

CQU



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*“A Strategy to Manage Corporate
Foreign Exchange Exposures
With Mutual Benefits to
Multinationals and Asia-Pacific
Countries”*

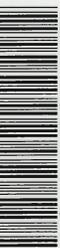
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ABSTRACT

Management of accounting exposure is often at the expense of increased transaction exposure or increased financing cost. Multinational firms want to mitigate both foreign exchange exposures and also reduce financing cost. This paper develops a model to demonstrate the potential for a comprehensive strategy which will mitigate accounting exposure without increasing transaction exposure or financing cost. The model has three main participants: multinational firms (as borrowers and business corporations), Asian-Pacific nations (as host countries), and their National Provident Funds (as lenders). The strategy involves direct local currency borrowing from National Provident Funds for multinational firms' investments in Asian-Pacific countries and the use of local currency sales revenue for servicing the debt. The strategy outlined satisfies the preferences of all the participants involved. The primary purpose of the paper is to provide a conceptual exposition of the potential, under certain conditions.

INTRODUCTION

Multinational corporations (MNCs) are exposed to currency fluctuations in the form of economic exposure, transaction exposure, and accounting exposure. Economic exposure (also called operating exposure) is the degree to which a firm's present value of future cash flows can be influenced by exchange rate fluctuations. Economic exposure deals with actual or "real" changes in values as it represents any impact of exchange rate fluctuations on firm's future cash flows. Transaction exposure, which is a subset of economic exposure, stems from future exchange gains or losses on foreign currency denominated transactions or financial obligations already committed. These gains or losses are also real as they impact on a firm's cash flows. Accounting exposure, (also called translation exposure and balance sheet exposure), is the potential for accounting-derived changes in financial statements arising from exchange rate movements. These gains or losses, however, are not real as they do not represent changes in cash flows. They are mere "paper" gains or losses.

Despite the fact that accounting exposure relates to paper gains or losses, managers endeavour to mitigate this exposure. Unfortunately, however, management of accounting exposure is often at the expense of increased transaction exposure or increased financing cost. Firms would certainly prefer a strategy which will mitigate accounting exposure without increasing transaction exposure and financing costs.

International debt financing is an important aspect of a typical MNC. Many MNCs borrow very large sums for very long terms. For example, in 1993, a big Dutch consumer electronic company, Philips Electronics NV, borrowed US\$500 million by selling US\$250 million in 10-year notes and US\$250 million in 20-year bonds in US capital markets (Eiteman, Stonehill, Moffett, 1995, pp. 344-345). In a world of currency fluctuations, long-term foreign currency debts subject the firm to considerable accounting and transaction exposures. Therefore, borrowing very large sums for very long terms in international capital markets while simultaneously minimising transaction exposure, accounting exposure, and financing cost is certainly a challenging task.

Over the last two decades, a plethora of foreign exchange exposure management techniques has been discussed in the international finance literature and practised by MNCs (Jesswein, Folks, Kwok, 1996, p.31). Elements of some of these techniques include local currency borrowing and reinvestment. However, these techniques generally address only a selected aspect, such as accounting exposure or transaction exposure, at a time. They do not consider a number of aspects simultaneously. As a result, those techniques may achieve one objective at the expense of one or more other objectives. For example, accounting exposure may be mitigated at the expense of increased transaction exposure or financing cost.

However, these techniques do not consider a number of aspects simultaneously.

On the other hand, while local currency borrowing has been considered as an element in mitigating accounting and transaction exposures, such borrowing from Asian-Pacific National Provident Funds (NPFs) has not been considered. Under the existing legislation, NPF loans to MNCs are not permissible. The NPF investment rules are designed to protect member funds from risky investments and to direct those investments towards socioeconomic development of the nation. Therefore, if it can be demonstrated that NPFs can invest in MNCs at a better return with no extra risk while at the same time contributing to socioeconomic development of the nation, then there is no rationale for NPFs not to invest in MNCs. Consequently, there should be no rationale for not amending the legislation to permit such investments.

