all take place through a vehicle—currency. The exchange of currencies is itself the largest of the financial markets. The interbank market, which must use currencies, bases its pricing through the single most widely quoted interest rate in the world—LIBOR (the London Interbank Offered Rate).

**Securities.** The securities—financial assets—at the heart of the global capital markets are the debt securities issued by highly industrialized country governments (e.g., U.S. Treasury Bonds, U.K. gilts). These low-risk or risk-free securities form the foundation for the creation, trading, and pricing of other financial securities like bank loans, corporate bonds, and equities (stock). In recent years, a number of additional securities—derivatives—have been created from existing securities, the value of which is based on market value changes of the underlying securities. The health and security of the global financial system rely on the quality of these securities.

**Institutions.** The institutions of global finance are the central banks, which create and control each country's money supply; the commercial banks, which take deposits and extend loans to businesses, both local and global; and the multitude of other financial institutions created to trade securities and derivatives. These institutions take many shapes and are subject to many different regulatory frameworks. The health and security of the global financial system rely on the stability of these financial institutions.

**Linkages.** The links between the financial institutions, the actual fluid or medium for exchange, are the interbank networks using currency. The ready exchange of currencies in the global marketplace is the first and foremost necessary element for the conduct of financial trading, and the global currency markets are the largest markets in the world. The exchange of currencies, and the subsequent exchange of all other securities globally via currency, is the international interbank market. This network, whose primary price is the London Interbank Offered Rate (LIBOR), is the core component of the global financial system. (In Chapter 8 we will examine the international effort to replace LIBOR and what it may mean for financial instruments and markets.)

The movement of capital across currencies and continents for the conduct of business has existed in many different forms for thousands of years. Yet it is only within the past 50 years that the velocity of these capital movements has increased to the pace of an electron in the digital marketplace. And it is only within the past 20 years that this market has been able to reach the most distant corners of the earth at any moment of the day. The result has been an explosion of innovative products and services—some for better and some for worse.

## The Market for Currencies

The price of any one country's currency in terms of another country's currency is called a *foreign currency exchange rate*. For example, the exchange rate between the U.S. dollar (indicated by the symbols \$ or USD) and the European euro (€ or EUR) may be stated as “1.1274 dollars per euro” or simply abbreviated as  $\$1.1274 = \text{€}1.00$ . This exchange rate can also be stated as “USD1.1274 = EUR1.00” using the three-digit ISO codes. Since most international business activities require at least one of the two parties in a business transaction to either pay or receive payment in a currency that is different from their own, an understanding of exchange rates is critical to the conduct of global business.

**Currency Symbols.** As noted, USD and EUR are often used as the symbols for the U.S. dollar and the European Union's euro. These are the computer symbols (ISO-4217 codes) used today on the world's digital networks. The financial press, however, has a rich history of using a variety of different symbols, and a variety of different abbreviations are commonly used. For example, the British pound sterling may be indicated by £ (the pound symbol), GBP (Great Britain pound), STG (British pound sterling), ST£ (pound sterling), or UKL or UK£ (United Kingdom pound). This book uses both the simpler common symbols—the \$ (dollar), the € (euro), the ¥ (yen), the £ (pound)—and the three-letter ISO codes.

**Exchange Rate Quotations and Terminology.** Exhibit 1.2 lists currency exchange rates for June 19, 2021, as would be quoted in New York or London. Each exchange rate listed is for a specific country's currency against the U.S. dollar, the euro, and the British pound. The

