

DIBF — Paper 3 – International Corporate Finance

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CH-1

International Corporate Finance and MNCs

Topic 1 — International Corporate Finance: Meaning and Scope

Corporate finance is about three decisions of a company: what to invest in, how to fund it, and how to manage day-to-day money. **International corporate finance** takes the same decisions when the company works in more than one country.

- **Investment decision** — Choosing plants, subsidiaries and acquisitions in different countries.
- **Financing decision** — Choosing the currency, market, tenor and lender for the funds needed.
- **Working capital decision** — Managing cash, receivables, inventory and payables across borders.
- **Risk decision** — Deciding which currency, interest-rate and country risks to keep or hedge.

What makes it different from domestic finance

Feature	Domestic company	Company working across borders
Currency	One home currency	Several currencies; exchange-rate risk on cash flows and balance sheet
Legal system	One law and one court system	Many laws; choice of law and jurisdiction matter
Political risk	Limited	Expropriation, transfer restrictions, sanctions, war
Tax	One tax system	Several tax systems; transfer pricing and withholding tax
Funding markets	Local banks and local capital market	Local plus global markets: Euro-loans, bonds, ECBs
Information	Familiar accounting and disclosure	Different accounting standards and languages

Remember this

- International corporate finance = domestic decisions + currency, country, legal and tax risks.

Topic 2 — Multinational Corporations and Their Structures

A **multinational corporation (MNC)** is a company that owns or controls business operations in more than one country. The top company is the **parent**. Units in other countries are its **foreign operations**.

Form of presence	What it is	Point for the lender
Representative office	Liaison office; cannot trade or earn income	No borrowing need; only market study and contacts
Branch	Part of the parent; not a separate legal person	Parent is directly liable for branch debts
Wholly owned subsidiary (WOS)	Separate company; 100% owned by parent	Liable only for its own debts unless parent guarantees
Joint venture (JV)	Separate company owned with a partner	Shared control; support depends on the JV agreement

Form of presence	What it is	Point for the lender
Holding company	Owns shares of operating companies	Repaid mainly from dividends of subsidiaries
Special purpose vehicle (SPV)	Company set up for one project or deal	Repaid from that project's cash flows
Regional treasury centre	Group company that pools and lends cash in a region	Lends to and borrows from group companies

Centralised and decentralised finance

- **Centralised** — Group treasury raises funds and lends them on to subsidiaries; this cuts cost and improves control.
- **Decentralised** — Each subsidiary borrows locally; this matches local currency and uses local knowledge.
- **Mixed** — Most large groups centralise policy and risk limits but let subsidiaries handle local payments.
- **Indian MNCs** — An Indian company sets up a foreign WOS or JV under the overseas investment (ODI) rules under FEMA.
- **ODI ceiling** — Its total financial commitment abroad (equity, loans and guarantees) must stay within **400% of its net worth** under the automatic route.

Topic 3 — Funding Needs of an MNC

Funding need	Typical tenor	Usual sources
Working capital	Up to 1 year	Overdraft, trade finance, commercial paper, export credit
Capital expenditure	3–10 years	Term loans, ECBs, bonds, export credit agency loans
Acquisition of a company abroad	3–7 years	Acquisition loans, bridge loans, bonds, equity
Refinancing of maturing debt	Matches old debt	New loans or bonds, often in cheaper markets
Project in a new country	10–20 years	Project finance with an SPV; multilateral lenders

Internal and external sources

- **Internal funds** — Retained profits, depreciation and cash from group companies through dividends or intra-group loans.
- **External debt** — Bank loans, syndicated loans, bonds, ECBs and trade credit.
- **External equity** — Fresh shares in home or foreign markets, ADRs or GDRs, or a strategic partner.
- **Pecking order** — Firms usually use internal funds first, then debt, and equity last, because equity is costliest and dilutes control.

The **funding gap** is the amount the group must raise from outside in a year.

$$\text{Funding gap} = \text{Capex} + \Delta \text{Working capital} + \text{Debt maturing} - \text{Internal cash}$$

Example: A group plans capex of USD 250 mn, extra working capital of USD 60 mn and must repay USD 90 mn of debt. Internal cash after dividends is USD 180 mn. Funding gap = 250 + 60 + 90 – 180 = **USD 220 mn**.

Topic 4 — Funding a Foreign Subsidiary: Parent Loan or Local Borrowing

A parent can fund its foreign subsidiary in three ways: **equity**, an **intra-group loan**, or a **guarantee** so that the subsidiary borrows locally.