This paper develops a model to demonstrate the potential for a comprehensive strategy which will mitigate MNCs accounting exposure without increasing their transaction exposure and financing cost. The model has three main participants: multinational firms (as borrowers and business corporations), Asian-Pacific nations (as host countries), and their National Provident Funds (as lenders). The strategy involves direct local currency borrowing from NPFs for multinational firms investments in Asian-Pacific countries and the use of local currency sales revenue for servicing the debt. The strategy outlined satisfies the preferences of all the participants involved. The primary purpose of the paper is to provide a conceptual exposition of the potential, under certain conditions. Mitigation of accounting exposure is illustrated by applying temporal and current rate methods to a hypothetical financial statement. Mitigation of transaction exposure is

explained by reasoning. Potential for a reduction in financing cost is explained by spelling out certain conditions and arguing that they are likely to be satisfied in reality.

The following section defines the accounting exposure and illustrates it with the help of hypothetical financial statements. This is followed by a discussion of the relevance and importance of accounting exposure. This discussion was prompted due to the inconclusive evidence on the issue. Participants in the model and their preferences are then outlined in preparation for the discussion of strategy. The paper ends with concluding remarks.

ACCOUNTING EXPOSURE

Translation gains or losses arise as the financial data of foreign subsidiaries are translated into a single reporting currency, (which is normally the parent company's home currency), to prepare worldwide consolidated financial statements. Some accounts of the foreign affiliate are translated at the current exchange rate, (that is the rate in effect at the balance sheet date), while other accounts are translated using a historic exchange rate, (that is the rate that was in effect when the account was first recognised in the books). Still other accounts, particularly those related to the income statement, may be translated at an average rate for some relevant period. Thus, translation adjustments to equity and/or reported income are necessary to balance the translated accounts. (Aggarwal, 1991).

The size and nature of these paper gains or losses depends on the accounting method used for the translation. These methods may be classified into four categories: monetary/non-monetary, temporal, current/non-current rates, and current rate. Monetary/non-monetary or temporal method was required in the USA when Statement of Financial Accounting Standards Number 8 (SFAS #8) was in operation. SFAS #8 was adopted in 1975 and it was replaced by FASB #52 in December 1981 (Eiteman, Stonehill, Moffett, 1995, 254). Current rate method became official U.S. practice with the issuance of SFAS # 52 (by the Financial Accounting Standard Board) and this method is the most prevalent in the world today. (Eiteman, Stonehill, and Moffett, 1995, 252-253; Shapiro,

Translation gains or losses arise as the financial data of foreign subsidiaries are translated into a single reporting currency,

In Australia, Australian Accounting Standards AASB 1012 specifies the foreign currency translation methods for the preparation of group accounts.

1996, 238-243). Under SFAS # 52, the current rate method is applicable for firms, which designate a foreign currency as their functional currency, and the temporal method for firms which designate the dollar as their functional currency (i.e., as if they still reported under SFAS # 8). As the method recommended by the Institute of Chartered Accountants of England and Wales and the Institute of Chartered Accountants of Scotland, current rate method is also widely used by British companies (Shapiro, 1996, 239-240). In Australia, Australian Accounting Standards AASB 1012 specifies the foreign currency translation methods for the preparation of group accounts. The temporal method is used for integrated foreign operations and current rate method for self-sustaining operations. (Hammond, 1990, pp. 338-342; ASCPA & CA, 1998, pp.1,034-1,060). This paper explains the accounting exposure using current rate and temporal method.

Perhaps the best way to explain the accounting exposure is to use hypothetical financial statements for an assumed subsidiary and then translate these financial statements using the two selected accounting methods. This approach has the added advantage that, later on, the figures in these financial statements can be used for the purpose of explaining how the proposed strategy will mitigate the translation exposure.

Consider the hypothetical balance sheet for an assumed US firm's subsidiary in Malaysia in Exhibit 1. Functional currency of the subsidiary is identified as the local currency. Balance sheet values, at beginning and end of the year, in the local currency, ringgit (M\$), are given in Exhibit 1. Assume, for simplicity with no loss in generality, that the exchange rate until the beginning of the current accounting period was US\$ 1 = M\$ 2, both the appropriate weighted average rate and the historical rate for the income statement is US\$ 1 = M\$ 2.5, the rate at the end of the period is US\$1=M\$ 4, and there are no taxes.

