

12.1: Chapter Introduction

Understanding the Roles of Finance and Accounting in Global Competitive Advantage

WHAT'S IN IT FOR ME?

1. What are the role of accounting in business and the impact of international standards?
2. What are the nature of currency risk and the methods of currency translation?
3. What are the sources of financing available to firms?
4. What are capital budgeting and the factors that influence international investment decisions?
5. What are global money management methods that reduce corporate transaction costs and taxes?

In this chapter, you'll learn the principles and techniques of global finance and accounting. In the opening case study, you'll see the increased role that governments are playing in the business finance arena. In a flat world, access to capital (i.e., part of the finance function) is uniform across countries, as are accounting standards. However, access to capital varies significantly across countries and between small and large firms. Accounting standards also vary, though these differences are decreasing.

In [Section 15.1](#), you'll get a glimpse into why countries developed different accounting rules in the past and how new international accounting standards have emerged to create smoother capital markets functioning in our increasingly global world.

In [Section 15.2](#), you'll learn the importance of consolidated financial statements, and the challenges they present in currency translation. You'll also explore two techniques of currency translation and two ways to mitigate the risks of currency exposure.

In [Section 15.3](#), you'll learn the sources of financing available to international firms and see how firms like L'Occitane, IBM, Hewlett-Packard, Kimberly-Clark, SAP, and McDonald's are making financing and investment decisions.

In [Section 15.4](#), you'll see the factors underlying political risk and economic volatility and learn three ways that multinational firms are structuring their financial organizations to deal with those risks. You'll also find out how religion can impact the financial laws of some countries.

Finally, in [Section 15.5](#), you'll delve into global money management and how firms like Colgate move money across borders to minimize costs and taxes, while gaining maximum returns on their capital.

Opening Case: Bucyrus and Ex-Im Bank

Among the many changes taking place in the international business landscape, numerous leading management consultants predict that government will play an increasingly active role. Governments will no longer simply be an external regulator but will be a direct participant in particular strategic choices and actions. The *new normal*, in terms of government involvement in business, is one in which government's hand in strategy and strategy execution will be highly visible and significant. Part of this governmental activism is a result of the growing scale and reach of global firms. For instance, even before the global financial meltdown in 2009, McKinsey & Company consultancy noted the following:

As businesses expand their global reach, and as the economic demands on the environment intensify, the level of societal suspicion about big business is likely to increase. The tenets of current global business ideology—for example, shareholder value, free trade, intellectual-property rights, and profit repatriation—are not understood, let alone accepted, in many parts of the world. Scandals and environmental mishaps seem as inevitable as the likelihood that these incidents will be subsequently blown out of proportion, thereby fueling resentment and creating a political and regulatory backlash. This trend is not just of the past 5 years but of the past 250 years. The increasing pace and extent of global business, and the emergence of truly giant global corporations, will exacerbate the pressures over the next 10 years. Ian Davis and Elizabeth Stephenson, "Ten Trends to Watch in 2006," *McKinsey Quarterly*, January 2006, accessed July 24, 2010, www.mckinseyquarterly.com/Ten_trends_to_watch_in_2006_1734.

Unfortunately for big (and small) business, the apparent systematic risk, managerial excesses, and imprudence that led to the global financial meltdown in 2008 and 2009 have only exacerbated the interest of government in business matters. Let's look at the example of Bucyrus International for how to survive and thrive in this new normal of governmental activism. Compiled based on reports in Rick Barrett, "Bucyrus Chief Dug Deep for Support," *Milwaukee (WI) Journal Sentinel*, July 3, 2010, accessed July 23, 2010, <http://www.jsonline.com/business/97745649.html>; James R. Hagerty, "U.S. Ex-Im Bank Reconsiders India Coal Project," *Wall Street Journal*, June 30, 2010, accessed July 23, 2010, http://online.wsj.com/article/SB10001424052748704334604575338791530127472.html?mod=WSJ_hps_LEFT_WhatsNews; Rich Rovito, "Bucyrus' Sullivan Wants Vote, and Sleep," *Milwaukee (WI) Business Journal*, July 6, 2010, accessed July 23, 2010,

http://milwaukee.bizjournals.com/milwaukee/blog/2010/07/bucyrus_sullivan_wants_vote_and_some_sleep.html?t=printable; Rick Barrett, “Export-Import Bank May Reconsider Bucyrus Decision,” *Milwaukee (WI) Journal Sentinel*, June 28, 2010, accessed July 23, 2010, <http://www.jsonline.com/business/97319564.html>.

