PART 1

Global Financial Environment

Part 1 is an introduction to the global financial environment in which the multinational enterprise (MNE) exists.

CHAPTER 1 describes the globalization process experienced by Trident, a hypothetical MNE that is used as an example throughout the book. It starts as a domestic firm, enters the international trade phase, and then expands its operations to an overseas location, thereby becoming an MNE. During this globalization process, Trident’s management must understand the theories and activities introduced in Chapter 1 and explained in the rest of this book. Thus, we eventually examine foreign exchange theory and markets, foreign exchange exposure and management, financing the global firm, the foreign investment decision, and management of working capital, taxes, and international trade finance. Chapter 1 continues with an analysis of management goals. This involves a description of the shareholder versus corporate wealth maximization behavior, corporate operational goals, corporate governance, failures in corporate governance, and reform.

CHAPTER 2 defines currency terminology. It describes the history of the international monetary system from 1876 to the present. It introduces the Eurocurrency market and LIBOR. It then compares contemporary currency regimes (systems) and the special case of emerging market currency regimes, including currency boards and dollarization. Chapter 2 concludes with a detailed examination of European monetary unification resulting in the launch of the new currency — the euro.
CHAPTER 3 examines the balance of payments. We analyze each account and the most important summary accounts. It explains why the balance of payments always “balances.” It then presents the detailed U.S. balance of payments accounts for the 1998–2002 period. It concludes with an analysis about how the balance of payments interacts with such key macroeconomic variables as gross domestic product, the exchange rate, interest rates, and inflation rates.
LEARNING OBJECTIVES

Consider how the globalization process moves a business from a purely domestic focus in its financial relationships and composition to one truly global in scope.

Learn what the implications of phase one of globalization — the international trade phase — means for the risks and returns of a business.

Discover what three major corporate currency exposures arise from multinational business.

Examine how the continuing globalization process extends from international trade to multinational operations to global activities.

Examine how financial and operational goals are perceived in a global context.

See how globalization affects corporate governance of the organization and how it creates value for its stakeholders.

Investigate failures in global corporate governance.
This book is about international financial management with special emphasis on the *multinational enterprise* (MNE). The MNE is defined as one that has operating subsidiaries, branches, or affiliates located in foreign countries. It also includes firms in service activities such as consulting, accounting, construction, legal, advertising, entertainment, banking, telecommunications, and lodging.

MNEs are headquartered all over the world. Many of them are owned by a mixture of domestic and foreign shareholders. The ownership of some firms is so dispersed internationally that they are known as transnational corporations. The transnationals are usually managed from a global perspective rather than from the perspective of any single country.

Although *Fundamentals of Multinational Finance* emphasizes MNEs, purely domestic firms also often have significant international activities. These include the import and export of products, components, and services. Domestic firms can also license foreign firms to conduct their foreign business. They have exposure to foreign competition in their domestic market. They also have indirect exposure to international risks through their relationships with customers and suppliers. Therefore, domestic firm managers need to understand international financial risk, especially those related to foreign exchange rates and the credit risks related to trade payments.

*Fundamentals of Multinational Finance* is written in English and usually uses the U.S. dollar in its exposition. However, the authors have tried to make it relevant for all multinational enterprises by using numerous non-U.S.-based MNEs. We use the term *multinational enterprise* throughout this text for two very important reasons. First, the term *multinational* is used rather than *international* because we focus on the third phase of the globalization process, in which firms operate businesses in many different countries. Secondly, we use the term *enterprise* instead of *corporation* because as businesses move into many emerging markets, they enter into joint ventures, strategic alliances, or simply operating agreements with enterprises which may not be publicly traded or even privately owned (and therefore not corporations), but actually extensions of government.

### What Is Different About Global Financial Management?

Exhibit 1.1 details some of the main differences between international and domestic financial management. These component differences include institutions, foreign exchange and political risks, and the modifications required of financial theory and financial instruments.

International financial management requires an understanding of cultural, historical, and institutional differences such as those affecting corporate governance. Although both domestic firms and MNEs are exposed to foreign exchange risks, MNEs alone face certain risks that are not normally a threat to domestic operations such as political risks.

MNEs also face other risks that can be classified as extensions of domestic finance theory. For example, the normal domestic approach to the cost of capital, sourcing debt and equity, capital budgeting, working capital management, taxation, and credit analysis needs to be modified to accommodate foreign complexities. Moreover, a number of financial instruments that are used in domestic financial management have been modified for use in international financial management. Examples are foreign currency options and futures, interest rate and currency swaps, and letters of credit.
Chapter 1: Financial Goals and Corporate Governance

EXHIBIT 1.1
What Is Different About International Financial Management?

<table>
<thead>
<tr>
<th>Concept</th>
<th>International</th>
<th>Domestic</th>
</tr>
</thead>
<tbody>
<tr>
<td>Culture, history, and institutions</td>
<td>Each foreign country is unique and not always understood by MNE management.</td>
<td>Each country has a known environment. Base case.</td>
</tr>
<tr>
<td>Corporate governance</td>
<td>Foreign countries’ regulations and institutional practices are all uniquely different.</td>
<td>Regulations and institutions are well known.</td>
</tr>
<tr>
<td>Foreign exchange risk</td>
<td>MNEs face foreign exchange risks due to their subsidiaries, as well as import/export and foreign competitors.</td>
<td>Foreign exchange risks arise from import/export and foreign competition, but not from subsidiaries.</td>
</tr>
<tr>
<td>Political risk</td>
<td>MNEs face political risks because of their foreign subsidiaries and high profile.</td>
<td>Political risks are negligible.</td>
</tr>
<tr>
<td>Modification of domestic finance theories</td>
<td>MNEs must modify finance theories like capital budgeting and cost of capital because of foreign complexities.</td>
<td>Base case.</td>
</tr>
<tr>
<td>Modification of domestic financial instruments</td>
<td>MNEs utilize modified financial instruments such as options, futures, swaps, and letters of credit.</td>
<td>Base case.</td>
</tr>
</tbody>
</table>

The main purpose of this book is to describe and analyze how a firm’s financial management tasks evolve as it pursues global strategic opportunities and new constraints emerge. In this opening chapter, we take a brief look at the challenges and risks associated with a company evolving from domestic in scope to being truly multinational. This will include the constraints that a company will face in terms of managerial goals and governance as it becomes increasingly involved in multinational operations. In the rest of this chapter we examine how cultural, historical, and institutional differences affect a firm’s choice of financial goals and corporate governance.

The Globalization Process

Trident Corporation (Trident) is a hypothetical U.S.–based firm that will be used as an illustrative example throughout the book to demonstrate the globalization process. The globalization process is the structural and managerial changes and challenges experienced by a firm as it moves from domestic to global in operations.

Global Transition I: Trident Moves from the Domestic Phase to the International Trade Phase

Trident is a young firm that manufactures and distributes an array of telecommunication devices. Its initial strategy is to develop a sustainable competitive advantage in the U.S. market. Like many other young firms it is constrained by its small size, other competitors, and lack of access to cheap and plentiful sources of capital. The top half of Exhibit 1.2 shows Trident in its early domestic phase. Trident sells its products in U.S. dollars to U.S. customers and buys its manufacturing and service inputs from U.S. suppliers, paying U.S. dollars. The creditworth of all suppliers and buyers is established under domestic U.S.
practices and procedures. A potential issue for Trident at this time is that although Trident itself is not international or global in its operations, some of its competitors or suppliers or buyers may be. This is often one of the key drivers to push a firm like Trident into the first transition of the globalization process, the international trade phase.

Trident was founded by James and Edgar Winston in Los Angeles in 1948 to make telecommunications equipment. The family-owned business expanded slowly but steadily over the following 40 years. The demands of continual technological investment in the 1980s, however, required that the firm raise additional equity capital in order to compete. This need led to its initial public offering (IPO) in 1988. As a U.S.–based publicly traded company on NASDAQ, Trident’s management sought to create value for its shareholders. Issues related to the goals and control of multinational enterprises are discussed in more detail later in this chapter.

As Trident became a visible and viable competitor in the U.S. market, strategic opportunities arose to expand the firm’s market reach by exporting products and services to one or more foreign markets. The North American Free Trade Agreement (NAFTA) made trade with Mexico and Canada attractive. This second phase of the globalization process is depicted in the lower half of Exhibit 1.2. Trident responded to these globalization forces by importing inputs from Mexican suppliers and making export sales to Canadian buyers. We define this stage of the globalization process as the international trade phase.

Exporting and importing products and services increases the demands of financial management over and above the traditional requirements of the domestic-only business. First, direct foreign exchange risks are now borne by the firm. Trident may now need to quote prices in foreign currencies, accept payment in foreign currencies, or pay suppliers in foreign currencies. As the value of currencies change from minute to minute in the global marketplace, Trident will now experience significant risks from the changing values associated with these foreign currency payments and receipts.
Second, the evaluation of the credit quality of foreign buyers and sellers is now more important than ever. Reducing the possibility of non-payment for exports and non-delivery of imports becomes one of two main financial management tasks during this international trade phase. This credit risk management task is much more difficult in international business, as buyers and suppliers are new, subject to differing business practices and legal systems, and generally more challenging for Trident to assess.

**Global Transition II: The International Trade Phase to the Multinational Phase**

If Trident is successful in its international trade activities, the time will come when the globalization process will progress to the next phase. Trident will soon need to establish foreign sales and service affiliates. This step is often followed by establishing manufacturing operations abroad or by licensing foreign firms to produce and service Trident’s products. The multitudes of issues and activities associated with this second larger global transition is the true purpose of this book.