Point	Parent loan in parent's currency	Local borrowing in local currency
Currency risk	Subsidiary carries it if its revenue is local	Low; debt and revenue in the same currency
Interest cost	Often lower nominal rate	Often higher nominal rate
Cash repatriation	Interest and principal flow back to parent	Cash stays local until dividends are paid
Political risk	Higher; payments can be blocked	Lower; local lenders are paid locally
Tax	Interest may be deductible; thin-capitalisation and transfer-pricing rules apply	Interest deductible locally
Parent support	Direct exposure of parent	Usually a parent guarantee or comfort letter

A lower foreign interest rate is not always cheaper. If the borrower's currency is expected to weaken, the **effective cost** of foreign currency debt is:

$$\text{Effective cost} = (1 + r_f) \times (1 + d) - 1$$

Here r_f is the foreign interest rate and d is the expected depreciation of the borrower's currency against the loan currency.

Example: A Brazilian subsidiary can borrow locally at 12%, or take a USD loan from its parent at 6%. The real is expected to weaken 5% a year against the USD. Effective cost of USD loan = $1.06 \times 1.05 - 1 = 11.3\%$. The saving is only about 0.7 percentage points, and it carries currency risk.

Remember this

- Compare **effective** costs, not headline interest rates.

Topic 5 — Cost of Capital for an MNC

The **cost of capital** is the minimum return the company must earn to satisfy lenders and shareholders. It is the hurdle rate for new projects. Interest is tax-deductible, so debt cost is taken after tax.

The **weighted average cost of capital (WACC)** is:

$$\text{WACC} = \frac{E}{V} \times K_e + \frac{D}{V} \times K_d \times (1 - t)$$

Here E is equity, D is debt, $V = E + D$, K_e is cost of equity, K_d is pre-tax cost of debt and t is the tax rate.

Example: Equity USD 600 mn at 12%, debt USD 400 mn at 6%, tax 25%. $\text{WACC} = 0.6 \times 12\% + 0.4 \times 6\% \times 0.75 = 7.2\% + 1.8\% = 9.0\%$.

- Wider access** — An MNC can borrow in the cheapest market, which may lower its cost of debt.
- Diversification** — Earnings from many countries can be more stable, which may lower risk.
- Extra risks** — Currency, political and transfer risks may raise the return investors demand.
- Project hurdle** — A project in a riskier country is often judged at a higher rate than group WACC.

Topic 6 — Sources of Repayment

A lender first asks: **from which cash will this loan be repaid?** The answer decides the appraisal method, the security and the covenants.

Source	Meaning	Strength
Primary: operating cash flow	Cash from the borrower's normal business after tax and capex	Most reliable; this is the main test
Secondary: refinancing	New loan or bond raised to repay the old one	Depends on market access and rating
Secondary: asset sale	Sale of a business, plant or shares	Value may fall in bad times
Secondary: guarantee	Payment by parent, bank or export credit agency	Only as good as the guarantor and the document
Last resort: security	Enforcement of mortgage, pledge or charge	Slow and costly, especially abroad

Repayment period gives a quick sense of debt burden.

$$\text{Repayment years} = \frac{\text{Total debt}}{\text{Free cash flow per year}}$$

Example: Debt USD 900 mn; free cash flow after tax, capex and dividends USD 150 mn a year. The group needs about $900 \div 150 = 6$ years to repay from its own cash.

Remember this

- Never lend on security alone; the **primary source** must be cash flow.

Topic 7 — Group Cash Flows and Structural Subordination

In a group, cash is earned by operating subsidiaries. A lender to the **holding company** is paid only from what is left after the subsidiary pays its own creditors. This is called **structural subordination**.

- Why it arises** — Creditors of a subsidiary have a direct claim on its assets; the parent has only a shareholder's claim.
- Trapped cash** — Exchange controls, dividend limits or local law may stop cash leaving a country.
- Transfer pricing** — Prices on intra-group sales must be at arm's length; tax authorities may challenge them.
- Withholding tax** — Tax on dividends and interest paid abroad reduces cash reaching the parent.
- Remedies** — Upstream guarantees from key subsidiaries, lending at the operating company, or limits on subsidiary debt.

Example: A subsidiary's assets realise USD 500 mn in a default. Its own creditors are owed USD 350 mn. Only USD 150 mn reaches the parent. If the parent's lenders are owed USD 200 mn, they recover $150 \div 200 = 75\%$ from this subsidiary.