Under the current rate method, foreign subsidiary's assets and liabilities are converted into the reporting currency at current exchange rates and share capital and other shareholders funds are converted at historical rates (prevailed at the dates of acquisition). This makes total assets at 31/12/97 equal to \$510 and total liabilities plus equity equals to \$887.50. The balance sheet will now

not balance. However, balance sheets must balance. Assets must equal liabilities plus equity accounts. To balance the reported balance sheet, a translation adjustment is made to a special account which is included in the equity amount reported to the parent company. This is often called the 'cumulative translation adjustment (CTA) account' or 'foreign currency translation reserve'. The CTA in Exhibit 1 is equal to a minus 377.50. If not for the CTA account, this balancing amount (which is the translation gain or loss) would have gone through the income statement causing an unreal increase or decrease in the net income. The way the current rate method treats the translation gain or loss makes them bypass the income statement. This treatment of translation gain (or loss) is expected to avoid unnecessary variability of consolidated net income. (Hammond, 1990, pp. 338-342; Madura, 1995, 286-308; Palmer, 1990, 38-41; Shapiro, 1996, 238-246;).

Temporal method is a variation of the monetary/non-monetary method. The difference is that under monetary/non-monetary method, inventory is always translated at the historical rate. Under the temporal method, while inventory is normally translated at the historical rate, it can be translated at the current rate if the inventory is shown on the balance sheet at market values. Therefore, if the foreign subsidiary keeps all its accounts on a historical cost basis, the temporal method is identical to the monetary/non-monetary method. (Shapiro, 1996, 239; Eiteman, Stonehill, Moffett, 1995, 254). For the analytical purpose of this paper, we assume that all accounts are kept on a historical basis which makes the two methods identical. Under this temporal method, monetary assets and liabilities are translated at current rate (US\$1=M\$4) while other assets and liabilities are translated at historical rates, (which, in our example, have been US\$1=M\$2). Contrary to the current rate method, under the temporal method, the unrealised paper gain or loss resulting from the translation of accounts is included in the income statement causing an artificial increase in the variability of reported earnings. In Exhibit 1, the translation loss of \$65 million will reduce the net income to \$15 million.

RELEVANCE AND IMPORTANCE OF ACCOUNTING EXPOSURE

Since the translation of accounts (using the accounting methods) does not affect the cash flows, some analysts would argue that it is not necessary to hedge or

This misinterpretation of financial statements gives misleading pictures about the performance.

even reduce accounting exposure. For example, the conventional efficient markets view is that the management of translation exposure involves undertaking activities with real costs to generate unrealised paper gains that generally have no real tax or other cash flow benefits (Aggarwal 1991, p.10). However, many firms are still concerned with the accounting translations impact on reported consolidated earnings and balance sheet values. (Madura, 1995,p. 286, 360). The reported values in the consolidated financial statements may have influence on the judgements of the firm's performance and its management's performance. Despite the notes which explain how they accounted for foreign currency translation, the dollar values reported in the consolidated financial statements are often used on their face value by many share holders, bankers, board directors, security analysts, credit rating agencies, and investors. This misinterpretation of financial statements gives misleading pictures about the performance of the company and its management.

Evidence regarding the relevance and importance of accounting exposure is not conclusive. In the middle 1970s, a survey found that most firms identified translation exposure to be more important than transaction exposure. A repeat of the survey in 1977 revealed the contrary. (Madura, 1995, p.286). Contradicting this, Dufey (1978, pp.51-57, as reported in Shapiro 1996, p. 248), demonstrated that firms act on the basis of balance sheet exposure rather than economic impact. Also a survey of firms, in the early 1990s, by *Institutional Investor* magazine found that more than one-third of firms believe that the hedging of accounting exposure is a major concern (Madura, 1995, p.360). A study by Aggarwal (1991) contends that it may be rational for a multinational firm to manage translation exposure in the presence of various agency costs, non-trivial direct and indirect costs of financial distress, and differential tax rates.

As reflected in the stock market reaction to the adoption of new foreign currency translation standards in USA, there also seems to be some indirect evidence of the rational and market value-relevance nature of translation exposure management. For example, Collins and Salatka (1993) conclude that the market perceives the earnings of firms using the temporal method to be of lower quality. Bartov (1997) finds that rules in SFAS # 8 produced a poor accounting measure

for valuing US multinational firms, and that the introduction of SFAS #52 has resulted in a significant improvement in the valuation relevance of the accounting numbers associated with the restatement of a foreign operation's financial statements. Ziebart and Kim (1987) demonstrate that the stock prices of US multinational firms reacted negatively to the introduction of SFAS # 8 and positively to SFAS # 52.