**EXHIBIT 1.2 Selected Global Currency Exchange Rates for June 18, 2021**

Country	Currency	Symbol	Code	Currency to equal 1 Dollar	Currency to equal 1 Euro	Currency to equal 1 Pound
Argentina	nuevo peso	Ps	ARS	95.3800	113.1875	131.8533
Australia	dollar	A\$	AUD	1.3342	1.5833	1.8444
Brazil	real	R\$	BRL	5.0522	5.9949	6.9800
Canada	dollar	C\$	CAD	1.2406	1.4722	1.7150
Chile	peso	\$	CLP	743.68	882.53	1,028.06
China	yuan	¥	CNY	6.4500	7.6542	8.9165
Czech Republic	koruna	Kc	CZK	21.5280	25.5470	29.7600
Denmark	krone	Dkr	DKK	6.2649	7.4346	8.6606
Eurozone	euro	€	EUR	0.8424	1.0000	1.1645
Hong Kong	dollar	HK\$	HKD	7.7643	9.2116	10.7295
Hungary	forint	Ft	HUF	299.730	355.760	414.240
India	rupee	Rs	INR	74.083	87.914	102.412
Indonesia	rupiah	Rp	IDR	14,495.25	17,052.88	19,865.09
Israel	shekel	Shk	ILS	3.2795	3.8889	4.5266
Japan	yen	¥	JPY	110.38	130.99	152.59
Kuwait	dinar	KD	KWD	0.2971	0.3524	0.4104
Malaysia	ringgit	RM	MYR	4.1370	4.9123	5.7190
Mexico	new peso	\$	MXN	20.6905	24.5534	28.6025
Morocco	dirham	DH	MAD	8.7967	10.4350	12.1501
New Zealand	dollar	NZ\$	NZD	1.4397	1.7095	1.9905
Norway	krone	NKr	NOK	8.6678	10.2861	11.9824
Pakistan	rupee	Rs	PKR	153.1770	181.7477	211.5997
Philippines	peso	?	PHP	47.8400	56.7228	66.0317
Peru	new sol	SI	PEN	3.7814	4.4856	5.2229
Poland	zloty	zl	PLN	3.8335	4.5519	5.3002
Russia	ruble	R	RUB	72.4350	86.0093	100.1470
Saudi Arabia	riyal	—	SAR	3.7117	4.4009	5.1231
Singapore	dollar	S\$	SGD	1.3441	1.5960	1.8584
South Africa	rand	R	ZAR	14.2702	16.9344	19.7271
South Korea	won	W	KRW	1,134.93	1,347.12	1,568.35
Sweden	krona	SKr	SEK	8.6176	10.2310	11.9147
Switzerland	franc	Fr.	CHF	0.9217	1.0938	1.2742
Taiwan	dollar	T\$	TWD	27.8020	33.0121	38.4390
Thailand	baht	B	THB	31.4700	37.3675	43.5100
Turkey	lira	YTL	TRY	8.7136	10.3465	12.0474
United Arab Emirates	dirham	—	AED	3.6726	4.3583	5.0770
United Kingdom	pound	£	GBP	0.7236	0.8582	1.0000
United States	dollar	\$	USD	1.0000	1.1867	1.3824
Vietnam	dong	d	VND	22,450.00	26,618.45	30,986.89

Note that a number of different currencies use the same symbol. (For example, both China and Japan have traditionally used the ¥ symbol, yen or yuan, meaning “round” or “circle.”) All quotes are mid rates and are drawn from the *Financial Times*.

rate listed is termed a “midrate” because it is the middle or average of the rates at which currency traders buy currency (*bid rate*) and sell currency (*offer rate*).

The U.S. dollar has been the focal point of currency trading since the 1940s. As a result, most of the world’s currencies are quoted against the dollar—Mexican pesos per dollar, Brazilian real per dollar, Hong Kong dollars per dollar, etc. They are also frequently quoted against other major world currencies like the euro and pound. For example, the Japanese yen is commonly quoted against the dollar, euro, and pound, as ¥110.38 = \$1.00, ¥130.99 = €1.00, and ¥152.59 = £1.00, as illustrated in Exhibit 1.2.

**Quotation Conventions.** Several of the world’s major currency exchange rates follow a specific quotation convention that is the result of tradition and history. The exchange rate between the U.S. dollar and the euro is always quoted as “dollars per euro” or \$ = €1.00—for example, \$1.1867 listed in Exhibit 1.2 for “United States.” Similarly, the exchange rate between the U.S. dollar and the British pound is always quoted as “dollars per pound” or \$ = £1.00—for example, \$1.3824 listed for “United States” in Exhibit 1.2. In addition, countries that were formerly members of the British Commonwealth will often be quoted against the U.S. dollar, as in U.S. dollars per Australian dollar.

*Global Finance in Practice 1.1* introduces the topic that is fundamental to this entire field of study, the quotation of currencies.

If exchange rates never changed, the global financial marketplace would be a much kinder, simpler place. But, alas, that is not the case. Exchange rates change, and when they do, they alter the business results and competitiveness of all players on the playing field. As illustrated in the following section, it requires a careful calculation of even the amount of the change—percentage change.

