Multinational Financial Management: Overview

Multinational corporations (MNCs) are defined as firms that engage in some form of international business. Their managers conduct international financial management, which involves international investing and financing decisions that are intended to maximize the value of the MNC. The goal of their managers is to maximize the value of the firm, which is similar to the goal of managers employed by domestic companies. Initially, firms may merely attempt to export products to a particular country or import supplies from a foreign manufacturer. Over time, however, many of them recognize additional foreign opportunities and eventually establish subsidiaries in foreign countries. Dow Chemical, IBM, Nike, and many other firms have more than half of their assets in foreign countries. Some businesses, such as ExxonMobil, Fortune Brands, and Colgate-Palmolive, commonly generate more than half of their sales in foreign countries. A prime example is the Coca-Cola Co., which distributes its products in more than 160 countries and uses 40 different currencies. Over 60 percent of its total annual operating income is typically generated outside the United States. Even smaller U.S. firms commonly generate more than 20 percent of their sales in foreign markets, including AMSCO International (Pennsylvania), Ferro (Ohio), Interlake (Illinois), Medtronic (Minnesota), Sybron (Wisconsin), and Synoptics (California). These U.S. firms that conduct international business tend to focus on the niches that have made them successful in the United States. Seventy-five percent of U.S. firms that export have fewer than 100 employees. International financial management is important even to companies that have no international business because these companies must recognize how their foreign competitors will be affected by movements in exchange rates, foreign interest rates, labor costs, and inflation. Such economic characteristics can affect the foreign competitors' costs of production and pricing policies. This chapter provides background on the goals of an MNC and the potential risk and returns from engaging in international business.

Management Structure of an MNC

The magnitude of agency costs can vary with the management style of the MNC. A centralized management style, as illustrated in the top section of Exhibit 1.1, can reduce agency costs because it allows managers of the parent to control foreign subsidiaries and therefore reduces the power of subsidiary managers. However, the parent's managers may make poor decisions for the subsidiary if they are not as informed as subsidiary managers about financial characteristics of the subsidiary.