## International Corporate Finance

Value Creation with Currency Derivatives in Global Capital Markets

Second Edition

LAURENT L. JACQUE

WILEY

## Contents

Preface	xvii
Acknowledgments	XXV
About the Author	xxvii
CHAPTER 1	
What Is International Corporate Finance?	1
The Uneven Reach of Globalization	2
The Rise of the Multinational Corporation	3 6
What is Different about International Corporate Finance? Risks in the Wonderland of International Finance	8
Internationalization and the Locus of the Finance Function	12
The International Control Conundrum	15
Exploiting The Multinational Enterprise System	16
Summary	19
Questions for Discussion	19
References	20
PART ONE The International Monetary Environment	21
CHAPTER 2	
Exchange Rates Regimes	23
Some First Principles about Exchange Rate Determination	24
World Map of Exchange Rate Regimes: The Flexibility ×	29
Convertibility Space Floating Exchange Rates	31
Stabilized or Pegged Exchange Rates	39
Controlled Exchange Rates	46
To Float or to Fix: The Trilemma of International Finance	49
Summary	50
Questions for Discussion	51
Problems	52
Internet Exercises	54
References	54

**viii** Contents

CHAPTER 3	
Yesterday and Yesteryear	57
Chronology of the International Monetary System	58
The Gold Standard (1878–1914, 1925–1931)	61
The Bretton Woods System (1944–1971)	63
Managed Floating Exchange Rates (1973–Present)	67
European Monetary System and the European Currency Unit	
(1979–1999)	68
Emerging Markets Currency Regimes and Crises	72
European Monetary Union and the Birth of the Euro (1999–Present)	76
Today and Tomorrow: The Current Map of Exchange Rates	84
Summary	86
Questions for Discussion	87
Problems	88
Internet Exercises	90
References	90
Case Study 3.1: Will the Eurozone Shutter? Plant Location	0.4
and Exchange Rates for Hyundai	91
CHAPTER 4	
The Balance of Payments	99
Fundamentals of Balance of International Payments Accounting	100
Current Account	105
Financial Account	107
Official Reserve Account	109
Statistical Discrepancies: Errors and Omissions	111
Balance of Payments and the Foreign Exchange Market	111
Debtor Versus Creditor Nations	115
Linking the Balance of Payments to National Income	118
Summary	119
Questions for Discussion	120
Problems	121
Internet Exercises	122
References	124
Case Study 4.1: When One of the BRIC(k)s Falls: Trials	
and Tribulations of the Indian Rupee	124
PART TWO	
The Foreign Exchange Market and Currency Derivatives	129
CHAPTER 5	
The Foreign Exchange Market	131
How Forex is Traded: The Institutional Framework	132
Foreign Exchange Products	140
Exchange Rate Quotations	142
Summary	155
Questions for Discussion	156

Contents	ix
----------	----

Problems	157
Internet Exercises	160
References	160
Case Study 5.1: Banco Mercantil Internacional's Forex Losses	160
CHAPTER 6	
Interest Rate Arbitrage and Parity	165
Interest Rate Arbitrage Theorem	166
Interest Rate Parity	174
Uncovered Interest Rate Arbitrage and the Carry Trade	181
Summary	184
Appendix 6A: Transaction Costs: Interest Rate Arbitarge	
with Bid-Ask Spreads (Advanced)	185
Appendix 6B: Interest Rate Parity and Asymmetric Taxation	187
Questions for Discussion	188
Problems	188
Internet Exercises	195
References	195
Case Study 6.1: Brazil Rede Globo's Short-Term Funding	195
CHAPTER 7	400
Purchasing Power Parity and the International Parities Framework	199
Purchasing Power Parity	200
The Linkages Between Interest, Inflation, and Exchange Rates	213
Questions for Discussion	220
Problems	220
Internet Exercises	221
References	222
CHAPTER 8	000
Currency Futures and Options	223
A Brief History of Derivatives	223
Currency Futures	228
Currency Options	234 236
Risk Profile of Currency Options	236
Option Strategies	245
Put-Call Parity Theorem The Valuation of Currency Options	243
Derivatives and Zero-Premium Options	254
Summary	254
Appendix 8A: Pricing Currency Options	259
Questions for Discussion	261
Problems	261
Internet Exercises	264
References	264
Case Study 8.1: Daewoo's Unorthodox Funding Strategy	264