## GLOBAL FINANCE IN PRACTICE 1.1

### Exchange Rate Quotations

Foreign exchange rate refers to the per unit value of a given currency in terms of another currency. Seemingly a very simple concept—except it is not. For example, on October 7, 2022, the following were the spot currency quotes across three major business and financial data sources for the value of the British pound sterling (GBP) in terms of the Chinese renminbi (CNY):

<i>Financial Times</i>	GBPCNY	7.8467
<i>Bloomberg</i>	GBP-CNY	7.8259
<i>Xe.com</i>	GBP/CNY	7.8819

To be clear, all three are saying nearly the same thing: that the value of one British pound is equivalent to seven renminbi and 85 fen (one hundred fen equals one renminbi). However, there are some unique characteristics that highlight the differences.

- First, they use the three-letter ISO-4217 code for each currency. For example, GBP instead of British pound sterling or £, or CNY instead of renminbi or ¥. This is how the rates are expressed in the financial markets. Yet, many news organizations and contemporary media still commonly use symbols like £, \$, €, or ¥.
- Second, the order of the currency codes is the same, GBP and then CNY. In this standardized format the first currency (GBP) is the “base” currency and the second currency (CNY) is known as the “underlying” currency. A standardized

quote provides the value of one unit of the base currency in terms of the underlying currency. This makes it easy to list currencies in tables and databases as it eliminates the need for details like “Renminbi per pound.”

- Third, all these quotes are different from the way currencies were quoted for decades, when the common way to express these would have been ¥ 7.8259/£, spoken as ¥7.8259 per pound.

Our objective in this book is to both educate and inform the reader with how international finance is conducted and communicated in the modern world. That means we will use both forms of currency symbols, the ISO-4217 codes and symbols like £, \$, and ¥. In certain cases, you may note that the same symbol is used for more than one currency. For Example, the U.S. dollar, Singapore dollar, and Australian dollar use the same symbol, \$. The standardized ISO-4217 codes eliminate this confusion (USD, SGD, and AUD).

The final difference is that the quotes rates are slightly different from each other. This is because the forex market is the only financial market that operates 24×7 as at least one currency zone is always operating at any given point in time. Also, different organizations use different sources to obtain their rates and sometimes the markets may not be in perfect sync with each other. However, it is much more complex than this, a subject best left for Chapter 5. Now back to your previously scheduled program.

## Percentage Change in Spot Exchange Rates

Assume that the Mexican peso has recently changed in value from MXN 16.00 = USD 1.00 to MXN 20.00 = USD 1.00. If your home currency is the U.S. dollar (USD), what is the percent change in the value of the Mexican peso (MXN)? The calculation depends upon the designated home currency.

**Foreign Currency Terms.** When the foreign currency price (the price, MXN) of the home currency (the unit, USD) is used, Mexican pesos per U.S. dollar in this case, the formula for the percent change (%Δ) in the foreign currency becomes

$$\% \Delta = \frac{\text{Begin rate} - \text{End rate}}{\text{End rate}} \times 100 = \frac{\text{MXN}16.00 - \text{MXN}20.00}{\text{MXN}20.00} \times 100 = -20.00\%$$

The Mexican peso fell in value 20% against the dollar. Note that it takes more pesos per dollar, and the calculation resulted in a negative value, both characteristics of a fall in value.

**Home Currency Terms.** When the home currency price (the price, USD) for a foreign currency (the unit, MXN) is used—the reciprocals of the foreign exchange quotes above—the formula for the percent change in the foreign currency is

$$\% \Delta = \frac{\text{End rate} - \text{Begin rate}}{\text{Begin rate}} \times 100 = \frac{\text{USD}0.05000 - \text{USD}0.06250}{\text{USD}0.06250} \times 100 = -20.00\%$$

The calculation yields the identical percentage change, a fall in the value of the peso by -20%. Many people find the home currency terms calculation to be the more intuitive because it reminds them of a general percentage change calculation (ending value less beginning value over beginning value); however, one must be careful to remember that these are exchanges of currency for currency, and the currency that is designated as the home currency is important.