Trident’s continued globalization will now require it to identify the sources of its competitive advantage, and with that knowledge in-hand, expand its intellectual capital and physical presence globally. A variety of strategic alternatives are available to Trident — the foreign direct investment sequence — as illustrated in Exhibit 1.3. These alternatives include the creation of foreign sales offices or the licensing of everything from its name to the manufacturing and distribution of its products to other firms in foreign markets. As Trident moves further down and to the right in Exhibit 1.3, the degree of its physical presence in foreign markets increases. It may now own its own...
distribution and production facilities, and ultimately, may find it wishes to own other companies which they acquire. Once Trident owns assets and enterprises in foreign countries it has entered the multinational phase of its globalization.

**PART I: THE GLOBAL FINANCIAL ENVIRONMENT**

But as Trident moves further down and to the right in this multinational phase, it bears greater risks, which arise from multinational activities. The foreign exchange risks and credit management risks suffered by Trident now only grow. In order to identify and manage its foreign currency risks, Trident must first develop a background knowledge of the global financial environment that influences the value of currencies. The international monetary system and the balance of payments are discussed in Chapters 2 and 3 of this book.

**PART II: FOREIGN EXCHANGE THEORY AND MARKETS**

Trident’s financial managers must now understand how foreign exchange rates are determined so they can develop some feel for forecasting exchange rates. This is the subject of Chapters 4 and 5. Trident’s management must also understand the institutional processes of how currencies are traded on world markets in order to undertake the currency trading activities needed to manage its growing global operations. This is covered in Chapter 6.

The task of forecasting foreign exchange rates is a subjective one and often yields unsatisfactory results. Therefore, Trident’s financial management must know what instruments exist that can reduce foreign exchange risks, regardless of whether or not exchange rates can be correctly forecast in practice. Trident’s financial managers will need to become adept in the use of various financial instruments and derivatives used to manage many of these foreign exchange rate and interest rate risks. This is the subject of Chapter 7.

**PART III: FOREIGN EXCHANGE EXPOSURE MEASUREMENT AND MANAGEMENT**

Part III of the text reaches directly into the core of multinational business and its financial management, as Trident is now faced with three major sources of foreign exchange exposure. The fact that more and more of Trident’s cash flows are denominated in foreign currency presents a significant risk that must be managed. This foreign exchange risk is called transaction exposure and is the subject of Chapter 8.

As the globalization process continues, Trident’s financial management tasks become considerably more complex. Foreign currency transaction exposures (Chapter 8) now include foreign exchange risks generated by Trident’s ownership of foreign sales, manufacturing, and service subsidiaries. Because Trident’s value as a firm will now vary with future unexpected changes in exchange rates, its operating exposure — its long-term competitiveness and ability to generate cash flows — becomes a major concern for management. The topic of operating exposure is the subject of Chapter 9.

The final major currency exposure that Trident faces is translation exposure. Translation exposure, sometimes referred to as accounting exposure, arises from the process of restating the foreign currency-denominated financial statements of Trident’s foreign subsidiaries into the home currency (the U.S. dollar) for reporting purposes. In order for Trident’s global operations to be reported to stockholders and creditors, it must be able to measure global financial results in a single currency. The consolidation process and the exchange rate risks associated with it are analyzed in Chapter 10.
PART IV: FINANCING THE GLOBAL FIRM

As Trident prospers and grows larger at home and abroad, it begins to confront a significant constraint to further growth — access to cheap and plentiful capital. This capital constraint prevents it from competing with its global competitors, as they have access to larger quantities of capital at lower cost. Trident can overcome this constraint by gaining access to global equity and debt markets while maintaining an optimal financial structure (the ratio of debt to equity in the company as a whole). The strategy of globalizing the cost and availability of capital is a critical one for firms wishing to reach true global competitiveness. The issues and opportunities in implementing this strategy are covered in Chapters 11–14. This analysis will include the current debate as to whether multinational enterprises have a lower or higher cost of capital than their domestic counterparts.

PART V: FOREIGN INVESTMENT DECISIONS

Trident Corporation’s foreign investment decisions combine strategy and finance. Trident’s global expansion is creating a portfolio of international assets. The management of Trident, as well as its current and potential shareholders, need to understand the risks and rewards of global portfolio diversification. This is analyzed in Chapter 15.

As Trident Corporation seeks to implement foreign direct investment, as shown in Exhibit 1.3, fundamental strategic questions need to be answered. What is Trident’s competitive advantage and is it transferable abroad? Does a foreign investment truly build value for shareholders? If it wishes to produce abroad should it attempt to control the assets or does it prefer to license another firm? If it wishes to control the assets should that control be through a wholly owned subsidiary or through a joint venture? These strategic questions are analyzed in Chapter 16.

Foreign direct investment will subject Trident to additional political and country risks. Trident may face risks that are firm-specific and controllable. However, it may also face risks that are country-specific and global-specific and uncontrollable. These risks are the subject of Chapter 17.

As is the case for domestic capital projects, Trident must analyze and evaluate all proposed new foreign-located projects using a capital budgeting framework. This financial management task becomes extremely complex since foreign projects involve analysis of foreign inflation, foreign exchange risks, blocked funds and other political risks, method of financing, expected cash flows to both the project and the parent (Trident Corporation), guesstimates of the project’s terminal value in both local currency and parent currency terms, and other complications. Capital budgeting is analyzed in Chapter 18.

We will follow Trident as it invests in a variety of forms around the world (see Exhibit 1.4). Trident’s first step in the implementation of its strategic plan is to build a new manufacturing and distribution center in Germany. This is typically termed a greenfield investment because prior to construction there was nothing there but a green field. It is most likely a long-term investment in business services or productive capabilities. The company follows this foreign expansion with the acquisition of an existing company in Brazil. Cross-border acquisitions are typically preferred when the acquisition target has capabilities which a firm like Trident cannot duplicate (for example through greenfield investing). The Brazilian investment was followed by the creation of a joint venture in China, in which Trident agreed to share investments and earnings with a partner. In many of the world’s emerging markets, like China, a foreign multinational firm like Trident is not allowed to hold sole ownership of enterprises without a local partner.
The financial management tasks associated with these international investment activities are again different than those conducted domestically. Trident would now need to conduct a *cross-border valuation* for any prospective acquisition target. After acquisition, Trident would need to assure a successful integration of any acquisition into Trident’s global operations. This is often constrained by different corporate cultures and styles of *corporate governance*, and may confront Trident with a complex set of post-acquisition management challenges. Exhibit 1.5 presents some of these issues.
related to global investment valuation and governance. The international acquisition and valuation process is the subject of the chapter available on this book’s web-site.

**PART VI: MANAGING MULTINATIONAL OPERATIONS**

The globalization process for Trident has to this point focused on how it has expanded its global scope and depth of operations. Financial management associated with the daily management of global operations, however, is not trivial; this is the subject of the final section of this book. Chapter 19 describes the processes involved in conducting international transactions in foreign trade, including contracts, documents, and procedures. It also analyzes how trade can be financed by using bankers’ acceptances and other specialized instruments.

Managerial strategies and tactics employed by Trident for the reduction of its global tax liabilities include, among other techniques, the use of transfer pricing (the prices charged on sales of goods and services between units of Trident itself globally), assessment of charges for intellectual capital used by foreign subsidiaries owned by the parent company — royalties and license fees, and differing financing structures. Trident must also consider the impact on taxation and the potential for blocked funds (governmental regulations that hinder the movement of capital out of a country) when choosing strategies that reposition earnings and cash flows. This is the subject of Chapter 20, tax management. Trident’s currency and tax environments are shown in Exhibit 1.6.

The financial management of working capital is a very important yet complex task faced by Trident’s management as the scope of its global business expands. Working capital management combines the cash, accounts receivable, inventories, accounts payable, short-term loans and access to banks, and other ongoing revenues and expenses associated with the day-to-day operations of each and every business unit around the globe. Working capital practices are integrally associated with the cultural

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**EXHIBIT 1.6**

The Currency and Tax Environments of Trident Corporation and Its Foreign Subsidiaries

- **Trident USA (Los Angeles, USA)**
  - Currency: US dollar ($)
  - Tax rate: 35%
  - 2004 earnings before tax (EBT): $4.5 million

- **Trident Europe (Hamburg, Germany)**
  - Currency: Euros (€)
  - Tax rate: 45%
  - 2004 EBT: €4.5 million
  - Avg exchange rate: €1.20/
  - 2004 EBT in US$: $5.4 million

- **Trident China (Shanghai, China)**
  - Currency: Chinese renminbi (Rmb)
  - Tax rate: 30%
  - 2004 EBT: (Rmb 2.5 million)
  - Avg exchange rate: Rmb 8.27/
  - 2004 EBT in US$: ($0.302 million)

- **Trident Brazil (São Paulo, Brazil)**
  - Currency: Brazilian real (R$)
  - Tax rate: 25%
  - 2004 EBT: R$6.25 million
  - Avg exchange rate: R$3.00/
  - 2004 EBT in US$: $2.083 million
and traditional business practices within each host country as well as the level of economic development and sophistication of the social and industrial infrastructure. The complexity of Trident’s global supply chain will require astute financial management and an integration of finance with procurement, logistics, global supplier management, and marketing. These issues and the associated management strategies that Trident might employ across global operations are the subject of Chapter 21.

What Is the Goal of Management?