Meet Bucyrus

Bucyrus caters to those who *mine* their own business. Bucyrus website, accessed July 23, 2010, www.bucyrus.com. To be precise, the company designs and manufactures surface and subsurface mining equipment and aftermarket replacement parts, as well as servicing its equipment. Its mining products are used for unearthing coal, gold, iron ore, oil sands, and other raw materials. The company sells products to customers worldwide, from large companies to small ones to quasi-governmental agencies operating largely in South America, Australia, Canada, China, India, South Africa, and the United States. Even though Bucyrus is a US-based company, international sales account for more than 70 percent of its revenues.

Bucyrus in Emerging Markets

Like many successful multinationals, much of Bucyrus’s new work takes place in emerging markets where the growth and need is greatest. For instance, Bucyrus struck a deal in which its mining shovels would be used to dig coal to fire a giant, new power plant being built by Reliance Industries in India. Reliance, with nearly 25,000 employees, is India’s largest private-sector conglomerate, with business interests in energy, retailing, chemicals, textiles, and communications. “10 Years Highlight: Financial Highlights,” Reliance Industries Limited, accessed July 23, 2010, www.ril.com/html/investor/10_yearshighlight.html.

Although Bucyrus and Reliance had agreed on the deal, the involvement of the Export-Import Bank of the United States (Ex-Im Bank) as a loan guarantor complicated things. Ex-Im Bank is the principal government agency responsible for aiding the export of American goods and services—thereby creating and sustaining US jobs—through a variety of loan, guarantee, and insurance programs. Although supporting US exports is its primary mission, the bank was sued by Friends of the Earth, Greenpeace and four American cities that brought a global warming lawsuit against the bank as well as the Overseas Private Investment Corporation (OPIC), contending that the agencies provided financial assistance to projects without first evaluating the projects’ global warming impacts. Friends of the Earth, “Landmark Global Warming Lawsuit Settled,” press release, February 6, 2009, accessed December 12, 2010, action.foe.org/t/6545/pressRelease.jsp?press_release_KEY=486. The lawsuit took seven years to resolve, but in the end the courts ruled that Ex-Im Bank and OPIC must consider the environmental effect of the projects they fund. “Settlement Agreement: Export-Import Bank of the United States,” Friends of the Earth, February 6, 2009, accessed December 12, 2010, www.foe.org/pdf/Ex-Im_Settlement.pdf; “Victory!,” *ClimateLawsuit.org*, accessed December 12, 2010, www.foe.org/climate/climatelawsuit/index.htm.

In reviewing Bucyrus’s loan-guarantee application, Ex-Im Bank expressed concerns about the project’s environmental impact. Bob Hague, “Ex-Im Bank Moves Forward on Bucyrus Deal,” *Wisconsin Radio Network*, July 14, 2010, accessed December 12, 2010, <http://www.wrn.com/2010/07/ex-im-bank-moves-forward-on-bucyrus-deal>. In the end, the bank rejected the application. It stated that the coal-fired power plant that would be fed by the mine conflicted with the Obama administration’s environmental goals. Mark Drajem, “Reliance Power’s India Plan Rejected by U.S. Export-Import Bank,” *BusinessWeek*, June 26, 2010, accessed December 12, 2010, <http://www.businessweek.com/news/2010-06-26/reliance-power-s-india-plan-rejected-by-u-s-export-import-bank.html>. The guarantees would have backed loans that Reliance would have used to purchase mining equipment from Bucyrus. If the bank’s rejection of the financing stood, Reliance could turn to another country, most likely China, for financing and equipment. James R. Hagerty and Amol Sharma, “Employment, Environment at Odds,” *Wall Street Journal*, June 28, 2010, accessed December 12, 2010, <http://online.wsj.com/article/SB10001424052748704846004575332810145193160.html>. The bank’s ruling was not appealable, but within hours of hearing about it, Bucyrus CEO Tim Sullivan launched an intense campaign aimed at getting Ex-Im Bank to reverse course before the Indian project’s equipment orders went to Chinese companies. Sullivan argued that the rejection could result in a loss of \$600 million in equipment sales for Bucyrus and up to 1,000 US jobs could be at stake. Patrick McIlheran, “Reprieve for Bucyrus in Era of Mojo,” *Milwaukee (WI) Journal Sentinel*, June 30, 2010, accessed December 12, 2010, <http://www.jsonline.com/news/opinion/97521434.html>.