The fall of the Argentine peso in 2015 serves as a clear example of percentage change. On December 16, 2015, the government of Argentina announced it would lift currency controls; it would no longer restrict the ability of its citizens to move money out of the country. Over the next 24 hours, as Argentinians took advantage of this new freedom, the value of the Argentine peso fell from ARG 9.7908 per U.S. dollar to 13.6160, as pesos poured out of Argentina into the foreign exchange markets.

$$\% \Delta = \frac{\text{Begin rate} - \text{End rate}}{\text{End rate}} \times 100 = \frac{\text{ARG}9.7908 - \text{ARG}13.6160}{\text{ARG}13.6160} \times 100 = -28\%$$

After the 28% drop in the value of the peso against the U.S. dollar, the peso stabilized. But a fall in its value of that magnitude, 28%, was both dramatic and devastating for some. The change in exchange rates is the first example of our next subject—*risk*.

## Financial Globalization and Risk

*Back in the halcyon pre-crisis days of the late 20th and early 21st centuries, it was taken as self evident that financial globalization was a good thing. But the subprime crisis and eurozone dramas are shaking that belief. . . what is the bigger risk now—particularly in the eurozone—is that financial globalization has created a system that is interconnected in some dangerous ways.*

—“Crisis Fears Fuel Debate on Capital Controls,” Gillian Tett, *Financial Times*, December 15, 2011.

Much of the discussion dominating global financial markets today is centered on the complexity of risks associated with *financial globalization*—the discussion goes far beyond whether such globalization is simply good or bad and encompasses ways to lead and manage multinational firms in the rapidly moving marketplace. The following is but a sampling of risks that must be explored, considered, and—ultimately—*managed*.

- The international monetary system, an eclectic mix of floating and managed fixed exchange rates, is under constant scrutiny. The rise of the Chinese renminbi is changing much of the world's outlook on currency exchange, reserve currencies, and the roles of the dollar and the euro (see Chapter 2).
- Large fiscal deficits, including the continuing eurozone crisis, plague most of the major trading countries of the world, complicating fiscal and monetary policies and, ultimately, leading to the use of negative interest rates in an attempt to stimulate economies and protect currencies (see Chapter 3).
- Many countries experience continuing balance of payments imbalances and, in some cases, dangerously large deficits and surpluses—whether it be the twin surpluses enjoyed by China, the current account surplus of Germany, or the continuing current account deficits of the United States and United Kingdom, all will inevitably move exchange rates (see Chapter 3).
- Ownership and governance vary dramatically across the world. The publicly traded company is not the dominant global business organization; the privately held firm or the state-owned enterprise dominates in many countries, changing corporate objectives and expectations for financial performance (see Chapter 4).
- Global capital markets that normally provide the means to lower a firm's cost of capital and, even more critically, increase the availability of capital, have in many ways shrunk in size and have become less open and accessible to many of the world's organizations (see Chapter 2).
- Today's emerging markets are confronted with a new dilemma: the problem of first being the recipients of capital inflows and then of experiencing rapid and massive capital outflows. Financial globalization has resulted in the ebb and flow of capital into and out of both industrial and emerging markets, greatly complicating financial management (Chapters 5 and 8).

## Eurocurrencies and Eurocurrency Interest Rates

One of the major linkages of global money and capital markets is the eurocurrency market.

**Eurocurrencies.** *Eurocurrencies* are domestic currencies of one country on deposit in a second country. For example, a U.S. dollar deposit in a British bank, a eurodollar deposit, is one type of eurocurrency. Banks will pay interest on these deposits—eurocurrency interest—depending on the agreed-upon maturity—a period ranging from overnight to more than a year or longer. Eurocurrency deposits are digitally transferred between banks.

The eurocurrency market serves two valuable purposes: (1) eurocurrency deposits are an efficient and convenient money market device for holding excess corporate liquidity; and (2) the eurocurrency market is a major source of short-term bank loans to finance corporate working capital needs, including the financing of imports and exports.

Any *convertible currency* can exist in “euro” form. Note that this use of the “euro” prefix should not be confused with the European currency called the euro. The eurocurrency market includes eurosterling (British pounds deposited outside the United Kingdom), euroeuros (euros on deposit outside the eurozone), euroyen (Japanese yen deposited outside Japan), and *eurodollars* (U.S. dollars deposited outside the U.S.).