As Trident becomes more deeply committed to multinational operations, a new constraint develops, one that springs from divergent worldwide opinions and practices as to just what the firms’ overall goal should be from the perspective of top management:

*What do investors want? First, of course, investors want performance: strong predictable earnings and sustainable growth. Second, they want transparency, accountability, open communications and effective corporate governance. Companies that fail to move toward international standards in each of these areas will fail to attract and retain international capital.*


An introductory course in finance is usually taught within the framework of maximizing shareholders’ wealth as the goal of management. In fact, every business student memorizes the concept of maximizing shareholder value somewhere in his or her collegiate education. This rather rote memorization, however, has at least two major challenges: (1) it is not necessarily the accepted goal of management across countries to maximize the wealth of shareholders — other stakeholders may carry substantial weight, and (2) it is extremely difficult to carry out. *Creating value* is — like so many lofty goals — much easier said than done. One must realize that the so-called universal truths taught in basic finance courses are actually culturally determined norms.

**SHAREHOLDER WEALTH MAXIMIZATION**

The Anglo-American markets are characterized by a philosophy that a firm’s objective should be to maximize shareholder wealth. Anglo-American is defined to mean the United States, United Kingdom, Canada, Australia, and New Zealand. This theory assumes that the firm should strive to maximize the return to shareholders — those individuals owning equity shares in the firm, as measured by the sum of capital gains and dividends, for a given level of risk. This in turn implies that management should always attempt to minimize the risk to shareholders for a given rate of return.

This shareholder focus has a tendency to assume that stock markets — the markets in which the individual shares of ownership of these firms are listed and traded between investors — are efficient. Efficiency in the field of finance has a very strict set of meanings, including the assumption that the market share price is typically “correct” because it captures all or most of the expectations of return and risk as seen by investors. The theory also assumes that the market moves quickly to incorporate all new information in the share price. And, in the end, it assumes that share prices are the best allocators of capital in the macro economy.

The shareholder wealth theory also defines risk in a very strict financial sense. Risk is defined as the added risk that the firm’s shares bring to a diversified portfolio,
systematic risk. The total operational risk of the firm can be eliminated through portfolio diversification by the investors. Thus, unsystematic risk, the risk of the individual security, should not be a prime concern for management unless it increases the prospect of bankruptcy. Systematic risk, the risk of the market in general, cannot be eliminated. This reflects risk that the share price will be a function of the stock market.

CORPORATE WEALTH MAXIMIZATION

Horoshi Suzuki’s first day on the job as president of Hoya Corporation differed from most senior management appointments. The company’s board of directors asked him to sit down and write down the name of his successor. “What they were telling me is if I screw up, I’ll be out,” says Suzuki with a smile.


The above definitions of return and risk are not universally accepted, and the experience of Horoshi Suzuki is not always the norm. In contrast to the shareholder focus, Continental European and Japanese markets are characterized by a philosophy that all of a corporation’s stakeholders should be considered, and the objective should be to maximize corporate wealth. Thus a firm should treat shareholders on a par with other corporate stakeholders, such as management, labor, the local community, suppliers, creditors, and even the government. The goal is to earn as much as possible in the long run, but to retain enough to increase the corporate wealth for the benefit of all. This model has also been labeled the stakeholder capitalism model.

The definition of corporate wealth is much broader than just “financial wealth.” It includes the firm’s technical, market, and human resources. This means that an MNE that believes it must close a manufacturing facility in Stuttgart, Germany, and shift its operations to Penang, Malaysia, may not do so without considering the employment and other social impacts on the Stuttgart community. As one study put it, “[Corporate wealth] goes beyond the wealth measured by conventional financial reports to include the firm’s market position as well as the knowledge and skill of its employees in technology, manufacturing processes, marketing and administration of the enterprise.”

The corporate wealth philosophy does not assume that equity markets are either efficient or inefficient. It does not really matter because the firm’s financial goals are not exclusively shareholder-oriented. In any case, the model assumes that long-term “loyal” shareholders should influence corporate strategy, not the transient portfolio investor. The stakeholder capitalism theory assumes that total risk — that is, operating and financial risk — does count. It is a specific corporate objective to generate growing earnings and dividends over the long run with as much certainty as possible, given the firm’s mission statement and goals. Risk is measured more by product market variability than by short-term variation in earnings and share price. Exhibit 1.7 provides a simplified comparison of the stakeholder and shareholder wealth maximization theories. Note that “the firm” is defined in a physical sense as its management.

There are, however, primary stakeholders in both the shareholder wealth and corporate wealth maximization models. These primary stakeholders are those individuals or entities that directly influence the development and implementation of the corporate strategy. In the Anglo-American markets, the primary stakeholders are clearly the shareholders. Management, those employed to act on behalf of shareholders (their agents), is positioned between shareholders and those providing debt capital to the

The Anglo-American Model has been frequently criticized as focusing on short-term profitability rather than long-term growth.

The Non-Anglo-American Model has come under increasing criticism for its lack of accountability to equity investors—its shareholders—while focusing on the demands of too diffuse a group of stakeholders.

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Whether an MNE is trying to maximize shareholder or corporate wealth, it must be guided by operational goals suitable for various levels of the firm. Even if the firm’s goal is to maximize shareholder value, the manner in which investors value the firm is not always obvious to the firm’s top management. Many top executives believe that the stock market moves in mysterious ways and is not always consistent in its conclusions.
Therefore, most firms hope to receive a favorable investor response to the achievement of operational goals that can be controlled by the way in which the firm performs.

Because the MNE is a collection of many business units operating in a multitude of economic environments, each MNE must determine for itself the proper balance between two common operational financial objectives:

1. Maximization of consolidated after-tax income and, subsequently, the minimization of the firm’s effective global tax burden
2. Correct positioning of the firm’s income, cash flows, and available funds as to country and currency

These goals are frequently incompatible, in that the pursuit of one may result in a less desirable outcome in regard to another. Management must make decisions about the proper tradeoffs between goals about the future — which is why people rather than computers are employed as managers.

The primary operational goal of the MNE is to maximize consolidated profits, after-tax. Consolidated profits are the profits of all the individual units of the firm originating in many different currencies expressed in the currency of the parent company. This is not to say that management is not striving to maximize the present value of all future cash flows. It is simply the case that most of the day-to-day decision-making in global management is about current earnings. The leaders of the MNE, the senior management team who are developing and implementing the firm’s strategy, must think far beyond current earnings.

For example, Trident’s foreign subsidiaries have their own set of traditional financial statements: (1) a statement of income, summarizing the revenues and expenses experienced by the firm over the year; (2) a balance sheet, summarizing the assets employed in generating the unit’s revenues and the financing of those assets; and (3) a statement of cash flows, summarizing those activities of the firm that generate and then use cash flows over the year. These financial statements are expressed initially in the local currency of the unit for tax and reporting purposes to the local government, but must be consolidated with the parent company’s financial statements for reporting to shareholders.

**Corporate Governance**

The relationship among stakeholders used to determine and control the strategic direction and performance of an organization is termed corporate governance. The corporate governance of the organization is therefore the way in which order and process is established to ensure that decisions are made and interests are represented — for all stakeholders — properly.

Although the governance structure of any company, domestic, international, or multinational, is fundamental to its very existence, this subject has become the lightning rod of political and business debate in the past few years as failures in governance in a variety of forms have led to corporate fraud and failure. Abuses and failures in corporate governance have dominated global business news in recent years. Beginning with the accounting fraud and questionable ethics of business conduct at Enron culminating in its bankruptcy in the fall of 2001, to the retirement pay package of Richard Grasso, the Chairman of the New York Stock Exchange, in September 2003, failures in corporate governance have raised issues about the very ethics and culture of the conduct of business.
THE GOAL OF CORPORATE GOVERNANCE

The single overriding objective of corporate governance in the shareholder wealth model is the optimization over time of the returns to shareholders. In order to achieve this, good governance practices should focus the attention of the board of directors of the corporation on this objective by developing and implementing a strategy for the corporation which ensures corporate growth and improvement in the value of the corporation’s equity. At the same time, it should assure an effective relationship with stakeholders.2

The most widely accepted statement of good corporate governance practices are those established by the Organisation for Economic Cooperation and Development (OECD) in 1999:3

- **The rights of shareholders.** The corporate governance framework should protect shareholders’ rights.
- **The equitable treatment of shareholders.** The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.
- **The role of stakeholders in corporate governance.** The corporate governance framework should recognize the rights of stakeholders as established by law and encourage active cooperation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.
- **Disclosure and transparency.** The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.
- **The responsibilities of the board.** The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board’s accountability to the company and the shareholders.

These principles obviously focus on several key areas — shareholder rights and roles, disclosure and transparency, and the responsibilities of boards — which we will discuss in more detail below.

THE STRUCTURE OF CORPORATE GOVERNANCE

Our first challenge is to try and capture what people mean when they use the expression “corporate governance.” Exhibit 1.8 provides an overview of the various parties and their associated responsibilities associated with the governance of the modern corporation. The modern corporation is a complex organism living in a complex environment. Its actions and behaviors are directed and controlled by both *internal forces* and *external forces*.

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2This definition of the corporate objective is based on that supported by the International Corporate Governance Network (ICGN), a nonprofit organization committed to improving corporate governance practices globally.

EXHIBIT 1.8
The Structure of Corporate Governance

The internal forces, the officers of the corporation (such as the chief executive officer or CEO) and the board of directors of the corporation (including the chairman of the board), are those directly responsible for determining both the strategic direction and the execution of the company’s future. But they are not acting within a vacuum; they are subject to the constant prying eyes of the external forces in the marketplace who question the validity and soundness of their decisions and performance. These include the equity markets in which the shares are traded, the analysts who critique their investment prospects, the creditors and credit agencies who lend them money, the auditors who testify to the fairness of their reporting, and the multitude of regulators who oversee their actions in order to protect the investment public.

