Question No.4 Discuss the sources of long term external finance for MNC's. How do they differ from those of domestic companies?

Solution: Firms have three general sources of funds available: internally generated cash. short-term external finance, and long-term external finance. External finance can come from individual or institutional, investors or lenders. The main alternative to issuing public debt securities directly in the open market is to obtain a loan from a specialised financial intermediary. MNCs commonly access long term capital from following sources:

1. Foreign Bonds

The foreign bond market is an important part of the international financial markets. It is simply that portion of the domestic bond market that represents issues floated by foreign companies or governments. As such, foreign bonds are subject to local laws and must be denominated in the local currency. At times, these issues face additional restrictions as well. For example, foreign bonds floated in Switzerland, Germany, and the Netherlands are subject to a queuing system, where they must wait for their turn in line. The United States and Switzerland have the biggest foreign bond markets. Major foreign bond markets are also located in Japan and Luxembourg. 'The outstanding amount of international debt securities issued touched US S.5.4 trillion at the end of 1999. US dollar and Euro denominated securities constituted more than 80% of the total outstanding amount of international debt securities issued at the end of 1999. The margin of spread (LIBOR +) widely differed between US high yield bonds and emerging market bonds. This margin has significantly varied between different years also. The choice of currency and markets can thus have important implications for design of global capital structure by MNCs.

2. Foreign Bank Loans

The foreign bank market represents that portion of domestic bank loans supplied to foreigners for use abroad. As in the case of foreign bond issues, governments often regulate the amounts of bank funds destined for foreign purposes. As of December 1999, German banks had the largest exposure to emerging markets. The total claims of banks in BIS-reporting countries on selected emerging markets as of December 1999 reached US $ 995 billion. Of this, claims of German, Japanese, French. UK and US banks comprised US $ 184 billion, US $ 143 billion, US $ 108 billion, US $ 106 billion and US $ 104 billion, respectively. The total announced syndicated credit facilities touched US $ 957.1 billion in 1999. The share of US borrowers and Industrial countries borrowers was 60% and 93% respectively.

3. Foreign Equity

The idea of placing stock in foreign markets has long attracted corporate finance managers. One attraction of the foreign equity market is the diversification' of equity funding risk. A pool of funds from a diversified shareholder base insulates a company from the vagaries of a single national market. For large companies located in small countries, foreign sales may be a necessity. When KLM, the Dutch airline, issued 50 million shares in 1986 to raise $ 304 million, it placed 7 million shares in Europe, 7 million in the United States, and 1 million in Japan. According to a spokesman for the company, "The domestic market is too small for such an operation". Selling stock overseas also increases the potential demand for the company's shares and hence its price, by attracting new shareholders. For example, a study showed that foreign companies that listed their shares in the United States experienced a decline in their expected return. This evidence is consistent with the theoretical work of Robert Merton, who shows that a company can lower its cost of equity capital and, thereby, increase its market value by expanding its http://eduspeaks.com/

investor base. In addition, for a firm that wants to project an international presence, an international stock offering can spread the firm's name in local markets.
In the words of a London investment banker, "If you are a company with a brand name, it's a way of making your product known and your presence known in the financial markets, which can have a knock-off effect on your overall business. A marketing exercise is done; it's just like selling soap".
Organised stock exchanges exist in all industrial countries and in a large number of developing countries. Trading equities in well organised exchanges with relatively sufficient depth to permit participation by foreign investors may be found in US, Australia, Belgium, Canada, France, Germany, Netherlands, Hong Kong, Italy, Japan, Singapore, South Africa, Sweden, Switzerland, and the United Kingdom.
Trading in stock exchanges outside of these countries poses serious problems to foreign investors. These markets are still generally primitive in nature, and lack the regulatory framework and structural safeguards that characterise equity markets in the United States and most of the industrial countries listed earlier. Trading is often shallow and price movements are, consequently, too erratic, particularly for large trades. Most of these markets are clearly inefficient, and information on the securities traded is difficult to obtain and transaction costs are relatively high.
In a typical stock exchange in an LDC there are few meaningful listing requirements, only few stocks are traded, and information about the companies whose stocks are traded is scanty. These limitations together with the higher perceived risk of investing in foreign stocks help explain why the internationalisation of equity markets has lagged considerably behind the integration of the international money and capital markets, particularly for debt-securities and syndicated loans. It was not until 1983 that truly international equity issues were floated in three separate markets. These issues by two Canadian firms, Alcan Aluminium and Canada Enterprises, were underwritten by three separate syndications and launched simultaneously in Canada, the United States, and Europe. Such issues have significant implications for financial managers of multinational firms, since they considerably widen the options available for long-term financing.
In the recent years, internationalisation of equity markets has taken a big boost. Even equity markets of emerging economies are getting rapidly internationalised. The strongest force behind the globalisation of emerging equity markets is the growth of depository receipt markets, predominantly American Depository Receipts (ADRs), Global Depository Receipts (GDRs), and European Depository Receipts (EDRs). Depository receipts are certificates representing ownership of shares in a company domiciled in one country (e.g., an emerging market) that are held by a depository that issues a certificate that can be traded in another country (e.g., US) and that represents a claim on the underlying shares. The other factors responsible for rapid internationalisation of emerging markets include established emerging market companies issuing their initial public offerings (IPOs) by-passing their local markets, in mature markets, 'bundling' of emerging market companies with mature market companies, and 'unbundling' of mature market companies.

4. Others

In addition to foreign bonds, loans and equity, MNCs do raise external finance from other sources also. These other sources of external finance include Euro-dollar markets, regional and international financial institutions like World Bank, Asian Development Bank, African Development Bank, and subsidies from host country governments.

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