Remember this

- Lend where the cash is, or get a **guarantee** from where the cash is.

Topic 8 — Risk Map for Lending to MNCs

Risk	What can go wrong	Common mitigant
Business risk	Sales or margins fall	Appraisal of market position; financial covenants
Financial risk	Too much debt; weak cover	Leverage and interest cover covenants
Currency risk	Revenue and debt in different currencies	Natural hedge, forwards, swaps; UFCE review
Interest-rate risk	Floating rates rise	Interest-rate swaps, caps, fixed-rate tranches
Country and transfer risk	Government blocks payments abroad	Offshore accounts, political risk insurance, country limits
Structural risk	Lender sits at the wrong company	Guarantees; lending to operating company
Legal risk	Documents not enforceable abroad	Legal opinions; governing-law and jurisdiction clauses
Sanctions and AML risk	Dealing with listed persons or countries	Screening, KYC, sanctions clauses
ESG risk	Environmental or social damage hurts value	ESG due diligence and covenants

Remember this

- Five big lenses: **business, financial, currency, country, structure.**

DIBF | Module 1 | CH-1 | MCQs

Q1. Equity USD 500 mn costs 14%; debt USD 500 mn costs 8% before tax; tax rate 30%. The WACC is: [Ref: Topic 5, p. 3]

- (a) 9.8% (b) 11.0% (c) 8.4% (d) 12.4%

Q2. A group needs capex USD 300 mn, extra working capital USD 40 mn and debt repayment USD 110 mn. Internal cash is USD 200 mn. The funding gap is: [Ref: Topic 3, p. 2]

- (a) USD 450 mn (b) USD 250 mn (c) USD 150 mn (d) USD 210 mn

Q3. A lender to a holding company is paid only after creditors of the operating subsidiary. This is called: [Ref: Topic 7, p. 3]

- (a) Contractual subordination (b) Pari passu ranking
(c) Structural subordination (d) Cross-default

Q4. Which form of foreign presence is NOT a separate legal person from the parent? [Ref: Topic 2, p. 2]

- (a) Wholly owned subsidiary (b) Joint venture company
(c) Special purpose vehicle (d) Branch

Q5. Subsidiary assets realise USD 800 mn; its creditors are owed USD 600 mn; the parent's lenders are owed USD 400 mn. Their recovery from this subsidiary is: [Ref: Topic 7, p. 3]

- (a) 100% (b) 50% (c) 75% (d) 25%

Q6. The most reliable primary source of repayment for a corporate term loan is: [Ref: Topic 6, p. 3]

- (a) Operating cash flow of the borrower
(b) Sale of the mortgaged factory
(c) Refinancing by another bank
(d) A comfort letter from the parent

Q7. Debt USD 1,200 mn and free cash flow USD 200 mn a year. Repayment years are about: [Ref: Topic 6, p. 3]

- (a) 4 years (b) 8 years (c) 10 years (d) 6 years

Q8. Cash earned by a subsidiary cannot be sent to the parent because of local exchange control. This is: [Ref: Topic 7, p. 3]

- (a) Translation exposure (b) Basis risk
(c) Trapped cash or transfer risk (d) Structural hedge risk

Q9. Under India's ODI rules, an Indian company's total financial commitment abroad under the automatic route is capped at: [Ref: Topic 2, p. 2]

- (a) 400% of its net worth
(b) 100% of its net worth
(c) 200% of its paid-up capital
(d) USD 1 billion per year in all cases

Q10. Why is the cost of debt taken after tax in WACC? [Ref: Topic 5, p. 3]

- (a) Debt is always cheaper than equity
(b) Lenders pay the borrower's tax
(c) Interest is a tax-deductible expense
(d) Dividends are tax-deductible

Q11. A regional treasury centre in an MNC mainly: [Ref: Topic 2, p. 2]

- (a) Acts only as a liaison office
(b) Pools group cash and lends to group companies
(c) Audits subsidiaries' accounts
(d) Sells the group's products

Q12. Best mitigant when a parent-level lender suffers structural subordination is: [Ref: Topic 7, p. 3]

- (a) A higher loan margin only
(b) A longer moratorium
(c) Lower documentation
(d) Upstream guarantees from key operating subsidiaries

Q13. Which risk is mainly mitigated by a governing-law clause and a legal opinion? [Ref: Topic 8, p. 4]

- (a) Interest-rate risk (b) Business risk
(c) Legal and enforceability risk (d) Currency risk