THE BOARD OF DIRECTORS. The legal body which is accountable for the governance of the corporation is its board of directors. The board is composed of both employees of the organization (inside members) and senior and influential nonemployees (outside members). Areas of debate surrounding boards include the following: (1) the proper balance between inside and outside members; (2) the means by which board members are compensated for their service; and (3) the actual ability of a board to adequately monitor and manage a corporation when board members are spending sometimes less than five days a year on board activities. Outside members, very often the current or retired chief executives of other major companies, may bring with them a healthy sense of distance and impartiality, which although refreshing, may also result in limited understanding of the true issues and events within the company.

OFFICERS AND MANAGEMENT. The senior officers of the corporation — the chief executive officer (CEO), the chief financial officer (CFO), and the chief operating officer (COO) — are not only the most knowledgeable of the business, but the creators and
directors of its strategic and operational direction. The management of the firm is, according to theory, acting as a contractor — as an agent — of shareholders to pursue value creation. They are motivated by salary, bonuses, and stock options (positively) or the risk of losing their jobs (negatively). They may, however, have biases of self-enrichment or personal agendas which the board and other corporate stakeholders are responsible for overseeing and policing. Interestingly enough, in more than 80% of the companies in the Fortune 500, the CEO is also the chairman of the board. This is, in the opinion of many, a conflict of interest and not in the best interests of the company and its shareholders.

EQUITY MARKETS. The publicly traded company, regardless of country of residence, is highly susceptible to the changing opinion of the marketplace. The equity markets themselves, whether they be the New York Stock Exchange, London Stock Exchange, or Mexico City Bolsa, should reflect the market’s constant reflections on the promise and performance of the individual company. The analysts are those self-described experts employed by the many investment banking firms who also trade in the client company shares. They are expected (sometimes naively) to evaluate the strategies, plans for execution of the strategies, and financial performance of the firms on a real-time basis. Analysts depend on the financial statements and other public disclosures of the firm for their information.

DEBT MARKETS. Although the debt markets (banks and other financial institutions providing loans and various forms of securitized debt like corporate bonds), are not specifically interested in building shareholder value, they are indeed interested in the financial health of the company. Their interest, specifically, is in the company’s ability to repay its debt in a timely and efficient manner. These markets, like the equity markets, must rely on the financial statements and other disclosures (public and private in this case) of the companies with which they work.

AUDITORS. Auditors are responsible for providing an external professional opinion as to the fairness and accuracy of corporate financial statements. In this process, they attempt to determine whether the firm’s financial records and practices follow what in the United States is termed generally accepted accounting principles (GAAP) in regard to accounting procedures. But auditors are hired by the firms they are auditing, leading to a rather unique practice of policing their employers. The additional difficulty which has arisen in recent years is that the major accounting firms pursued the development of large consulting practices, often leading to a conflict of interest. An auditor not giving a clean bill of health to a client could not expect to gain many lucrative consulting contracts from that same firm in the near future.

REGULATORS. Publicly traded firms in the United States and elsewhere are subject to the regulatory oversight of both governmental organizations and nongovernmental organizations. In the United States the Securities and Exchange Commission (SEC) is a careful watchdog of the publicly traded equity markets, both in the behavior of the companies themselves in those markets and of the various investors participating in those markets. The SEC and other authorities like it outside of the United States require a regular and orderly disclosure process of corporate performance in order that all investors may evaluate the company’s investment value with adequate, accurate, and fairly distributed information. This regulatory oversight is often focused on when and what information is released by the company, and to whom.
A publicly traded firm in the United States is also subject to the rules and regulations of the exchange on which they are traded (New York Stock Exchange, American Stock Exchange, and NASDAQ being the largest). These organizations, typically categorized as “self-regulatory” in nature, construct and enforce standards of conduct for both their member companies and themselves in share trading. Unfortunately, as the recent case of Richard Grasso and his retirement package of $148 million pointed out, it often appears that the “fox is in charge of the hen house.”

**COMPARATIVE CORPORATE GOVERNANCE**

The origins of the need for a corporate governance process arise from the separation of ownership from management, and from the varying views by culture of who the stakeholders are and of what significance. This assures that corporate governance practices will differ across countries, economies, and cultures. As described in Exhibit 1.9, though, the various corporate governance regimes may be classified by regime. The regimes in turn reflect the evolution of business ownership and direction within the countries over time.

*Market-based regimes*, like those of the United States and the United Kingdom, are characterized by relatively efficient capital markets in which the ownership of publicly traded companies is widely dispersed. *Family-based systems*, like those characterized in many of the emerging markets, Asian markets, and Latin American markets, not only started with strong concentrations of family ownership (as opposed to partnerships or small investment groups which are not family based), but have continued to be largely controlled by families even after going public. *Bank-based and government-based regimes* are those reflecting markets in which government ownership of property and industry has been the constant force over time, resulting in only marginal “public ownership” of enterprise, and even then, subject to significant restrictions on business practices.

These regimes are therefore a function of at least three major factors in the evolution of corporate governance principles and practices globally: (1) financial market development, (2) the degree of separation between management and ownership, and (3) the concept of disclosure and transparency.

### EXHIBIT 1.9

Comparative Corporate Governance Regimes

<table>
<thead>
<tr>
<th>Regime Basis</th>
<th>Characteristics</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market based</td>
<td>Efficient equity markets; dispersed ownership</td>
<td>United States, United Kingdom, Canada, Australia</td>
</tr>
<tr>
<td>Family based</td>
<td>Management and ownership is combined; family/ majority and minority shareholders</td>
<td>Hong Kong, Indonesia, Malaysia, Singapore, Taiwan, France</td>
</tr>
<tr>
<td>Bank based</td>
<td>Government influence in bank lending; lack of transparency; family control</td>
<td>Korea, Germany</td>
</tr>
<tr>
<td>Government affiliated</td>
<td>State ownership of enterprise; lack of transparency; no minority influence</td>
<td>China, Russia</td>
</tr>
</tbody>
</table>

The depth and breadth of capital markets is critical to the evolution of corporate governance practices. Country markets which have had relatively slow growth, as in the emerging markets, or have industrialized rapidly utilizing neighboring capital markets (as is the case of Western Europe), may not form large public equity market systems. Without significant public trading of ownership shares, high concentrations of ownership are preserved and few disciplined processes of governance developed.

In countries and cultures in which the ownership of the firm has continued to be an integral part of management, agency issues and failures have been less a problem. In countries like the United States, in which ownership has become largely separated from management (and widely dispersed), aligning the goals of management and ownership is much more difficult.

The extent of disclosure regarding the operations and financial results of a company vary dramatically across countries. Disclosure practices reflect a wide range of cultural and social forces, including the degree of ownership which is public, the degree to which government feels the need to protect investor's rights versus ownership rights, and the extent to which family-based and government-based business remains central to the culture. Transparency, a parallel concept to disclosure, reflects the visibility of decision-making processes within the business organization.

Note that the word ethics has not been used. All of the principles and practices described so far have assumed that the individuals in roles of responsibility and leadership pursue them truly and fairly. That, however, has not always been the case.

Although much of the discussion about corporate governance concentrates on the market-based regimes (Exhibit 1.9), family-based regimes are arguably more common and more important worldwide, including in the United States and Western Europe. For example, in a study of 5,232 corporations in 13 Western European countries, family-controlled firms represented 44.29% of the sample, compared to 36.93% that were widely held.4

Recent research indicates that, as opposed to popular belief, family-owned firms in some highly developed economies typically outperform publicly owned firms. This is true not only in Western Europe but also in the United States. A recent study of firms included in the S&P500 found that families are present in fully one third of the S&P500 and account for 18% of their outstanding equity. And, as opposed to popular opinion, family firms outperform nonfamily firms. (An added insight is that firms possessing a CEO from the family also perform better than those with outside CEOs.) Interestingly, it seems that minority shareholders are actually better off according to this study when part of a family-influenced firm.5

Another study based on 120 Norwegian, founding-family controlled and nonfounding family controlled firms, concluded that founding-family control was associated with higher firm value. Furthermore, the impact of founding-family directors on

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firm value is not affected by corporate governance conditions such as firm age, board independence, and number of share classes. The authors also found that the relationship between founding-family ownership and firm value is greater among older firms, firms with larger boards, and particularly when these firms have multiple classes of stock. It is common for Norwegian firms and firms based in several other European countries to have dual classes of stock with differential voting rights.

FAILURES IN CORPORATE GOVERNANCE

Failures in corporate governance have become increasingly visible in recent years. The Enron scandal in the United States is described in the mini-case at the end of this chapter. In addition to Enron, other U.S. firms that have revealed major accounting and disclosure failures, as well as executives looting the firm, are WorldCom, Global Crossing, Tyco, Adelphia, and HealthSouth.

In each case, prestigious auditing firms, such as Arthur Andersen, missed the violations or minimized them presumably because of lucrative consulting relationships or other conflicts of interest. Moreover, security analysts urged investors to buy the shares of these and other firms that they knew to be highly risky or even close to bankruptcy. Even more egregious, most of the top executives that were responsible for the mismanagement that destroyed their firms, walked away with huge gains on shares sold before the downfall, and even overly generous severance payments.

It appears that the day of reckoning has come. The first to fall was Arthur Andersen, for its involvement with Enron. However, many more legal actions against former executives are underway. Some of these are described in Real World Example 1.1.