At times managers might fear loss of bonus tied to reported profits, or possibly loss of a job if an investment is made in another country and subsequently the translated financial statements report severe translation losses back to the home office (Eiteman, Stonehill, Moffett, 1995, p.262). Such managers might avoid economically profitable foreign investments when devaluations (of those foreign currencies) are expected. On the other hand, if these managers decide to invest in those countries, they might take various measures to heavily hedge the translation exposure of those subsidiaries operations. Those measures often have adverse effects on a subsidiary's financing cost, transaction exposure, operational efficiency, or cash profitability. Firms would certainly prefer a strategy which will mitigate accounting exposure without increasing transaction exposure and financing costs.

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STRATEGY

We start by describing the relevant characteristics and preferences of the main participants involved in the strategy.

These characteristics and preferences are the ones which are immediately pertinent to the development of the proposed model.

[insert table]

Exhibit 1

Translation of a Subsidiary's Financial Statements Under Current Rate and Temporal Methods (figures are in millions)

	Local Currency (M\$)	Accounting Method				
	1/1/97	31/12/97	Current Translation Rates	Temporal US\$	Translation Rates	US\$
Assets						
Cash	260	360	.25	90	.25	90
Accounts Receivable	380	430	.25	107.50	.25	107.50
Inventory	400	425	.25	106.25	.5	212.50
Fixed Assets – Net	800	825	.25	206.25	.5	412.50
Total Assets	1840	2,040		510.00		822.50
Liabilities & Equity						
Accounts Payable	350	350	.25	87.5	.25	87.5
Long-term Debt	100	100	.25	25	.25	25
Stockholders' Equity						
Common Stock	600	600	.5	300	.5	300
Retained Earnings	790	990		475		410
CTA				(377.50)		
Total Liabilities plus Equity	1,840	2,040		510		822.50

Income Statement for the year ended 31 December 1997

Sales	1,200		.4	480	.4	480
- Cost of goods sold	700		.4	280	.4	280
= Gross profit	500			200		200
- Operating expenses	300		.4	120	.4	120
= Operating Profit	200			80		80
- Translation gain (loss)						(65)
= Net income **	200			80		15

Translation Adjustment Versus Translation Gain (Loss)

Beginning net assets		1,390		695		695
Ending net assets		1,590		397.50		710
Difference to be accounted for		200		-297.50		15
Operating income		200		80		80
Translation gain (loss)		---		----		(65)
Net income		200		80		15
Translation adjustment		---		(377.50)		----
Change in owners' funds		200		(297.50)		15

As noted earlier, the three main participants of the model are, MNCs (borrowers), NPFs (lenders), and Asia-Pacific nations (host countries). Their selected characteristics and preferences, some of which have already been discussed, are listed below.

In relation to MNCs (borrowers):

- financing, investment and other business activities are subject to foreign exchange exposure (e.g., transaction and accounting exposures);
- need to secure large sums of debt, particularly for very long-terms;
- want to increase the multinational corporation's presence in the host countries (to eliminate the host countries' scepticism about the MNCs' contribution to the national development); and
- want to reduce accounting and transaction exposures and financing cost.

In relation to NPFs (lenders):

- large sums of funds are available for lending at different maturity periods;
- large sums of funds can easily be committed for very long terms;
- want their investment to be free from foreign exchange risk;
- want to invest in virtually risk-free assets ;
- want to earn a better return; and
- want to mobilise savings for socioeconomic development of their nations.

In relation to Asia-Pacific Nations (host countries):

- rapidly growing economies with large and growing markets;
- sceptical about the MNCs' contribution to the nation;
- prefer higher returns at no extra risk for their NPF investments;
- some (e.g. Fiji, PNG) prefer to encourage domestic investment of NPF monies;
- some (e.g. Singapore, Malaysia) prefer to invest certain proportions of NPF monies outside their own countries but within Asia-Pacific region; and
- want economic growth and higher level of employment.