Preparation + Reaching Out to Stakeholders...and a Little Luck

Sullivan fumed at the bank’s rejection of his loan application. He had recently gone out on a limb and made the bold move of convincing his board of directors to spend \$250 million to expand and refurbish Bucyrus’s South Milwaukee operations, while the company’s competitors were moving work to China. Rick Barrett, “Bucyrus Chief Dug Deep for Support,” *Milwaukee (WI) Journal Sentinel*, July 3, 2010, accessed July 23, 2010, <http://www.jsonline.com/business/97745649.html>. Instead of accepting defeat with the bank’s decision, he went on the attack. Sullivan notified elected officials, many of whom were engaged in reelection

campaigns. Given the prevailing tough US economic atmosphere, the officials would likely back an initiative that would retain or increase US jobs. Sullivan also called business and labor union leaders and enlisted support from Bucyrus's hundreds of suppliers. The president of the United Steelworkers of America, Leo Gerard, appealed to the public to participate in a letter-writing campaign to protest Ex-Im Bank's refusal to finance mining equipment that would be made by union members. "At a time when we are losing good-paying jobs, and at a time when President Obama wants to double US exports, how can the Export-Import Bank deny a loan that would create and protect jobs at Bucyrus International? It was a dumb decision," Gerard told the *Journal Sentinel*. Rick Barrett, "Obama Visit to Racine Wednesday May Be Pushing Review," *Milwaukee (WI) Journal Sentinel*, June 28, 2010, <http://www.jsonline.com/business/97319564.html> accessed November 28, 2010.

As Sullivan rallied potential supporters, luck played its role: President Barack Obama was planning for a town hall meeting in Racine, Wisconsin, just a few miles from Bucyrus's headquarters. Even better, the town hall meeting topic was the economy. A local business association took out full-page advertisements in the local newspapers asking the president to help reverse the bank's decision and save US jobs. Sullivan was astute in pushing the right political hot buttons, but getting Obama's attention would have been much harder had he not been coming to Racine.

All-Night Negotiations and a Surprise Reversal of the Ex-Im Bank Decision

It is important to remember that Bucyrus is not a coal miner but instead a supplier to that industry, so Ex-Im Bank's complaint was really with Bucyrus's customer, Reliance. After all-night negotiations, still prior to President Obama's visit to Wisconsin, Reliance and Ex-Im Bank remained in disagreement. The bank's primary mission is to support US exports. Carter Wood, "Ex-Im Bank: Starting to Get Things Right, Slowly," *Shop Floor*, July 15, 2010, accessed December 12, 2010, shopfloor.org/tag/export-import-bank, but it still wanted Reliance to commit to buying US equipment for renewable energy projects as a condition of its approving the loan guarantees. Rick Barrett, "Reversal Revives Bucyrus' Big Deal," *Milwaukee (WI) Journal Sentinel*, June 30, 2010, accessed December 12, 2010, <http://www.jsonline.com/business/97484379.html>. Reliance, however, stated that making such a promise would violate World Trade Organization rules. The impasse was finally settled when Reliance agreed to pursue renewable energy projects in addition to the coal-fired power plant. Rick Barrett, "Reversal Revives Bucyrus' Big Deal," *Milwaukee (WI) Journal Sentinel*, June 30, 2010, accessed December 12, 2010, <http://www.jsonline.com/business/97484379.html>. In an Export-Import Bank news release, Ex-Im Bank chairman and president Fred P. Hochberg said, "We are pleased that Reliance is making this commitment to renewable energy, which allows us to sustain U.S. jobs and promote both conventional and renewable energy exports." Export-Import Bank of the United States, "Ex-Im Bank Approves Preliminary Review of Export Financing Application for India's Sasan Power Plant," press release, July 14, 2010, accessed December 12, 2010, www.exim.gov/pressrelease.cfm/D25FB2CF-D13D-A3B0-A324873AFCC72DC7. Renewable energy sources only account for about 12 percent of India's power. Prashant Bawankule, "Renewable Energy Sources: What Will Work for India?," *Chilli Breeze*, November 2010, accessed December 12, 2010, www.chillibreeze.com/articles_various/Renewable-Energy.asp, while 50 percent comes from coal-fired plants and the rest from oil and gas. Prashant Bawankule, "Renewable Energy Sources: What Will Work for India?," *Chilli Breeze*, November 2010, accessed December 12, 2010, www.chillibreeze.com/articles_various/Renewable-Energy.asp. Therefore, progress on alternative energy sources in India was seen as a victory (or at least a face-saving reason) for Ex-Im Bank's reversing its original decision.