Real World Example 1.1
CORPORATE CRIME: THE RECKONING

The federal indictment of Bernard J. Ebbers, the former CEO and chairman of WorldCom, is but the latest in a long list of actions taken in reaction to the wave of corporate fraud and financial finagling that accompanied America’s great boom and bust. To those cynics who predicted that nothing much would be done to reform Big Business and Wall Street, just look at the record.

New York Attorney General Eliot Spitzer negotiated settlements that reduce conflicts of interest among stock analysts, clean up the initial public offering market, provide independent research to investors, and punish investment banks for past sins. He is now taking the mutual-fund industry to task for late trading. Congress passed Sarbanes-Oxley legislation that reforms both accounting and corporate governance while the Financial Accounting Standards Board is about to implement new rules requiring companies to expense stock options.

Meanwhile, the list of corporate chieftains charged with illegal acts grows. WorldCom’s Scott D. Sullivan pleaded guilty, Enron Corp. Ex-Chief Financial Officer Andrew S. Fastow pleaded guilty, and former CEO Jeffrey K. Skilling is under indictment. Only former Chairman Kenneth L. Lay remains untouched. Tyco International Ltd.’s Mark Schwartz and L. Dennis Kozlowski are on trial. HealthSouth Corp.’s Richard M. Scrushy is about to go on trial. Adelphia Communications Corp. founder John Rigas and his two sons are on trial.

America has many strengths, but none is as important as its ability to quickly repair itself. After a series of business and financial scandals unprecedented in modern times, the system is now fairer and more transparent. The quality of earnings is higher, boards are more independent, and investors have renewed confidence. Thanks to reform, the foundation for a strong rebound in the economy in the months ahead has been laid.


Real World Example 1.2
WHEN SCANDALS GO GLOBAL

The cockroach theory of financial scandals says that, for every one you see, hundreds more are hiding in the woodwork. So it was in the U.S., when the scandal at Enron was followed by blowups at WorldCom, HealthSouth, and elsewhere. And so it is now abroad; first Dutch grocer Ahold, then Italian dairy-products company Parmalat, and now Hollinger International Inc., the newspaper company controlled by Conrad M. Black, a Canadian-born British lord.

Scandals break out in bunches because they have common causes. They occur when insiders take advantage of weak corporate governance, feeble government oversight, and a financial system that too often looks the other way.

Indeed, Parmalat’s failure reflects badly on what were some of the biggest names in international finance in the ‘90s. Bank of America, Chase Manhattan, Bank of Boston, Deutsche Bank, Barclays, and Merrill Lynch sold billions of dollars in Parmalat debt over the years. While there’s no evidence that the financial giants broke rules, a little skeptical probing would have revealed the rot at the heart of Parmalat years ago.

The slow-motion fall of Conrad Black appears to be a case of high-handedness and questionable governance. The press baron is denying allegations in a lawsuit that he arranged payments to himself and others that weren’t properly authorized by the board of directors. If the board let Black run Hollinger for his own benefit, it reflects badly on luminary directors such as Henry A. Kissinger and Richard N. Perle.

There is obvious harm to these companies’ shareholders and creditors, such as Parmalat bondholder AFLAC Inc. Less visible but more serious is the destruction of trust, which makes it harder for honest companies to raise the money they need to grow. Overseas, as in the U.S., the solutions are clear: Transparency. Accountability. Tough audits. And criminal penalties for those who cheat. Halfway measures are an invitation to more cheating.


Although the corruption scandals were first revealed in the United States, they have spread to Canada and the European Union countries. These scandals are described in Real World Example 1.2.

GOOD GOVERNANCE AND REPUTATION

Does good governance matter? This is actually a difficult question, and the realistic answer has been largely dependent on outcomes historically. For example, as long as Enron’s share price continued to rise dramatically throughout the 1990s, questions over transparency, accounting propriety, and even financial facts were largely overlooked by all of the stakeholders of the corporation. Yet, eventually, the fraud and deceit and failure of the multitude of corporate governance practices resulted in the bankruptcy of the firm, destroying not only the wealth of investors, but the careers, incomes, and savings of so many of its basic stakeholders — its own employees. Ultimately, yes, good governance does matter. A lot.

A second way of valuing good governance is by measuring the attitudes and tendencies of the large global institutional investors who make the largest decisions about where capital may go. A recent McKinsey study surveyed over 200 institutional investors as to the value they placed on good governance. The survey results, presented in Exhibit 1.10, quantify good governance as the premium that institutional investors would be willing to pay for companies with good governance within specific country markets. Although this is not exactly equivalent to saying who has “good” or “bad” corporate governance globally, it does provide some insight as to in which countries institutional investors see good governance as scarce. It is again important to note that
Chapter 1: Financial Goals and Corporate Governance

EXHIBIT 1.10
The Value of Good Governance

How much more (what premium) would you be willing to pay for a share in a ‘good governance’ company in the following countries?


most of the emerging market nations have relatively few publicly traded companies even today.

This is not a surprise to the “sell-side” — the companies themselves. Corporate leadership globally is increasingly concerned with the nature of its reputation, and corporate governance failures are high on the list of issues that impact corporate reputation.

CORPORATE GOVERNANCE REFORM

The debate regarding what needs to be done about corporate governance reform depends on which systems and regimes are deemed superior. To date, reform in the United States has been largely regulatory.

SARBANES-OXLEY ACT. The U.S. Congress passed the Sarbanes-Oxley Act in July 2002. It had three major requirements: (1) CEOs of publicly traded firms must vouch for the veracity of the firm’s published financial statements; (2) corporate boards must have audit committees drawn from independent (outside) directors; and (3) companies are prohibited from making loans to corporate officers and directors. The first provision — the so-called signature clause — has already had significant impacts on the way in which companies prepare their financial statements. Although the provision was intended to instill a sense of responsibility and accountability in senior management (and therefore fewer explanations of “the auditors signed off on it”), the companies themselves have pushed the same procedure downward in their organizations, often
requiring business unit managers and directors at lower levels to sign their financial statements.

Sarbanes-Oxley has been quite controversial internationally, as it is in conflict with a number of the existing corporate governance practices already in place in markets that view themselves as having better governance records than the United States. A foreign firm wishing to list or continue listing their shares on a U.S. exchange must comply with the law. Some companies, such as Porsche, withdrew plans for a U.S. listing specifically in opposition to Sarbanes-Oxley. Other companies, however, including many of the largest foreign companies traded on U.S. exchanges such as Unilever, Siemens, and ST Microelectronics, have stated their willingness to comply — if they can find acceptable compromises between U.S. law and the governance requirements and principles in their own countries. For example, in Germany, supervisory board audit committees must include employee representatives, but according to U.S. law, employees are not independent.

**BOARD STRUCTURE AND COMPENSATION.** Many critics have argued for the United States to move toward structural reforms more consistent with European standards, such as prohibiting CEOs from also being chairmen. Although this is increasingly common, there is no regulatory or other legal requirement to force the issue. Second, and more radically, would be to move toward the two-tiered structure of countries like Germany, in which there is a supervisory board (largely outsiders, and typically large — Siemens’ board has 18 members) and a management board (predominantly insiders, and smaller — Siemens’ has eight members). As illustrated by Exhibit 1.11, it is not clear that the director composition of boards is truly the problem.

Also under considerable debate is the amount and form of board compensation. In the past, the United States was characterized by boards in which compensation was a combination of an annual stipend and the award of significant stock options. The stock option incentive, although intended to align the goals and objectives of boards and executive directors with the interests of shareholders, seemingly resulted in a mind-set more akin to the gift of lotto tickets — encouraging aggressive growth and accounting in the interest of earnings growth and share price appreciation.

**TRANSPARENCY, ACCOUNTING, AND AUDITING.** The concept of transparency has been raised in a variety of markets and contexts. Transparency is a rather common term used to describe the degree to which an investor — either existing or potential —

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### EXHIBIT 1.11

Board Composition and Compensation, *Fortune* 100

<table>
<thead>
<tr>
<th>Size of Company (sales)</th>
<th>Total Directors</th>
<th>Outside Directors</th>
<th>Avg. Annual Retainer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than $3 billion</td>
<td>9</td>
<td>7</td>
<td>$33,792</td>
</tr>
<tr>
<td>$3–$4.9 billion</td>
<td>10</td>
<td>8</td>
<td>$37,567</td>
</tr>
<tr>
<td>$5–$9.9 billion</td>
<td>12</td>
<td>10</td>
<td>$42,264</td>
</tr>
<tr>
<td>$10–$19.9 billion</td>
<td>12</td>
<td>10</td>
<td>$47,589</td>
</tr>
<tr>
<td>$20 billion and over</td>
<td>13</td>
<td>11</td>
<td>$6,587</td>
</tr>
</tbody>
</table>

can discern the true activities and value drivers of a company from the disclosures and financial results reported. For example, Enron was often considered a “black box” when it came to what the actual operational and financial results and risks were for its multitude of business lines. The consensus of corporate governance experts is that all firms, globally, should work toward increasing the transparency of the firm’s risk-return profile.

The accounting process itself has now come under debate. The U.S. system is characterized as strictly rule-based, rather than conceptually based, as is common in Western Europe. Many critics of U.S. corporate governance practices point to this as a fundamental flaw, in which constantly more clever accountants find ways to follow the rules, yet not meet the underlying purpose for which the rules were intended. An extension of the accounting process debate is that of the role and remuneration associated with auditing, the process of using third parties, paid by the firm, to vet their reporting practices as being consistent with generally accepted accounting principles. As illustrated by the collapse of Arthur Andersen following the Enron debacle, there are serious questions as to how much faith investors can place in the results of this current practice.