In addition to the three main participants (MNCs, NPFs, and host countries) in the strategic framework, banks may involve as a side participant. Some examples of host countries and their NPFs are: Malaysia and its Employee Provident Fund (EPF), Singapore and its Central Provident Fund (CPF), Fiji and its Fiji

National Provident Fund (FNPF), Papua New Guinea and its NPF. For clarity and ease of comprehension, a strategic framework is outlined using the names of some host (or Asian-Pacific) countries and their NPFs (rather than using generic descriptions). The hypothetical case used for illustration assumes an U.S.-based (parent) company with subsidiaries in Singapore, Malaysia, and some other countries. In this paper, local currencies in Singapore and Malaysia, namely, Singapore dollar and ringgit, respectively, are denoted as S\$ and M\$.

For simplicity, a skeleton model with minimum features is adopted.

For simplicity without loss of generality, a skeleton model, with minimum features necessary to demonstrate the potential of the strategy, is adopted. This model has two products (X and Y), two countries (Singapore and Malaysia), and their two NPFs (CPF and EPF). A detailed strategy for a particular firm will, obviously, have much more details and operational (as opposed to conceptual) variations from the basic skeleton model outlined here. Several alternative strategies can be developed by expanding the skeleton model by adding more countries, products, financial, investment, and trade flows, and operational features. The skeleton strategy deliberately presents a simplified and straightforward model to easily illustrate the point.

Basic features of the skeleton model are outlined below:

- multinational firm borrows certain proportions of its total debt requirement in local currencies (S\$ and M\$) from CPF and EPF;
- invest these monies in their respective countries;
- product A is manufactured in Singapore and B in Malaysia;
- sell part of product A in Singapore and receive S\$;
- sell part of product B in Malaysia and receive M\$;
- export part of product A to Malaysia and part of product B to Singapore such that the values of each export are equal;
- product A imported to Malaysia is sold in Malaysia for M\$;
- product B imported to Singapore is sold in Singapore for S\$;
- use S\$ earned from sale of A and B to service debt from CPF;
- use M\$ earned from sale of A and B to service debt from EPF;

Mitigation of accounting exposure under this model is illustrated by changing the appropriate numbers in Exhibit 1. For explaining the mitigation of accounting exposure in a simple way without loss of generality a number of assumptions

are made: one subsidiary (which is in Malaysia); one product (B); no exports; subsidiary has adopted the strategy of increasing M\$ debt and the balance sheet at the beginning of the year contains M\$690 long-term debt and M\$200 retained earnings (as shown in Exhibit 2 under 1/1/97 column); sales, cost of goods sold, and operating expenses remain unchanged. It may be noted that in Exhibit 2, the debt figure is increased by reducing the retained earnings figure for convenience. However, the point made will remain valid if it is assumed that the M\$100 million debt in Exhibit 1 (without strategy) was an US dollar loan (US\$50 million) converted into M\$ and then in Exhibit 2 (with strategy) it is a local currency debt of M\$100.

The balance sheet, income statement, and translation adjustments for the subsidiary which has adopted the proposed strategy are shown in Exhibit 2. As seen in Exhibit 2, the proposed strategy produces better outcomes (compared to without strategy in Exhibit 1) under both current and temporal methods. Negative cumulative translation adjustment has reduced from US\$377.50 to US\$230. Reduction in owners' equity has been decreased from US\$ 297.50 to US\$150 under the current rate and the increase in owners' equity has gone up from US\$15 to US\$162.50 under the temporal method. Reported net income under the temporal method has increased from US\$15 to US\$162.50 as a

Exhibit 2

Financial Statements of the Subsidiary which had Adopted the Proposed Strategy (figures are in millions)

	Local Currency (M\$)		Accounting Method			
	1/1/97	31/12/97	Current Rate		Temporal	
			Translation Rates	US\$	Translation Rates	US\$
Assets						
Cash	260	360	.25	90	.25	90
Accounts Receivable	380	430	.25	107.50	.25	107.50
Inventory	400	425	.25	106.25	.5	212.50
Fixed Assets – Net	800	825	.25	206.25	.5	412.50
Total Assets	1840	2,040		510.00		822.50
Liabilities & Equity						
Accounts Payable	350	350	.25	87.5	.25	87.5
Long-term Debt	690	690	.25	172.50	.25	172.50
Stockholders' Equity						
Common Stock	600	600	.5	300	.5	300
Retained Earnings	200	400		180		262.50
CTA				(230)		
Total Liabilities plus Equity	1,840	2,040		510		822.50

consequence of turning the US\$65 translation loss into a translation gain of US\$82.50.

