- **http://www.timeanddate.com/worldclock/converter.html?p1=1440 (http://www.timeanddate.com/worldclock/converter.html?p1=1440)**
- **http://earthsky.org/astronomy-essentials/universal-time (http://earthsky.org/astronomy-essentials/universal-time)**
- Submit your graded quiz, covering Modules 13 and 14, by 11:59 p.m. MT on Saturday.

Finance principles for this module

- Principle 1: Cash Flow is What Matters – We are concerned with the money in hand, not accounting profit.
- Principle 3: Risk Requires a Reward – We don't take additional risk unless we are compensated with additional return.
- Principle 4: Market Prices are Generally Right – The value of financial assets in public markets instantly changes to reflect all available information.

Learning Outcomes

1. Understand risk and its measurement.
2. Understand expected return and its measurement.
3. Understand and synthesize capital budgeting techniques and practices.

1. Globalization of Product and Financial Markets

As organizations look to expand their product markets globally, they often face additional risk factors that may not exist in their home country. As you may recall from Module 6, there are two primary categories of risk, systematic and unsystematic.

Systematic Risk

Unsystematic Risk

Unsystematic risk that is specific to the organization is generally very similar in domestic expansions as well as global expansions. This type of risk can be reduced through diversification, and sometimes globalization of product lines provides effective diversification. Globalization can be used to expand product markets, production resources, and franchise operations among other expansion activities (Keown et al., 2017).

Review this brief student video: Globalization & The Coca-Cola Company to capture a glimpse of the potential that globalization brings to organizations:

Globalization & The Coca-Cola Company

(Source: http://www.youtube.com/watch?v=x9PcuZSUxnk)

In this documentary, our team studied the Coca-Cola Company and how it has been impacted by globalization. Since Coca-Cola was first sold in 1886 in Atlanta, Georgia, it has taken over the globe and now operates in more than two hundred companies.

2. Foreign Exchange in Interest Rate Parity

Foreign exchange (**Forex**) refers to the exchange rate between two currencies. Due to the globalization of multinational organizations and the transactions throughout the world, the market for foreign exchange is the largest financial market in the world. When organizations purchase products and services from foreign suppliers, the supplier most often requires payment in their local currency (Keown et al., 2017).

Two important elements of Forex rates are the fluidity of the rates and currency transportability. Exchange rates can be affected by global economic and political events that significantly adjust the rates. One global example of these adjustments is Venezuela, where high inflation and a deep economic recession have reduced the ability for foreign organizations to profitably invest in the country (Ezequiel, 2015). These risks can also influence currency transportability, which relates to the physical exchange of currency. As exchange rates vacillate, the ability to deliver sufficient currency to meet payment requirements is more complex. Forex risks are considered systematic; however, the risks may be reduced through arbitrage or interest rate parity (Keown et al., 2017).

Arbitrage **Interest rate parity**

Arbitrage involves buying and selling foreign currency for the purpose of eliminating the foreign exchange risk from the original transaction.

The exchange rate between the Saudi Arabian riyal (SAR) and the United States dollar (USD) has been very stable for several years (1 SAR ≈ 0.27 USD). Exchange rates are generally quoted with 4 to 5 decimal places where the variation occurred between the SAR and USD (Keown et al., 2017). As an example, over the five years from July 2010 to July 2015, the low exchange rate between these two currencies was 1 SAR = 0.2660 USD and the high exchange rate was 1 SAR = 0.2667 (Bloomberg Business, 2015).

Let's include the foreign exchange rate (understanding that it is fluid) between the U.S. dollar and the SAR. A discussion of the cost of currency transportability may also be appropriate here (consider how U.S. firms with a global presence have taken major losses specific to currency costs in 2015).

The following brief video from Investopedia (2016), *Interest rate and currency value and exchange rate,* does a good job of explaining the foreign currency market: **http://www.investopedia.com/video/play/interest-rate-and-currency-value-and-exchange-rate/ (http://www.investopedia.com/video/play/interest-rate-and-currency-value-and-exchange-rate/)**.

Check Your Understanding

Click Here to Begin

3. Capital Budgeting for Foreign Direct Investment (FDI)

As we learned in Module 12, capital budgeting is used whenever a company considers expanding to improve business. As you recall, examples of capital budgeting decisions include the investment in long-term assets. In the case of globalization, this most often includes adding new locations in a new market or acquiring organizations within the target market. In addition to the normal nonsystematic risks that are related specifically to the organization, there are other systematic risks that are unique to the country. These may include political risks as well as exchange rate risk that we discussed in the previous section (Keown et al., 2017).

Foriegn direct investment (FDI) (http://www.investopedia.com/terms/f/fdi.asp) is also known as direct foreign investment (DFI). The terms are interchangeable; however, FDI seems to be more prevalent in the global markets. From the accepted global definition, FDI is long-term investment from a foreign investor of at least 10% of the total ownership. FDI may also include involvement in the daily operations and management of the organization (Keown et al., 2017).

The focus of FDI is different from the June 15, 2015 opening of the Saudi Arabian stock market to direct investment. According to Hankir and El Baltaji (2015), qualified foreign investors (QFIs) for the open market are currently limited to very large banks and investment companies and ownership in any one Saudi Arabian organization is limited to 49% of the total stock ownership. Certain sectors of the Saudi Arabian economy are restricted from QFI investment (Hankir & El Baltaji).

The following video by Investopedia.com provides an excellent brief explanation of FDI.
http://www.investopedia.com/terms/f/fdi.asp (http://www.investopedia.com/terms/f/fdi.asp)

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