MINORITY SHAREHOLDER RIGHTS. Finally, the issue of minority shareholder rights continues to rage in many of the world’s largest markets. Many of the emerging markets are still characterized by the family-based corporate governance regime, where the family remains in control even after the firm has gone public. But what of the interests and voices of the other shareholders? How are their interests preserved in organizations where families or private investors control all true decisions, including the boards? As Real World Example 1.3 on Conrad Black of Hollinger International points out, minority shareholder rights are threatened in all markets, industrialized or emerging.

Poor performance of management usually requires changes to management, ownership, or both. Exhibit 1.12 illustrates some of the alternative paths available to shareholders when dissatisfied with firm performance.

Real World Example 1.3
CONRAD BLACK AND MINORITY SHAREHOLDER RIGHTS

Conrad Black was CEO of Hollinger International, a Canadian corporation listed on the New York Stock Exchange. Black controlled the company via a complex management agreement and through a holding company which held a majority of Hollinger’s voting shares. He was known to have little patience for shareholder questions, particularly when they were about how he was managing the firm. In a 2003 stockholder meeting he responded to continued questions with the following: “You have a right to say whatever it is that is on your mind, all of you,” he informed his investors. “You don’t know what you are talking about, but you are still welcome as shareholders.” He resigned as chairman and CEO in November 2003, under pressure.

EXHIBIT 1.12
Potential Responses to Shareholder Dissatisfaction

<table>
<thead>
<tr>
<th>Possible Action</th>
<th>Popular Term</th>
</tr>
</thead>
<tbody>
<tr>
<td>Remain Quietly Disgruntled</td>
<td>The Past</td>
</tr>
<tr>
<td>Sell the Shares</td>
<td>Walk-Away</td>
</tr>
<tr>
<td>Change Management</td>
<td>Shareholder Activism</td>
</tr>
<tr>
<td>Initiate a Takeover</td>
<td>Maximum Threat</td>
</tr>
</tbody>
</table>

What counts is that the management of a publicly quoted company, and its board of directors, know that the company can become the subject of a hostile takeover bid if they fail to perform.

Mini-Case

The Failure of Corporate Governance at Enron

“The tragic consequences of the related-party transactions and accounting errors were the result of failures at many levels and by many people: a flawed idea, self-enrichment by employees, inadequately-designed controls, poor implementation, inattentive oversight, simple (and not-so-simple) accounting mistakes, and overreaching in a culture that appears to have encouraged pushing the limits. Our review indicates that many of those consequences could and should have been avoided.”


On December 2, 2001, Enron Corporation filed for bankruptcy protection under Chapter 11. Enron failed as a result of a complex combination of business and governance failures. As noted in the quotation from the board report reprinted above, the failures involved organizations and individuals both inside and outside of Enron. But outside of the courts and sensational press, the question remains as to how the system allowed it to happen. Why did the many structures and safeguards within the U.S. corporate governance system not catch, stop, or prevent the failure of Enron?

Enron’s Collapse

According to former Enron CEO Jeffrey Skilling, Enron failed because of a “run on the bank.” This in fact, is probably technically correct. When Enron’s credit rating was downgraded to below investment grade in November 2001 by the credit rating agencies, its business was effectively stopped. This was because as a trading company it needed to maintain an investment-grade rating in order for other companies to trade with it. No grade, no trade.

But that answer largely begs the question of why the company was downgraded — because Enron’s total indebtedness was now determined to be $38 billion, not $13 billion. Why was the debt now, suddenly, so high? Because much of the debt that had been classified as off-balance sheet was now reclassified to on-balance sheet. Why the reclassification? Because many of the special-purpose entities (SPEs) and off-balance sheet partnerships carrying this debt were either found to have been misclassified to begin with or were reconsolidated with the company as a result of their equity falling in value (Enron shares). Which leads us back to the beginning — why did Enron’s share price tumble in 2001? Was it simply a natural result of a failing business, or had Enron’s reported and prospective earnings, in combination with its general financial health, not been honestly reported and evaluated?
 Failure of Corporate Governance at Enron
Enron’s senior management team, primarily the CEO Kenneth Lay and COO Jeffrey Skilling (later CEO) were responsible for the formulation and implementation of the company’s strategy, including its operating and financial results. Like most companies of its size, Enron had literally hundreds of accountants and lawyers on its permanent staff. It was the concerns of one accountant, Sherron Watkins, which became public in August and September 2001 and contributed to the rapidly escalating examination of Enron and its operations in the fall of 2001.

In the case of Enron, the external corporate governance bodies have been the focus of much criticism.

- **Auditor.** Arthur Andersen (one of the so-called Big Five) was Enron’s auditor. Andersen’s job was to determine and annually testify as to whether Enron had followed generally accepted accounting practices in the statements of its financial results. Andersen, like all auditors, was hired and paid by the company it was auditing: Enron. Andersen also provided a large variety of consulting activities for Enron, the sum of which was a much larger line of business than the basic audit practice.

- **Legal counsel.** Enron’s legal counsel, primarily the firm of Vinson & Elkins of Houston, was responsible for providing legal opinions on the many strategies, structures, and general legality of much of what Enron did. As was the case with Arthur Andersen, when questioned later as to why it did not oppose certain ideas or practices, Vinson & Elkins explained that it had not been fully informed of all of the details and complexities of the management and ownership of the SPEs.

- **Regulators.** Enron actually fell between the cracks of most U.S. regulatory bodies by industry. Because Enron was a trader in the energy markets, the Federal Energy Regulatory Commission (FERC) had some distant oversight responsibilities in regard to some of the markets and trading which the company participated in, but were largely separate issues from Enron’s overall activities.

- **Equity markets.** As a publicly traded company, Enron was subject to the rules and regulations of the Securities and Exchange Commission (SEC). The SEC, however, does little firsthand investigation or confirmation of reporting diligence itself, relying instead on the testimonies of other bodies like the company’s auditor. Because its shares were traded on the New York Stock Exchange (NYSE), Enron was governed by the rules and regulations of that exchange. At this time, however, the reporting requirements of the NYSE differed little if at all from those of the SEC. The NYSE did no firsthand verification of compliance on its own.

Analysts for a multitude of investment banking firms were responsible for following, analyzing, and evaluating Enron’s results on a constant basis. Enron’s relation-

ships with its investment bankers frequently involved quid pro quo behavior, in which firms that cooperated with Enron and supported its performance stories were rewarded with new business and new mandates for other investment banking activities that were profitable to the firms.

- **Debt markets.** Enron, like all companies who desired and needed a credit rating, paid companies like Standard & Poor’s and Moody’s to provide it with a credit rating. These ratings are needed for the company’s debt securities to be issued and traded in the marketplace. Again, one of the problems which the credit ratings agencies had with Enron was that they could only provide analysis on what was known to them of Enron’s operational and financial activities and results. And, in the case of debt knowingly held by off-balance sheet special-purposes entities, there is considerable debate as to whether the credit rating agencies had full detail and knowingly chose to overlook them in the company’s total indebtedness or not.

And finally let’s not forget the banks and bankers themselves, who provided the access to the debt capital. Most of these banks made millions in interest and fees as a result of leading and managing debt issuances for Enron.

Feeding the Beast
A particularly troublesome feature of Enron’s emerging business model in the late 1990s was that revenues grew much faster than earnings. The cost of undertaking large international power projects (such as in India), electrical power trading, and even new trading ventures such as the trading in water rights and broadband, were, in the words of one former executive, “hideous.” The salaries, bonuses, startup costs, and general lack of control over all operating costs drowned whatever profits arose from the new ventures. Even the more successful trading lines, including electricity, did not generate the margins the marketplace had come to expect from Enron and its older portfolio of businesses (primarily natural gas trading). As illustrated in Exhibit 1, the actual operating income (income before interest and taxes or IBIT) by business line was not growing at the same pace as revenues.

The growing deficit in corporate cash flows also led to a more fundamental financial management problem for Enron, the growing need for external capital, or as it was described in-house, “feeding the beast.” Rapidly escalating investments in new businesses, whether they be the Portland General Electric (PGE) acquisition of 1997 or the power projects pursued by Rebecca Mark (the director of Enron’s international development group) globally, were absorbing more capital than current business could self-finance. Enron’s cash flows fell increasingly behind its investments and sales.
Enron needed additional external capital — new debt and new equity. Ken Lay and Jeff Skilling, however, were both reluctant to issue large amounts of new equity because it would dilute earnings and the holdings of existing shareholders. The debt option was also limited, given the already high debt levels Enron was carrying (and which it had carried since its inception) which left it in the continuously precarious position of being rated BBB, just barely investment grade, by credit agency standards.

Although Jeff Skilling had first employed the concept of a fund of capital to be created to support business development within Enron with the creation of the Cactus Fund in 1991, it was Andrew Fastow who took the concept to a whole new level. Fastow’s experience in banking, specifically in the use of special-purpose entities (SPEs), a common tool in financial services, was his ticket up the corporate ladder at Enron. He eventually rose to the CFO position.

Many of the transactions involve an accounting structure known as a “special purpose entity” or “special purpose vehicle” (referred to as an “SPE” in this Summary and in the Report). A company that does business with an SPE may treat that SPE as if it were an independent, outside entity for accounting purposes if two conditions are met: (1) an owner independent of the company must make a substantive equity investment of at least 3% of the SPE’s assets, and that 3% must remain at risk throughout the transaction; and (2) the independent owner must exercise control of the SPE. In those circumstances, the company may record gains and losses on transactions with the SPE, and the assets and liabilities of the SPE are not included in the company’s balance sheet, even though the company and the SPE are closely related. It was the technical failure of some of the structures with which Enron did business to satisfy these requirements that led to Enron’s restatement.7

The SPEs created by Andy Fastow and his assistant Michael Kopper served two very important purposes. First, by selling troubled assets to the partnerships, Enron removed them from its balance sheet, taking pressure off the firm’s total indebtedness and simultaneously hiding underperforming investments. This also freed up additional room on the balance sheet to fund new investment opportunities. Secondly, the sale of the troubled investments to the partnerships generated income which Enron could then use to make its quarterly earnings commitments to Wall Street.