The proposed strategy reduces the transaction exposure as both the original loan and the subsequent debt services are in local currency. Debt services are made from the local currency (S\$ and M\$) earned by sales in the same host countries (Singapore and Malaysia). Therefore, the exchange rate fluctuations do not expose the subsidiary to transaction exposure. On the other hand, if the loans were obtained in US\$ and converted to S\$ and M\$ for investing in Singapore and Malaysia, then the firm will be subjected to transaction exposure (loss) when the S\$ and M\$ depreciates over time. The amount of local currency required for the repayment of a given amount of US\$ denominated debt will increase. This is particularly so for long-term (say 10 to 20-year) loans, as the value of many Asian-Pacific currencies seem to substantially depreciate over time. This can also happen, at times, even within short time periods. For example, with the Asian currency crisis, the value of the Malaysian ringgit (M\$), Thai Baht, and Indonesian Rupiah against the US\$ depreciated dramatically within a short time. Their values dropped to around M\$3.8, Baht 50, and Rupiah 9,075 per US\$ in February 1998 (compared to their rates a year ago, which were around M\$2.5, Baht 25, and Rupiah 2,399 per US\$).

The proposed strategy can also reduce the financing cost compared to existing local currency borrowing.

The proposed strategy can also reduce the financing cost compared to existing local currency borrowing as the proposed strategy involves direct borrowing by multinational firms from the NPFs. Direct large size loans reduces the financing cost for two reasons, namely, lower (per unit) transaction cost due to economies of scale and reduction in (or elimination of) financial intermediary. In order to satisfy the preferences of both the lender (NPF) and the borrower (MNC), the following four conditions should be satisfied:

$$R_{mnc} = (I_{npf} + F_{bg}) \leq R_o \quad (1)$$

$$I_{npf} \geq I_{gv} I_{bd} I_o \quad (2)$$

$$RISK_{mnc} \leq RISK_{mnc\ exist} \quad (3)$$

$$RISK_{npf} \leq RISK_{npf\ exist} \quad (4)$$

where,

- R_{mnc} = financing cost (as a percent per annum) to the MNC of proposed NPF loans;
- I_{npf} = rate of return to NPF on its loans to the MNC (i.e. interest rate on NPF loans to the MNC);
- F_{bg} = bank guarantee and loan syndication fees (as a percent per annum) paid by the MNC for guaranteeing the debt service of NPF loans to the MNC;
- R_o = cost of borrowing (as a percent per annum) to the MNC from sources other than NPFs
- I_{bd} = rate of return to the NPF on investments in term deposits with domestic banks
- I_{gs} = rate of return to the NPF on investments with government securities
- I_o = rate of return to the NPF on investing in other domestic assets (e.g. loans to local government authorities and companies)
- $RISK_{mnc}$ = foreign exchange risk to the MNC of proposed borrowings from the NPF
- $RISK_{mnc\ exist}$ = foreign exchange risk to the MNC of current sources of borrowing
- $RISK_{npf}$ = risk of proposed NPF loans to the MNC
- $RISK_{npf\ exist}$ = level of risk in NPF's existing investment portfolio

It is obvious that condition 3 is easily satisfied under the proposed strategy and needs no explanations. Condition 4 can be satisfied by arranging a bank guarantee if necessary. On the other hand, it can be argued that the credit worthiness of many multinational firms is so high that there is no greater risk in lending to MNCs than the NPFs current practice of lending to (say, term deposits with) banks.

Is it possible to satisfy the necessary conditions (1) and (2) for borrowing and lending? In other words, how can the MNC lower its financing cost (i.e. borrow at a lower cost than what it pays otherwise) and pay the NPF a higher interest rate (than what the NPF gets otherwise)? This is possible for two reasons, namely, lower (per unit) transaction cost of large size loans, and reduction in financial intermediary cost. The interest spread (between bank

In a best situation, returns to the NPF from the MNC debt securities may exceed returns from any other existing NPF investments.

deposit and lending rates) in domestic markets is significant. This spread (or at least part of it) can be shared between the MNC and the NPF. Even the sharing of a narrower spread should still be sufficient to maintain a higher return to the NPF and a lower borrowing cost to the MNC after allowing for bank guarantee fees. Through the reduction in the financial intermediary process, a part of the intermediary's spread is now shared by the lender (NPF) and the borrower (MNC). Also the economies of scale are now shared by the lender and the borrower.