**X** Contents

PART THREE	
International Financing	269
CHAPTER 9	
The International Financial Sector and the Dynamics of Global	
Capital Markets	<b>27</b> 1
Financing as a Global Procurement Decision	272
The Financial System and Financial (Dis)Intermediation	273
Securitization and the (Lower) Cost of Consumer Financing	281
Deregulation	287
Mapping the Financial System/Capital Market Emergence Process	290
Summary	297
Questions for Discussion	298
Problems	298
Internet Exercises	300
References	300
Case Study 9.1: How Thai Airways FOILs Jet Fuel Price Risk	301
CHAPTER 10	
Sourcing Equity Globally	307
A Grand Tour of Equity Markets	308
Global Equity Financing as a Procurement Decision	317
Internationalizing the Cost of Capital: The Landmark Case	
of Novo Industri	318
Why do Firms Cross-List?	323
How to Source Equity Globally	325
Summary	331
Questions for Discussion	332
Problems	333
Internet Exercises	334
References	335
Case Study 10.1: Jazztel's Foreign IPO	335
CHAPTER 11	
Sourcing Debt from Global Bond Markets	345
The International Debt Procurement Decision	346
Grand Tour of the Global Debt Market	347
Cost of Foreign Currency Debt Financing	356
Debt Refinancing	361
The International Debt Financing Conundrum	364
Summary	366
Questions for Discussion	366
Problems	367
Internet Exercises	372
References	372
Case Study 11.1: McDonald's Dim Sum Bonds: "Lovin' It"	372

Contents Xi

CHAPTER 12	
Currency, Interest Rate, and Credit Default Swaps	377
Currency Swaps	378
Interest Rate Swaps	383
Credit Default Swaps	391
Summary	397
Questions for Discussion	397
Problems	398
Internet Exercises	400
References	400
Case Study 12.1: The Demise of AIG	400
CHAPTER 13	
International Trade Financing	405
A Brief History of International Trade	406
The Trilogy of Risks in Exporting	407
Managing Credit Risk	409
Managing Currency Risk	410
Managing Country Risk	411
The Mechanics of Trade Financing with a Letter of Credit	412
Financing Exports	415
Pre-Export Financing	418
Government-Sponsored Export Credit Agencies	422
Summary	423
Questions for Discussion	424
Problems	424
Internet Exercises	426
Case Study 13.1: Warrick Pharmaceuticals Inc.	426
PART FOUR	
Managing Foreign Exchange Risk	431
CHAPTER 14	
The Case for Foreign Exchange Risk Management	433
Defining Foreign Exchange Risk Management and its Objectives	435
Can Hedging Currency Risk Increase the Value of the Firm?	437
When is Hedging Currency Risk Irrelevant?	440
From Hedging to Managing Currency Risk	441
The Building Blocks of Foreign Exchange Risk Management	443
Summary	445
Appendix 14A: Foreign Exchange Risk Management: What do	
Firms do?	446
Questions for Discussion	446
References	447
Case Study 14.1: Bio-Oils Energy S.L.	447

**Xİİ** Contents

CHAPTER 15	
Forecasting Exchange Rates	455
Market-Based Forecasts	456
Model-Based Forecasts: Technical Versus Econometric Modeling	
Approaches	461
Composite Forecasts	468
How to Use Currency Forecasts	469
Summary	470
Appendix 15A: Forecasting Pegged Yet Adjustable	
Exchange Rates	470
Questions for Discussion	476
Problems	477
Internet Exercises	479
References	479
Case Study 15.1: Euclides Engineering, Ltd.	480
CHAPTER 16	
Managing Transaction Exposure	483
Measuring Transaction Exposure	484
The Mechanics of Hedging Transaction Exposure	488
Hedging and Financing International Trade	500
Eliminating Foreign Exchange Rate Risk in Long-Term Contracts	501
Exchange Rate Risk in International Bidding	508
How Much to Hedge Transaction Exposure	512
Summary	513
Questions for Discussion	514
Problems	514
References	520
Case Study 16.1: Hedging Currency Risk at TT Textiles	521
CHAPTER 17	
Managing Translation Exposure	531
What is Translation Exposure?	531
Should Translation Exposure be Hedged?	532
Alternative Translation Methods	533
The Mechanics of Contractual Hedging	539
The Mechanics of Financial Hedging	546
Summary	550
Appendix 17A: Accounting Valuation and the Concept	
of Translation Exposure	551
Questions for Discussion	555
Problems	555
Internet Exercises	560
References	560
Case Study 17.1: Wilkinson Sword's Trials and Tribulations in	
Turkey	560

