

## OPTIMAL FINANCIAL STRUCTURE

### I. Additional Variables:

1. International availability of capital may affect the optimal debt ratio of an MNC
2. Financial risk is reduced through international diversification of cash flows
3. Financial structure of foreign affiliates

### II. Other Determinants of MNC's Debt Ratio

- a. Country debt ratio norms: low in Southeast Asia, Latin America, and Anglo America; high in Scandinavia, Mediterranean, and the Indian subcontinent
- b. Localized financial structure for foreign affiliates can
  - reduce criticisms (low contribution of risk capital, insensitivity to local money policy)
  - facilitate evaluation of ROE relative to local competitors in the same industry
  - cause a loss of competitive advantage when conforming to local norm
  - matter very little, since lenders look at consolidated worldwide cash flows

## **COST OF CAPITAL AND FINANCIAL STRUCTRE**

Objective: To maximize firm value by minimizing the weighted-average cost of capital.

Method: Take an international approach to designing a financial structure to take advantage of lower-cost sources of funds

Factors influencing cost of capital:

1. Availability of capital: cheaper sources because of increased market liquidity
2. Segmentation of capital markets: cheaper fund from international markets
3. International diversification motive: lower required rate of return
4. Adjustment of cost of capital to reflect foreign exchange and political risk
5. Taxation policies
6. Disclosure of firm's financial position
7. Effect of Multinational operations on optimal financial structure:  
diversified cash flows -> lower cost of debt
8. Financial structure of affiliates
  - parent capital structure
  - subsidiary capital structure
  - consolidated capital structure