In a best situation, returns to the NPF from the MNC debt securities may exceed returns from any other existing NPF investments, and financing cost to the MNC of its proposed borrowing from the NPF may be lower than that of its any other sources of finance. In a minimum acceptable situation, returns to the NPF from the MNC debt may exceed returns from at least one other NPF investments (of comparable risk) and financing cost to the MNC of its borrowing from the NPF may be lower than that of at least one other sources of its finance.

The proposed strategy involves four beneficial elements for the MNC:

- potential for lowering financing cost;
- easy accessibility for large sums of loanable funds (from NPFs) on very long-term maturities;
- potential for reducing accounting and transaction exposures; and
- increased presence of the MNC in the host country.

The MNC can borrow from selected Asia-Pacific NPFs in their local currencies for different maturity periods to suit the MNCs' debt maturity requirements. Asia Pacific National Provident Funds (NPFs) have large volumes of funds available for long-term investments. As an indication of the magnitude of the investible funds available in some Asia-Pacific NPFs, relevant figures for two funds are quoted below. The total investment portfolio in Malaysia's EPF in 1993, obtained from the EPF's 1993 Annual Report and converted into US\$ using International Monetary Fund's International Financial Statistics exchange rates, was over US\$25 billion. The comparative figure for Singapore's CPF in

1992 was over US\$32 billion (Asia Pacific Economics Group, 1994, p.181). Since the NPF monies are trust fund monies which are held and invested by the NPFs on behalf of their members, they are being largely invested in risk-free assets such as government securities, bank term deposits, and bank or government guaranteed loans to private-sector companies, statutory authorities, and local government authorities (Dayananda & Irons 1996). For example, over 90 percent of CPF's investments are in government securities. The proposed model suggests a different mix for the NPF investment portfolios, which includes a new asset, namely, loans to MNCs.

The proposed model also involves reinvestment of MNCs' borrowing from NPFs in their respective host countries. This will facilitate the achievement of host country preferences (economic growth and higher employment), NPFs' secondary objective (mobilisation of savings for socioeconomic development), and one of the MNC objectives (increased presence in the host country).

For the proposed strategy to be realistic, it is necessary that MNCs invest in the Asia-Pacific region. This condition is easily satisfied. Many MNCs already have plant locations and investments in the region. On the other hand, the size and growth of markets have been found to be an important determinant of foreign investment (Tepstra & Yu 1988), and in this respect, the size of the Asia-Pacific market is substantial and its growth is very rapid. Given the host countries' perceptions about MNCs and strategic considerations, multinationals normally prefer to increase their presence in the host countries. The proposed model involves financing, investing and selling in the Asia-Pacific region. All these increase the presence of the MNCs in the host countries.

CONCLUDING REMARKS

The paper provides a conceptual exposition of a strategy for multinational firms to simultaneously reduce accounting and transaction exposures and financing cost and increase the firms' presence in host countries. The implicit assumption underlying the model development is that Asian-Pacific currencies depreciate over time against US\$ (or currencies of the countries which are the homes of multinational firms). The latent potential of the model presented is based on the

The proposed model suggests a different mix for the NPF investment portfolios

NPF investments in MNCs, restructuring the finance mix and business operations of MNCs, and the principles of risk transformation, financial disintermediation, and transaction cost reduction. While the features outlined in the skeleton strategy are the minimum simplified operational characteristics of the model sufficient for a theoretical demonstration of the concept, an actual strategy will involve more detailed features and mechanisms and even various deviations from the skeleton model. These additions and variations are essential to make the conceptual strategy suitable for different multinational firm's different circumstances.

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This collaborative research group is funded by the Central Queensland University to encourage academics to develop specialised research skills pertinent to the study of Australian businesses operating in the Asia-Pacific region. Its main aims and objectives are to learn about the intricacies of conducting research in different Asia-Pacific cultures, learn about sensitivities in business networking in the region, identify and access information and expert resources and formulate and conduct specific research projects.

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