Contents

CHAPTER 18	
Managing Economic Exposure	<b>567</b>
A Taxonomy of Economic Exposures	568
Toward an Operational Measure of Economic Exposure	575
Managing Operating Exposure	578
Summary	583
Questions for Discussion	584
Problems	584
References	587
Case Study 18.1: Peugeot Citroën SA's Economic Exposure to the South Korean Won	588
PART FIVE	
Cross-Border Valuation and Foreign Investment Analysis	591
CHAPTER 19	
Foreign Market Entry Strategies and Country Risk Management	593
Contractual Modes of Foreign Market Entry	594
Foreign Market Entry Through Foreign Direct Investments	599
Country Risk	600
Costs/Benefits of Foreign Direct Investment to Host Countries	608
Summary	612
Questions for Discussion	613
Internet Exercises	613
References	614
Case Study 19.1: Carrefour's Indian Entry Strategy	614
CHAPTER 20	
International Capital Budgeting	619
The Foreign Direct Investment Decision-Making Process	619
A Primer on Evaluating Investment Opportunities	622
What is Different About Evaluating Foreign Investment Proposals?	624
Case Study: Renault Invests in India	629
Global Cost of Equity Capital	639
Optimal Worldwide Capital Structure	643
Summary	644
Appendix 20A: Adjusted Present Value	645
Appendix 20B: Real Options	648
Questions for Discussion	656
Problems	656
Internet Exercises	660
References	660
CHAPTER 21	
Cross-Border Mergers and Acquisitions	661
A Brief History of Mergers and Acquisitions	662
The Industrial Logic of Mergers and Acquisitions	662

Are Cross-Border Acquisitions Different?	664
Valuation of Foreign Acquisitions	671
Ciments Lafarge Enters Vietnam	673
_	680
Summary	
Questions for Discussion	681
Problems	681
Internet Exercises	683
Case Study 21.1: Etihad's Proposed Acquisition	
of Malaysia Airlines	684
CHAPTER 22	
Project Finance	689
What is Project Finance?	690
Anatomy of Project Finance: The Case of the Ras Laffan Liquefied	070
	696
Natural Gas Company	
Valuing Project Finance: The Esty Model	696
Summary	704
Questions for Discussion	705
References	705
Case Study 22.1: Clean Infra Ltd Project Finance	706
CHAPTER 23	
Global Investing	713
The Basics of International Portfolio Management	714
The Gains from International Diversification	722
Trials and Tribulations in Foreign Equity Investing	729
Currency Risk in Global Investing	730
Alternative Modes of Investing in Foreign Equity	733
The New Landscape of Global Investing	734
	73 <del>4</del> 741
Summary	/41
Appendix 23A: In Search of Alpha at Global Thematic Partner is	744
found on the Book Website at www.wiley.com/go/intlcorpfinance2e	741
Questions for Discussion	742
Problems	742
Internet Exercises	744
References	744
PART SIX	
Managing the Multinational Financial System	747
CHAPTER 24	
Managing the Multinational Financial System	749
A Primer on International Taxation	749
The Multinational Financial System	753
·	755 755
Exploiting the System's Potential to Minimize Global Tax Liabilities Designing a Global Dividends Remittance Strategy	753 761

Contents		Х
----------	--	---

Centralizing Cash Management	765
Summary	774
Questions for Discussion	775
Problems	775
Internet Exercises	777
References	777
Appendix: Answers to Selected Problems	779
About the Companion Website	787
Index	789
Continued on the Website	
CHAPTER 25	
International Control Conundrum (extension of Part 6)	805
A Primer on Managerial Control The International Control Conundrum	806 809
EVA-Based Contingent Budgeting and Performance Assessment	815
Summary	821
Appendix 25A: Applying The EVA-Based Control System	822
Questions for Discussion	826
References	826
CHAPTER 26	827
<b>Asian Finance and Banking (extension of Part 3)</b> Asian Finance: Common Historical Roots, Diverse Paths	828
Adaptive Responses: Crises and Institutional Change in Asian	020
Finance	832
Business Organization, Corporate Ownership, and Governance	836
Corporate Governance	841
Capital Market Development	846
Capital Structure and the Cost of Capital Performance, Value, and the Practice of Corporate Finance	855 857
Summary	860
Questions for Discussion	860
References	861
CHAPTER 27	252
Islamic Banking and Finance (extension of Part 3)	863
The Underlying Principles of Islamic Finance	864
The Evolution of Islamic Finance	868

kvi	Contents

Glossary	899
Partners (GTP)	894
Appendix 23A to Chapter 23: In Search of Alpha at Global Thematics	
Case Sindy 27.11. When Elimates Hilling Taps Islamic Hilling	
Case Study 27.1: When Emirates Airline Taps Islamic Finan	
References	888
Questions for Discussion	888
Summary	886
Islamic Finance and the Global Financial Meltdown	885
Islamic Banking	880
Shariah-Compliant Asset Management	879
Islamic Financing Products	872