Q14. A company with debt in USD and all revenue in INR, without hedges, mainly carries: [Ref: Topic 8, p. 4]

- (a) Currency mismatch risk (b) Structural subordination
(c) Liquidity premium risk (d) Settlement risk

Q15. Under the pecking-order idea, a firm usually raises funds in which order? [Ref: Topic 3, p. 2]

- (a) Equity, then debt, then internal funds
(b) Debt, then equity, then internal funds
(c) Internal funds, then equity, then debt
(d) Internal funds, then debt, then equity

Answer key

Q	Ans	Q	Ans	Q	Ans	Q	Ans	Q	Ans
1	a	4	d	7	d	10	c	13	c
2	b	5	b	8	c	11	b	14	a
3	c	6	a	9	a	12	d	15	d

CH-2

Lending to MNCs: Credit Appraisal

Topic 1 — Credit Appraisal Framework for MNC Lending

Credit appraisal is the lender's study of whether a borrower can and will repay. For an MNC, the lender looks at the whole group, the borrowing entity, and the countries where cash is earned.

The five Cs of credit

- **Character** — Integrity, track record and governance of the promoters and management.
- **Capacity** — Ability to repay from cash flow; this is the core test.
- **Capital** — Owners' money in the business; a cushion against losses.
- **Collateral** — Security and guarantees available if cash flow fails.
- **Conditions** — Industry, economy, currency and country conditions.

Steps in appraisal

Step	Work done
1. Know the borrower	KYC, beneficial owners, sanctions and adverse-media screening of all group entities
2. Understand the need	Purpose, amount, currency and tenor of the facility
3. Business analysis	Industry, market share, competition, management, country spread
4. Financial analysis	Three to five years of audited accounts; ratios and trends
5. Cash-flow projection	Base case and stress cases for the loan tenor
6. Structure	Borrower entity, guarantors, security, covenants, hedging
7. Rating and pricing	Internal rating, expected loss, capital charge, margin and fees
8. Sanction	Approval by the right authority; terms and conditions recorded

Remember this

- Appraise the **group**, the **borrower** and the **country**, in that frame.

Topic 2 — Business Risk Analysis

Area	Questions the lender asks
Industry	Is demand growing? Is the industry cyclical? Are there entry barriers or heavy regulation?
Market position	What is the market share? Are customers and suppliers concentrated?
Diversification	How many products and countries? Does weakness in one area hurt the whole group?
Management	Experience, succession, strategy, past acquisitions and how they were funded
Governance	Board independence, audit quality, related-party deals, disclosure record
Country mix	Share of earnings from high-risk countries; exchange controls there
ESG	Carbon intensity, pollution, labour issues, legal disputes

- **Benchmarking** — Compare the borrower with its global peers, not only with Indian firms.
- **Accounting basis** — Note whether accounts follow IFRS, US GAAP or Ind AS before comparing ratios.
- **Consolidated view** — Read consolidated and standalone accounts together to see where debt and cash sit.

Topic 3 — Financial Analysis and Key Ratios

Ratios turn financial statements into simple tests of liquidity, leverage, coverage and profitability. **EBITDA** is earnings before interest, tax, depreciation and amortisation. **EBIT** is earnings before interest and tax.

Ratio	How computed	What it shows
Current ratio	Current assets ÷ current liabilities	Short-term liquidity
Debt-equity	Total debt ÷ shareholders' equity	Leverage; owners' stake
Debt / EBITDA	Total debt ÷ EBITDA	Years of operating earnings to repay debt
Interest coverage (ICR)	EBIT ÷ interest	How many times interest is earned
DSCR	(PAT + depreciation + interest) ÷ (interest + principal due)	Cover for total debt service in a period
EBITDA margin	EBITDA ÷ revenue	Operating profitability

Key formulas used in covenants:

$$ICR = \frac{EBIT}{Interest}$$

$$DSCR = \frac{PAT + Depreciation + Interest}{Interest + Principal instalment}$$

Example: An MNC (USD mn): revenue 2,000; EBITDA 360; depreciation 80; EBIT 280; interest 70; tax 25%; PAT = (280 – 70) × 0.75 = 157.5. Current assets 700, current liabilities 500, debt 1,080, equity 1,200, principal due this year 150.

Ratio	Working	Result
Current ratio	700 ÷ 500	1.40
Debt-equity	1,080 ÷ 1,200	0.90
Debt / EBITDA	1,080 ÷ 360	3.0 times
ICR	280 ÷ 70	4.0 times