MS&E247s International Investments

MWF 1:15-2:05  Skilling 193

Opening
Summer 2002

Reading Assignments

Scan  Read

Levich  Chap  Pages
Context and applications in the international financial markets

Luenberger  Chap  Pages
Principles, fundamentals, key theorems, essential literature, precise and rigorous language, a must-read

Refreshers:
Mankiw 5e  Chap 5  Open Economy
http://www.bfwpub.com/pdfs/mankiw/0716752379_05.pdf

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Reading Assignments

Scan  Read

Collective experience and observation from more than 50 managers actively involved in multinational companies, mainly leading U.S. firms, in the Greater China area. E.g., construction, fast food and beverages, financial, high tech.

The new financial regulations and its effects on the future U.S. and international financial systems, e.g., the Gramm-Leach-Bliley Act (Financial Modernization Act) passed in 1999 and the industry convergence effect.

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Reading Assignments

Scan  Read

Foreign Investment Strategy:
• Positive Present Value and Economic Rent
• Modes of International Business
• Theories of Direct Foreign Investment (Foreign Direct Investment)
• Real Options in International Capital Budgeting

CFA exams: levels one, two and three
The course coverage falls mostly into level three of the CFA exam.

Economist: Fasten your seatbelts
http://www.economist.com/opinion/PrinterFriendly.cfm?Story_ID=1146047

Economist: The greenback slips
http://www.economist.com/opinion/PrinterFriendly.cfm?Story_ID=1108725

Economist: Big MacCurrencies
http://www.economist.com/opinion/PrinterFriendly.cfm?Story_ID=1098872

International Capital Flows

Having developed a basic understanding of why capital flows between countries, notice that these flows can take three main forms:

Portfolio Investment - ownership of corporate stocks, bonds, government bonds, and other bonds.

Intermediated Investment - short and long-term bank lending and deposit-taking activity.

Foreign Direct Investment - investment obtaining ownership of greater than 10% of voting shares in a foreign firm.

Why FDI? Why do we need multinationals?
1. FDI has grown rapidly since W.W.II and especially in the last 15 years. FDI stock, by host country, $bn:

<table>
<thead>
<tr>
<th>Year</th>
<th>Developed</th>
<th>Developing</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>400</td>
<td>50</td>
</tr>
<tr>
<td>1995</td>
<td>1900</td>
<td>700</td>
</tr>
</tbody>
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2. Developing countries account for an increasing share of inflows:
- in 1995 developing countries received a record $100 of $315 billion in inflows.
- excluding intra-European flows, developing countries received 60% of all flows in 1995 - up from 17% in 1989.

3. Most FDI flows (97%) originate in developed countries.

4. Much two-way FDI flows (‘cross-hauling’) takes place between pairs of developed countries - even at industry level.

5. Most FDI production is sold in recipient country.

6. Degree of FDI varies widely across and within industry. (examples Pepsi vs. Coke and Banks vs. Food).

7. Multinationals tend to have:
   - high levels of R&D
   - large share of professional and technical workers
   - products that are new or technically complex
   - high levels of advertising and product differentiation.
   - high values of intangible assets vs. market value.

8. Most of US corporations’ international exposure is through FDI - not exports:
   - In-country sales of US foreign affiliates were $1.8 trillion in 1995 vs $576 billion in exports.
   - US foreign affiliates exported more than the US domestic operations in 1995: $580 vs. $576.

9. 80% of US FDI is via M&A - not greenfield investment.

10. US FDI:
    1. Europe - 50%
    2. Latin America - 18.1%
    3. Canada - 11.5%
    4. Japan, Australia, NZ - 9.3%
    5. Rest of Asia - 9%