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Review of Money in the Multinational Enterprise: A Study of Financial Policy, by Sidney M. Robbins and Robert B. Stobaugh

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a complicated political situation to offer us a welcome addition to this series of monographs on international crises and the role of law.⁸

T. R. Schuck

MONEY IN THE MULTINATIONAL ENTERPRISE: A STUDY OF FINANCIAL POLICY. By Sidney M. Robbins¹ and Robert B. Stobaugh.² New York: Basic Books, Inc., 1973. Pp. xiv, 231. \$11.00

Money in the Multinational Enterprise is the third volume to appear in the Harvard Business School series on the multinational enterprise, the best known being Raymond Vernon's *Sovereignty at Bay*. In these days of considerable concern³ with the impact upon the international economic system—and national monetary management—of short term flows resulting from multinational enterprise maneuvers,⁴ one would imagine that a book with such an intriguing title as *Money in the Multinational Enterprise* would bare all the secrets of how the multinationals play the international money markets and how the clever treasurers stage bear raids on the limping pound or dollar or leap on the performance bandwagon of the mark. In short, one expects to be told the story of how the multinationals profit from money as a commodity, just as the Russians have been clever about wheat and, more recently, sugar. On the contrary, Messrs. Robbins and Stobaugh have managed to write a study of management of the financial function in their sample of 187 multinational enterprises, including one chapter specifically describing their subjects' efforts to avoid loss through depreciation (as measured in dollar terms) in the value of foreign currency assets because of devaluation of those currencies (or loss where the

8. Concluding comments by Professors Louis Henkin of the Columbia University School of Law, Edwin C. Hoyt of the University of New Mexico, and Hans A. Linde of the University of Oregon School of Law are appended to the study.

1. Professor of Finance, Graduate School of Business, Columbia University.

2. Professor of Business Administration, Harvard Business School.

3. In the course of the Senate hearings on the amendatory legislation necessary to change the par value of the dollar in terms of gold, Senator Proxmire queried the then Under-Secretary of the Treasury for Monetary Affairs on the role of multinational corporations in short-term money flows and received the answer that no data were available. *Hearings on S. 929 before the Senate Committee on Banking, Housing and Urban Affairs*, 93d Cong., 1st Sess. 47 (1973). The result was legislation directing the Treasury to require multinational corporations subject to the jurisdiction of the United States to submit reports of foreign currency transactions. Pub. L. No. 93-110. The Treasury issued proposed reporting requirements on June 27, 1974, 39 FED. REG. 23830-23844 (1974), but, except for banks, has not as of this writing issued final ones. In large part, Senator Proxmire's questions will not be answered by the information that the proposed reports will elicit.

4. See L. KRAUSE, *THE INTERNATIONAL ECONOMIC SYSTEM AND THE MULTINATIONAL CORPORATION* (1972).

enterprise is a *debtor* in a currency gone up), without once suggesting that their subjects ever do anything so crass as to speculate in currencies for gain. Indeed, they note that for the multinational enterprise as represented by their sample, "the fear of loss from devaluations or revaluations abroad has always been more important as a governor of action than the hope of gain from devaluations and revaluations" (p. 119).

Why? One reason is said to be that the accountants will insist on showing such a loss on the books, but accounting principles do not permit reporting certain types of gain unless offset by a loss. Also, as the authors note, governments are less likely to frown upon a firm's protecting against a loss than a firm's deliberately trying to profit from movements in exchange rates. Therefore, the strategy described by the firms in interviews as that followed by them in their transnational financial planning has been to reduce exchange loss as much as possible. The authors accept this description of the aim of the maneuvers described and have entitled the chapter describing the procedures utilized by the firms to achieve this aim, "Protecting against Exchange Risks."