The problem with this solution was that it was only temporary. The SPEs were largely funded from three sources: (1) equity in the form of Enron shares by Enron; (2) equity in the form of a minimum 3% of assets by an unrelated third party (in principle, although this was later found to not be true in a number of cases); and (3) large quantities of debt from major banks. This capital base made up the right-hand side of the

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SPE’s balance sheet. On the left-hand side, the capital was used to purchase a variety of assets from Enron. Fastow sold these partnership deals to the banks on the premise that because he was uniquely positioned as both the CFO of Enron and the managing partner in the SPE, he could essentially cherry-pick the assets to be purchased by the SPE. Fastow did indeed cherry-pick, but they were the rotten cherries. Most of the assets purchased by the SPEs were troubled or underperforming.

A final detail of the SPEs proved in the end devastating to the financial future of Enron. Since the primary equity in the SPEs was Enron stock, as the share price rose throughout 1999 and 2000, the SPEs could periodically be marked-to-market, resulting in an appreciation in the value of the SPE and contributing significant earnings to Enron. These same shares, once their price began sliding in 2001, resulted in partnerships which should have been marked-to-market for substantial losses, but were not. As Enron’s share price plummeted in the early fall of 2001, the equity in the SPEs would no longer meet accounting guidelines for remaining off-balance sheet. The SPEs were becoming something of a synthetic business for Enron.

“The trouble was, the Raptors, like the rest of LJM2, had become something of a dumping ground for bad properties. In an effort to make quarterly earnings (and, of course, annual bonuses), Enron originators were hooked on making deals with Fastow instead of outside third parties — who would have asked a lot of questions, slowed down the process, and, in many cases, killed deals. Again, none of this mattered to most people at Enron, as long as the stock kept rising.”

The Failure of People
As it turns out, much of what Enron reported as earnings were not. Much of the debt raised by the company via the partnerships which was not disclosed in corporate financial statements should have been. Simultaneously to the overreporting of profits and the underreporting of debt, were the massive compensation packages and bonuses earned by corporate officers. So how could this happen?

• It appears that the executive officers of the firm were successful in manipulating the board of directors. Management had moved the company into a number of new markets in which the firm suffered substantial losses, resulting in redoubled attempts on their part to somehow generate the earnings needed to meet Wall Street’s unquenchable thirst for profitable growth.
• The board failed in its duties to protect shareholder interests through lack of due diligence and most likely a faith in the competence and integrity of the company’s senior officers. It is also notable that Enron’s legal advisors, some of whom reported to the board directly, also failed to provide leadership on a number of instances of malfeasance.
• Enron’s auditors, Arthur Andersen, committed serious errors in its judgments regarding accounting treatment for many Enron activities, including the SPE partnerships. Andersen was reported to have had serious conflicts of interest, earning $5 million in auditing fees from Enron in 2001, but more than $50 million in consulting fees in the same year.
• Enron’s analysts were, in a few cases, blinded by the sheer euphoria over Enron’s successes in the mid to late 1990s, or were working within investment banks that were earning substantial investment banking fees related to the complex partnerships. Although a few analysts continued to note that the company’s earnings seemed strangely large relative to the falling cash flows reported, Enron’s management was generally successful in arguing their point.

The rise and fall of Enron is a story that is far from complete. It may be in the end, however, that the true moral of the story is not in the failure of any specific process in place within the American system of corporate governance, nor in the mistaken focus on fair value accounting, nor in the lack of diligence of the board’s own audit committee, but simply the failure of people in a wide variety of positions in a great many different organizations to act reputably and responsibly.

Case Questions
1. Which parts of the corporate governance system, internal and external, do you believe failed Enron the most?
2. Describe how you think each of the individual stakeholders and components of the corporate governance system should have either prevented the problems at Enron or acted to resolve the problems before they reached crisis proportions.
3. If all publicly traded firms in the United States are operating within the same basic corporate governance system as Enron, why would some people believe this was an isolated incident and not an example of many failures to come?

*Power Failure, by Sherron Watkins, p. 232. “Raptors” and “LJM2” refer to special-purpose entities.
PART 1 | Global Financial Environment

Summary of Learning Objectives

Consider how the globalization process moves a business from a purely domestic focus in its financial relationships and composition to one truly global in scope

- Financial management is an integral part of a firm’s strategy. The main purpose of this book is to analyze how a firm’s financial management tasks evolve as it pursues global strategic opportunities and new constraints unfold.

Learn what the implications of phase one of globalization — the international trade phase — are for the risks and returns of a business

- The evolution of firms from purely domestic to multinational is called the globalization process. A firm may first enter into international trade transactions, then international contractual arrangements such as sales offices and franchising, and ultimately the acquisition of foreign subsidiaries. It is at this final stage that it truly becomes a multinational enterprise (MNE).
- This globalization process results in a firm becoming increasingly influenced by exchange rate movements and other global political and economic forces in general.

Examine how the continuing globalization process extends from international trade to multinational operations to global activities

- The decision whether or not to invest abroad is driven by strategic motives, and may require the MNE to enter into global licensing agreements, joint ventures, cross-border acquisitions, or greenfield investments.

Discover what three major corporate currency exposures arise from multinational business

- The three major currency exposures arising from the conduct of multinational business that impact all firms are transaction exposure, operating exposure, and translation exposure.

See how globalization affects governance of the organization and how it creates value for its stakeholders

- In the Anglo-American markets, the shareholder wealth maximization model is the culturally-determined norm. In many non-Anglo-American markets, the corporate wealth maximization model is the culturally determined norm. Distinct differences exist as to how these models treat return and risk. Additionally, these culturally determined norms are in process of evolution within many countries.
- As MNEs become more dependent on global capital markets for financing they may need to modify their policies of corporate governance. A trend exists for firms resident in non-Anglo-American markets to move toward being more “stockholder friendly.” Simultaneously, firms from the Anglo-American markets may be moving toward being more “stakeholder friendly.”

Investigate failures in global corporate governance

- The relationship among stakeholders used to determine and control the strategic direction and performance of an organization is termed corporate governance.
- Dimensions of corporate governance include agency theory; composition and control of boards of directors; and cultural, historical, and institutional variables.
- Failures in corporate governance, especially in the United States, have recently been in the spotlight and have been given partial blame for the decline in value of the U.S. stock markets.
- Shareholders who are dissatisfied with their firm’s performance typically have four choices: remain quietly disgruntled; sell their shares; change management; or initiate a takeover.
- The recent failures in corporate governance in the United States have spawned a flurry of government and private initiatives to prevent the same kind of failures in the future.
- The United States has already reacted to the recent failures in corporate governance by passing the Sarbanes-Oxley Act of 2002. The Act specifically asks the CEOs of firms to vouch for their financial statements and to create audit committees from independent directors. The Act, however, is inconsistent with the policies and practices employed in
many other countries, and has been a point of contention for firms considering listing (or continued listings) in the United States.

- The coming decade may see a growing consensus of corporate leaders who see the objectives of the firm to include the environmental and social soundness of the firm’s activities in addition to the pursuit of profit.

**QUESTIONS**

1. **Trident's globalization.** After reading the chapter’s description of Trident’s globalization process, how would you explain the distinctions between international, multinational, and global companies?

2. **Trident, the MNE.** At what point in the globalization process did Trident become a multinational enterprise (MNE)?

3. **Trident's advantages.** What are the main advantages that Trident gains by developing a multinational presence?

4. **Trident’s phases.** What are the main phases that Trident passed through as it evolved into a truly global firm? What are the advantages and disadvantages of each?

5. **Corporate goals: shareholder wealth maximization.** Explain the assumptions and objectives of the shareholder wealth maximization model.

6. **Corporate goals: corporate wealth maximization.** Explain the assumptions and objectives of the corporate wealth maximization model.

7. **Corporate governance.** Define the following terms
   a. Corporate governance
   b. The market for corporate control
   c. Agency theory
   d. Stakeholder capitalism

8. **Operational goals.** What should be the primary operational goal of an MNE?

9. **Knowledge assets.** Knowledge assets are a firm’s intangible assets, the sources and uses of its intellectual talent — its competitive advantage. What are some of the most important knowledge assets that create shareholder value?

10. **Labor unions.** In Germany and Scandinavia, among others, labor unions have representation on boards of directors or supervisory boards. How might such union representation be viewed under the shareholder wealth maximization model compared to the corporate wealth maximization model?

11. **Interlocking directorates.** In an interlocking directorate, members of the board of directors of one firm also sit on the board of directors of other firms. How would interlocking directorates be viewed by the shareholder wealth maximization model compared to the corporate wealth maximization model?

12. **Leveraged buyouts.** A leveraged buyout is a financial strategy in which a group of investors gain voting control of a firm and then liquidate its assets in order to repay the loans used to purchase the firm’s shares. How would leveraged buyouts be viewed by the shareholder wealth maximization model compared to the corporate wealth maximization model?

13. **High leverage.** How would a high degree of leverage (debt/assets) be viewed by the shareholder wealth maximization model compared to the corporate wealth maximization model?

