CORPORATE STRATEGY AND FOREIGN DIRECT INVESTMENT

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CHAPTER OVERVIEW:

I. THEORY OF THE MULITNATIONAL CORPORATION

II. THE STRATEGY OF MULTINATIONAL ENTERPRISE

III. DESIGNING A GLOBAL EXPANSION STRATEGY

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I. THE THEORY OF THE MULTINATIONAL CORPORATION

A. The MNC as an Oligopolist: Why FDI?

1. When is FDI justified?
2. Internalization
3. Market Integration
   a. Vertical
   b. Horizontal

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B. Financial Market Imperfections

1. Hypothesis

2. Diversification Effect of the MNC

II. THE STRATEGY OF THE MNC

A. Three strategies:

1. That of the Innovation-based MNC

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Strategies (con't)

2. That of the mature MNC
   a. the importance of economies of scale and
   b. economies of scope
3. The senescent MNC
   a. global scanning capability
   b. the role of rationalization and integration.

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4. FDI and Survival
   a. Cost reduction
   b. Economies of scale
   c. Multiple sourcing
   d. Keeping domestic customers

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III. DESIGNING A GLOBAL EXPANSION STRATEGY

5 Necessary Elements:

1. Awareness of profitable investments
   -building competitive advantage
2. Selecting a mode of entry
   -evaluate systematically

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5 Necessary Elements (con't)

3. Adjusting the Effectiveness of the Entry Mode
   - continual auditing
4. Using appropriate evaluation criteria
5. Estimating the longevity of competitive advantage:
   a. Develop competitive strength transferable overseas.
   b. Not easily duplicated

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I. THE BENEFITS OF INTERNATIONAL EQUITY INVESTING

A. Advantages

1. Offers more opportunities than a domestic portfolio only
2. Larger firms often are overseas

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B. International Diversification

1. Risk-return tradeoff:

may be greater

basic rule-

the broader the diversification,

more stable the returns and the more diffuse the risk.

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2. International diversification and systematic risk
   a. Diversifying across nations with different economic cycles
   b. While there is systematic risk within a nation, it may be nonsystematic and diversifiable outside the country.

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3. Recent History
   a. National stock markets have wide differences in returns and risk.
   b. Emerging markets have higher risk and return than developed markets.
   c. Cross-market correlations have been relatively low.

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C. Correlations and the Gains From Diversification

1. Correlation of foreign market betas

$$\text{Foreign market beta} = \text{Correlation with U.S. market} \times \frac{\text{Std dev for mkt.}}{\text{std dev U.S mkt.}}$$

Past empirical evidence suggests inter-national diversification reduces portfolio risk.

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3. Theoretical Conclusion

   International diversification pushes out the efficient frontier.

4. Calculation of Expected Return:

$$r_p = a\, r_{US} + (1 - a)\, r_{rw}$$

where r_p = portfolio expected return

r_{US} = expected U.S. market return

r_{rw} = expected global return

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5. Calculation of Expected Portfolio Risk (σ_P)

$$\sigma_P = [a^2 \sigma_{US}^2 + (1-a)^2 \sigma_{rw}^2 + 2a(1-a)\, \sigma_{US}\sigma_{rw}\, \sigma_{US,rw}]^{1/2}$$

where $\sigma_{US,rw}$ = the cross-market correlation

σ_{US}^2 = U.S. returns variance

σ_{rw}^2 = World returns variance

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6. Cross-market correlations
   a. Recent markets seem to be most correlated when volatility is greatest
   b. Result:

      Efficient frontier retreats

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D. Investing in Emerging Markets

a. Offers highest risk and returns

b. Low correlations with returns elsewhere

c. As impediments to capital market mobility fall, correlations are likely to increase in the future.

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E. Barriers to International Diversification

1. Segmented markets
2. Lack of liquidity
3. Exchange rate controls
4. Less developed capital markets
5. Exchange rate risk
6. Lack of information
   a. readily accessible
   b. comparable

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F. Methods to Diversify

1. Trade in American Depository Receipts (ADRs)
2. Trade in American shares
3. Trade internationally diversified mutual funds:
   - a. Global
   - b. International
   - c. Single-country

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II. INTERNATIONAL BOND INVESTING

-internationally diversified bond portfolios offer superior performance

A. Empirical Evidence

1. Foreign bonds provide higher returns
2. Foreign portfolios outperform purely domestic

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III. OPTIMAL INTERNATIONAL ASSET ALLOCATION

-a diversified combination of stocks and bonds

A. Offered better risk-return tradeoff

B. Weighting options flexible

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IV. MEASURING TOTAL RETURNS FROM FOREIGN PORTFOLIOS

A. Bonds

Dollar return	=	Foreign currency return	x	Currency gain (loss)

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Bond return formula:

$$1 + R_{\$} = \left[\frac{1 + B(1) - B(0) + C}{B(0)} \right] (1+g)$$

where $R_{\$}$ = dollar return

$B(1)$ = foreign currency bond price at time 1

C = coupon income

g = depreciation/appreciation

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B. Stocks (Calculating return)

Formula:

$$1 + R_{\$} = \left[\frac{1 + P(1) - P(0) + D}{P(0)} \right] (1+g)$$

where $R_{\$}$ = dollar return

$P(1)$ = foreign currency stock price at time 1

D = foreign currency annual dividend