It should be noted that this chapter describing the firm's strategies to deal with shifting currency values is only one chapter of ten. The structure of the book is a double one: the authors counterpoise the description of how the firms studied finance their foreign affiliates, withdraw funds from abroad, and deal with the possibilities inherent in currency value changes,⁵ with a description of the results achieved—with maximization of profits as the optimal result—by choice of manipulation of financial links through use of their simulation model. Appendix B to the book describes the model. The authors establish a relatively simple paradigm of a parent company with two subsidiaries, each unit located in a different country with varying economic environments including devaluations of the currency in the two subsidiary countries. The model was prepared to accord with the international monetary system of fixed rates with episodes of devaluations and revaluations of individual currencies, rather than with the present regime of floating rates. Nevertheless, the model is so constructed that anticipation of the market direction of a currency can be built into it as easily as the three devaluations that the authors inserted.

The model is equipped with all of the possibilities for manipulation of financial links in the system that the authors found used by the most sophisticated companies.⁶ These include the adjustment of transfer

5. For a description of these financial procedures (and their presumed effects) from quite another normative viewpoint, see the recent two-part article. Barnett and Muller, *A Reporter at Large, Global Reach*, THE NEW YORKER, Dec. 2 and 9, 1974, at 53-128 and 104-159.

6. For the person trained in law, one of the most interesting points of the book is the extent to which the sophisticated companies shift the characterization of the financial linkages to maximize *flexibility* in the transfer of funds. Funds can go into a subsidiary

prices, credit on receivables, short-term loans, long-term loans, royalties, management fees, and timing of dividends. Other than a set of tax results, there is a minimum of governmental constraints. The model evidently lives in a world where its governing jurisdictions believe that maximization of profits for the parent company will redound to the ultimate benefit of all.

Lo and behold, of all the financial practices tried on the model, it develops that the various maneuvers employed to minimize loss on exchange risk (shifting of funds throughout the multinational system to find the moment's currency value catbird seat) are the same ones that maximize profits for the model by producing an exchange profit of \$53 million. In analyzing the cause of maximization of profits when utilizing an "optimal policy" in the model, the authors refer tactfully to the "system's ability to take advantage of currency relations" (p. 166). In short, effective centralized planning by multinationals aims for gains through currency value changes, and the simulation model is the tool for this planning.⁷ Spokesmen for such enterprises say that the monetary policies of the companies are defensive, while the lobbyists for regulation will talk of currency speculation. As the authors, who have studied the policies and prepared a model for their "optimal" use, admit in their final chapter:

Large-scale short-term flights of capital ordinarily come about because of expected currency devaluations or revaluations rather than interest-rate arbitrage. When such movements occur, it is extremely difficult to ascertain with assurance the proportion attributable to so-called currency speculation and that attributable to the defensive efforts of multinational firms securing protection for the purchasing power of their liquid assets. [p. 182]

To be fair to the authors, they are well aware of the possible impact of their model upon the world community. Whether the aim is de-

in another country as debt, equity, or as the authors point out, longer than usual credit on receivables; they can come out dressed as dividends, repayment of debt or interest on trade credit—or simply as higher prices on goods sold to the subsidiary (so-called "transfer pricing"). One is reminded of the bad old days before article IX of the U.C.C. in which one had a whole choice of possible structures for a security interest with the optimal decision depending on the variables of the legal and tax environment of the jurisdiction. A simulation model of this sort would have been useful—and presumably would be in any area of the law where formalism still reigns supreme.

7. This tool is much more than an academic exercise. Chemical Bank of New York is presently advertising its "Foreign Exchange Advisory Service" ("helping the multinational corporation to manage foreign exchange exposure better"). The service includes use of two computer models: STRATSIM (Strategy Simulator) to evaluate "your worldwide currency exposure, analyse tax effects and permit you to test strategies for periods up to one year to modify your positions" and ALTDET (Alternative Debt Evaluator) to "analyse borrowing and capital budgeting alternatives in the multinational currency environment." This material is available on distribution from Chemical Bank.

fensive or offensive (in the sense of taking advantage of currency relations), "there is evidence that the policies of multinational enterprises have the potential of bringing about major adjustments in balance-of-payments relationships" (p. 180). They foresee that "Sooner or later, government action will severely limit the multinational enterprise's use of credit tools in shuttling funds throughout its system; thus the enterprises will be shackled in their ability to protect against currency changes" (p. 186). The authors do not deplore this result so long as "all multinational enterprises are faced with the same rules . . ." They note that then the managers can "concentrate on using their other competitive weapons, such as marketing and technology, which were the basic reasons for their foreign investments in the first place" (p. 187).