A few of hours before Obama landed in Wisconsin, therefore, Ex-Im Bank announced it would reconsider its rejection of the loan guarantees and would review the application again, taking "into account Reliance's expressed commitment to invest in the renewable energy sector" in its review. Mark Drajem, "U.S. Export-Import Bank Reconsiders India Coal Financing Deal," *BusinessWeek*, July 1, 2010, accessed December 12, 2010, <http://www.businessweek.com/news/2010-07-01/u-s-export-import-bank-reconsiders-india-coal-financing-deal.html>. In a letter to Reliance chairman Anil Ambani, Hochberg asked Reliance to consider building renewable-energy power plants capable of producing at least 250 megawatts of power, which would be among the largest renewable projects built in India to date. Fred P. Hochberg, letter to Anil Ambani, Chairman, Reliance ADAG, June 30, 2010, accessed December 12, 2010, media.journalinteractive.com/documents/EI-bank-ltr_062010.pdf. The letter did not, however, make the loan guarantees contingent on a fixed amount of renewable energy nor did it impose a deadline for those projects. Rick Barrett, "Reversal Revives Bucyrus' Big Deal," *Milwaukee (WI) Journal Sentinel*, June 30, 2010, accessed December 12, 2010, <http://www.jsonline.com/business/97484379.html>.

Nonetheless, Reliance's agreement to support renewable energy projects was the key factor in the bank's reversed decision. "If we can encourage India to move faster toward renewable energy as part of this project, and to increase opportunities for U.S. exporters, and to finalize the deal with Bucyrus and save jobs, that's a big victory for everyone," an Ex-Im Bank official said. Rick Barrett,

“Reversal Revives Bucyrus’ Big Deal,” *Milwaukee (WI) Journal Sentinel*, June 30, 2010, accessed December 12, 2010, <http://www.jsonline.com/business/97484379.html>.

Although experts agree that Obama’s involvement was vital to the bank’s reverse decision, many think Bucyrus would have prevailed in the long run anyway, because the bank’s decision would not prevent the plant from being built but merely result in the equipment contract going to a foreign competitor.

Experts said Bucyrus’s reaction to the bank’s initial decision could be a great example of how a company should behave when a deal is threatened by a government agency. Rick Barrett, “Bucyrus Chief Dug Deep for Support,” *Milwaukee (WI) Journal Sentinel*, July 3, 2010, accessed July 23, 2010, <http://www.jsonline.com/business/97745649.html>. Sullivan may have been lucky with Obama’s pending visit to Racine, but he also had courage and knew how to seize the moment, enlisting the help of business leaders, union officials, and elected officials alike. “If you are going to be aggressive, the way Bucyrus was in this case, then you had better have the facts on your side,” said University of Wisconsin–Madison professor Mason Carpenter. Bucyrus took risks and expended much political capital. “The stakes were big here,” Carpenter said. “To me, this was a case of how to respond to a crisis in our new, more political world.” Rick Barrett, “Bucyrus Chief Dug Deep for Support,” *Milwaukee (WI) Journal Sentinel*, July 3, 2010, accessed July 23, 2010, <http://www.jsonline.com/business/97745649.html>.

Opening Case Exercises

(AACSB: Ethical Reasoning, Multiculturalism, Reflective Thinking, Analytical Skills)

1. How was the deal between Bucyrus and Reliance threatened by a government agency?
2. What do you think of how Bucyrus’s CEO handled the situation?
3. Do you think governmental agencies will become more involved in business matters? Why or why not?

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