14. **Conglomerates.** Conglomerates are firms that have diversified into unrelated fields. How would a policy of conglomerates be viewed by the shareholder wealth maximization model compared to the corporate wealth maximization model?

15. **Risk.** How is risk defined in the shareholder wealth maximization model compared to the corporate wealth maximization model?

16. **Stock options.** How would stock options granted to a firm’s management and employees be viewed by the shareholder wealth maximization model compared to the corporate wealth maximization model?

17. **Shareholder dissatisfaction.** If shareholders are dissatisfied with their company, what alternative actions can they take?

18. **Dual classes of common stock.** In many countries it is common for a firm to have two or more classes of common stock with different voting rights. In the United States the norm is for a firm to have one class of common stock with one-share-one-vote. What are the advantages and disadvantages of each system?
19. **Emerging markets corporate governance failures.**
   It has been claimed that failures in corporate governance have hampered the growth and profitability of some prominent firms located in emerging markets. What are some typical causes of these failures in corporate governance?

20. **Emerging markets corporate governance improvements.** In recent years emerging market MNEs have improved their corporate governance policies and become more shareholder-friendly. What do you think is driving this phenomenon?

**PROBLEMS**

*Use the following formula for shareholder returns to answer questions 1 through 3, where \( P_t \) is the share price at time \( t \), and \( D_t \) is the dividend paid at time \( t \).*

\[
\text{Shareholder return} = \frac{P_2 - P_1 + D_2}{P_1}
\]

1. **Shareholder returns.** If a share price rises from $16.00 to $18.00 over a one-year period, what was the rate of return to the shareholder if
   a. The company paid no dividends?
   b. The company paid a dividend of $1.00 per share?

2. **Shareholder choices.** Wilford Fong, a prominent investor, is evaluating investment alternatives. If he believes an individual equity will rise in price from $62 to $74 in the coming one-year period, and the share is expected to pay a dividend of $2.25 per share, and he expects at least a 12% rate of return on an investment of this type, should he invest in this particular equity?

3. **Microsoft’s dividend.** In January 2003 Microsoft announced that it would begin paying a dividend of $0.16 per share. Given the following share prices for Microsoft stock in the recent past, how would a constant dividend of $0.16 per share per year have changed the company’s return to its shareholders over this period?

4. **Dual classes of common stock (A).** Dual classes of common stock are popular in a number of countries. Assume that Powlitz Manufacturing has the following capital structure at book value:

<table>
<thead>
<tr>
<th>Local Currency (millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Powlitz Manufacturing</strong></td>
</tr>
<tr>
<td>Long-term debt</td>
</tr>
<tr>
<td>Retained earnings</td>
</tr>
<tr>
<td>Paid-in common stock: 1 million A-shares</td>
</tr>
<tr>
<td>Paid-in common stock: 4 million B-shares</td>
</tr>
<tr>
<td>Total long-term capital</td>
</tr>
</tbody>
</table>

The A-shares each have 10 votes; the B-shares each have 1 vote per share.

   a. What proportion of the total long-term capital has been raised by A-shares?
   b. What proportion of voting rights is represented by A-shares?
   c. What proportion of the dividends should the A-shares receive?

5. **Dual classes of common stock (B).** Assuming all of the same debt and equity values for Powlitz Manufacturing as in problem 4, with the sole exception that both A-shares and B-shares have the same voting rights, 1 vote per share:
   a. What proportion of the total long-term capital has been raised by A-shares?
   b. What proportion of voting rights is represented by A-shares?
   c. What proportion of the dividends should the A-shares receive?

6. **Price/earnings ratios and acquisitions.** During the 1960s many conglomerates were created by a firm enjoying a high price/earnings ratio (P/E). They then used their highly valued stock to acquire other firms that had lower P/E ratios, usually in unrelated domestic industries. These conglomerates went out of fashion during the 1980s when they lost their high P/E ratios, thus making it more difficult to find other firms with lower P/E ratios to acquire.

   During the 1990s, the same acquisition strategy was possible for firms located in countries where high P/E ratios were common compared to firms in other countries where low P/E ratios were common. Assume the following hypothetical firms in the pharmaceutical industry.

*End-of-chapter problems that utilize spreadsheets are available online at www.aw-bc.com/moffett and are accompanied by this icon.*
Pharm-USA wants to acquire Pharm-Italy. It offers 5,500,000 shares of Pharm-USA, with a current market value of $220,000,000 and a 10% premium on Pharm-Italy’s shares, for all of Pharm-Italy’s shares.

**a.** How many shares would Pharm-USA have outstanding after the acquisition of Pharm-Italy?

**b.** What would be the consolidated earnings of the combined Pharm-USA and Pharm-Italy?

**c.** Assuming the market continues to capitalize Pharm-USA’s earnings at a P/E ratio of 40, what would be the new market value for Pharm-USA?

**d.** What is the new earnings per share of Pharm-USA?

**e.** What is the new market value of a share of Pharm-USA?

**f.** How much did Pharm-USA’s stock price increase?

**g.** Assume that the market takes a negative view of the merger and lowers Pharm-USA’s P/E ratio to 30. What would be the new market price per share of stock? What would be its percentage loss?

### 7. Corporate governance: Overstating earnings.
A number of firms, especially in the United States, have had to lower their previously reported earnings due to accounting errors or fraud. Assume that Pharm-USA (problem 6) had to lower its earnings to $5,000,000 from the previously reported $10,000,000. What might be its new market value prior to the acquisition? Could it still do the acquisition?

### Trident Corporation
Problems 8 through 10 are based on the hypothetical MNE Trident Corporation. Trident is a U.S.-based multinational manufacturing firm, with wholly-owned subsidiaries in Brazil, Germany, and China, in addition to domestic operations in the United States. Trident is traded on the NASDAQ. Trident currently has 650,000 shares outstanding. The basic operating characteristics of the various business units is as follows:

<table>
<thead>
<tr>
<th>Country</th>
<th>Earnings before tax (EBT)</th>
<th>Corporate income tax rate</th>
<th>Average exchange rate for period</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>$4,500</td>
<td>35%</td>
<td>R$3.50/$</td>
</tr>
<tr>
<td>Brazil</td>
<td>R$6,250</td>
<td>25%</td>
<td>$0.9260/$</td>
</tr>
<tr>
<td>Germany</td>
<td>€4,500</td>
<td>40%</td>
<td>€0.8260/$</td>
</tr>
<tr>
<td>China</td>
<td>Rmb2,500</td>
<td>30%</td>
<td>Rmb8.50/$</td>
</tr>
</tbody>
</table>

#### 8. Trident Corporation’s consolidated earnings.
Trident must pay corporate income tax in each country in which it currently has operations.

**a.** After deducting taxes in each country, what are Trident’s consolidated earnings and consolidated earnings per share in U.S. dollars?

**b.** What proportion of Trident’s consolidated earnings arise from each individual country?

**c.** What proportion of Trident’s consolidated earnings arise from outside the United States?

#### 9. Trident’s EPS sensitivity to exchange rates.
Assume a major political crisis wracks Brazil, first affecting the value of the Brazilian real and, subsequently, inducing an economic recession within the country.

**a.** What would be the impact on Trident’s consolidated EPS if the Brazilian real were to fall to R$4.50/$, with all other earnings and exchange rates remaining the same?

**b.** What would be the impact on Trident’s consolidated EPS if, in addition to the fall in the value of the real to R$4.50/$, but earnings before taxes in Brazil fell as a result of the recession to R$5,800,000?

#### 10. Trident’s earnings and global taxation.
All MNEs attempt to minimize their global tax liabilities. Return to the original set of baseline assumptions and answer the following questions regarding Trident’s global tax liabilities.

**a.** What is the total amount — in U.S. dollars — which Trident is paying across its global business in corporate income taxes?

**b.** What is Trident’s effective tax rate on a global basis (total taxes paid as a percentage of pretax profits)?

**c.** What would be the impact on Trident’s EPS and global effective tax rate if Germany instituted a corporate tax reduction to 28%, and Trident’s earnings before tax in Germany rose to €5,000,000?
Internet Exercises

1. Multinational firms and global assets/income. The differences across MNEs is striking. Using a sample of firms such as those listed here, pull from their individual Web pages the proportions of their incomes that are earned outside their country of incorporation. (Note how Nestlé calls itself a “transnational company.”)

   Walt Disney
   http://disney.go.com/
   Nestlé S. A.
   http://www.nestle.com/
   Intel
   http://www.intel.com/
   DaimlerChrysler
   http://www.daimlerchrysler.de
   Mitsubishi Motors
   http://www.mitsubishi.com/
   Nokia
   http://www.nokia.com/
   Royal Dutch/Shell
   http://www.shell.com/

   Also note the way in which international business is now conducted via the Internet. Several of the above home pages allow the user to choose the language of the presentation viewed.

2. Corporate governance. There is no hotter topic in business today than corporate governance. Use the following sites to view recent research, current events and news items, and other information related to the relationships between a business and its stakeholders.

   Corporate Governance Net
   http://www.corpgov.net/

3. Fortune Global 500. Fortune magazine is famous for its listing of the Fortune 500 firms in the global marketplace. Use Fortune’s Web site to find the most recent list of which firms from which countries are in this distinguished club.

   Fortune
   http://www.fortune.com/fortune/

4. Financial Times. The Financial Times, based in London — the global center of international finance — has a Web site that possesses a wealth of information. After going to the home page, go to the Markets & Funds Data page, and examine the recent stock market activity around the globe. Note the similarity in movement on a daily basis among the world’s major equity markets.

   Financial Times
   http://www.ft.com/