Unfortunately, while *Money in the Multinational Enterprise* offers a model for centralized planning for the use of credit tools to maximize the profits of the parent enterprise, it does not offer any prescription⁸ for the optimal program of government action to limit the use of these tools in the interest of the world community.⁹ To the contrary, the authors write with a curious air of neutrality: describing how one presently plays the game, giving a model by which one can improve his playing, and expressing their expectation that because the game has wide-ranging social effects¹⁰ the government will eventually change the rules of the game. Thus, while the morally neutral approach is no longer in fashion at the law schools, it is apparently still an approved mode in schools of business administration. Don't judge the game, just teach others to play it well. Or perhaps again this is unfair to the authors. The curious tone of the book may be caused simply by their recognition that the game as it is played is only a game, and that the goal, maximization of profits of the enterprise as measured by *accounting* concepts, is itself unreal, or at least bears no necessary relation to economic gains and losses.¹¹

Chapter two contains a small number of pages (six) on the concept of exchange loss in which the authors explain the difference between conversion loss and translation loss¹² and explain in addition that both

8. The authors, of course, may believe that optimality and regulation are incongruous.

9. The case that the governmental side could use some help has recently been presented in an excellent article by Professor Muller. Muller, *National Instability and Global Corporations: Must They Grow Together?* 11 BUS. AND SOC. REV. 61 (1974).

10. See note 5, *supra*.

11. For the peculiar effects of accounting principles in the operation of securities laws, see Kripke, *The SEC, The Accountants, Some Myths and Some Realities*, 45 N.Y.U.L. REV. 1151 (1970).

12. This portion of the book would be very helpful to the practitioner or scholar preparing to dip into the mysteries of the United States Internal Revenue Code and exchange gains and losses. See D. RAVENSCROFT, *TAXATION AND FOREIGN CURRENCY* (1973).

are measured by a process (the accountant's measurement of devaluation losses and gains) that "has a fundamental flaw in that it deviates from economic values. . . . Yet, when a devaluation occurs, accounting methods . . . usually result in the reporting of a loss in the consolidated statements of the parent, even if no actual loss has occurred or is to be expected" (p. 25). They point out, for example, that in economic terms, a devaluation might cause profits of other members of the enterprise system to rise because of increased transactions with the subsidiary in the country with the devalued currency. Nevertheless, the policies adopted by the multinationals to avoid exchange loss are policies aimed at the *accounting* losses or gains rather than economic losses or gains. The authors note:

True, some executives realize that only by chance does the economic gain or loss equal the gain or loss reported by accountants, but they still feel the need to minimize those reported losses because of their possible effect on the stock market. For these executives feel that players in the stock market look upon accounting losses as economic losses. But other executives believe that the accounting rules measure the economic losses, which obviously should be minimized. [p. 26]

The policies adopted to minimize losses or maximize gains have very real, if presently nonquantifiable, economic effects, culminating in violently fluctuating short-term capital flows. The authors know that the multinational ideology, *i.e.*, the belief on the part of executives that the accounting rules measure the economic losses (or gains), results in the adoption of policies that do have real effects; and they confidently expect that the governments will take steps to "shackle" the execution of those policies. Unfortunately, by never reminding their readers after the preliminary chapter that their model's gains are also only accounting gains, they reinforce the ideology. To the extent, therefore, that being shackled requires the cooperation of the shackled, the authors decrease the likelihood of government successfully changing the rules of the game in the near future.

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