Required:
Explain the circumstances under which it may be appropriate for an MNC to use local currency to evaluate a foreign subsidiary.

10. Developing a global business strategy for an MNC is a highly complex task.

    Required:
    Briefly discuss the complexities referred to in the preceding statement.

11. Globalization has made cultural values irrelevant as a factor influencing multinational business and accounting.

    Required:
    State whether or not you agree with the preceding statement, and develop an argument to support the position you have taken.

Case 12-1

Canyon Power Company

Late in 2004, Canyon Power Company (CPC) management was considering expansion of the company's international business activities. CPC was an Arizona manufacturer of specialist electric motors for use in industrial equipment. All of the company's sales were to other manufacturers in the industrial equipment industry. CPC's worldwide market was supplied from subsidiaries in Germany, Mexico, and Malaysia as well as the United States. The company was particularly successful in Asia mainly due to the high quality of its products, its technical expertise, excellent after-sale service, and of course the continued rapid economic growth in many Asian countries. This success led corporate management to consider seriously the feasibility of further expansion of its business in the Asian region.

The Malaysian subsidiary of CPC distributed and assembled electric motors. It also had limited manufacturing facilities so that it could undertake special adaptations required. With the maturing of the Asian market, particularly in the industrial sector, an expansion of capacity in that market was of strategic importance. The Malaysian subsidiary had been urging corporate management to expand its capacity since the beginning of 2004. However, an alternative scenario appeared more promising. The Indian economy, with its liberalized economic policies, was growing at annual rates higher much than those of many industrialized countries. Further, India had considerably lower labor costs and certain government incentives that were not available in Malaysia. Therefore, the company chose India for its Asian expansion project, and had a four-year investment project proposal prepared by the treasurer's staff.

The proposal was to establish a wholly owned subsidiary in India producing electric motors for the Indian domestic market as well as for export to other Asian countries. The initial equity investment would be $1.5 million, equivalent to 67.5 million Indian rupees (Rs) at the exchange rate of Rs 45 to the U.S. dollar. (Assume that the Indian rupee is freely convertible, and there are no restrictions on transfers of foreign exchange out of India.) An additional Rs 27 million would be raised by borrowing from a commercial bank in India at an interest rate of 10 percent

per annum. The principal amount of the bank loan would be payable in full at the end of the fourth year. The combined capital would be sufficient to purchase plant of $1.8 million and other initial expenses including working capital. The cost of installation would be $15,000, with another $5,000 for testing. No new working capital would be required during the four-year period. The plant will have a salvage value of Rs 10 million at the end of four years. Straight-line depreciation would be applied to the original cost of the plant.

The firm's overall marginal after-tax cost of capital was about 12 percent. However, because of the higher risks associated with an Indian venture, CPC decided that a 16 percent discount rate would be applied to the project.

Present value factors at 16 percent are as follows:

Period	Factor
1	0.862
2	0.743
3	0.641
4	0.552

Sales forecasts are as follows:

	Sales (units)	
Year	(Domestic)	(Export)
1	5,000	10,000
2	6,000	12,000
3	7,000	14,000
4	8,000	16,000

The initial selling price of an electric motor was to be Rs 4,500 for Indian domestic sales and export sales in the Asian region, and the selling price in both cases was to increase at an annual rate of 10 percent. The exchange rate between the Indian rupee and the U.S. dollar was expected to vary as follows:

January 1, Year 1	Rs 45 per U.S. dollar
December 31, Year 1	Rs 45 per U.S. dollar
December 31, Year 2	Rs 43 per U.S. dollar
December 31, Year 3	Rs 40 per U.S. dollar
December 31, Year 4	Rs 38 per U.S. dollar

The annual cash expenditure for operating expenses, excluding interest payments, would be Rs 40 million. The Indian subsidiary is expected to pay a royalty of Rs 20 million to the parent company at the end of each of the four years. The company would be in the 35 percent bracket for U.S. income tax purposes. For convenience, ignore Indian local taxation.

Required:

Using the information provided, you are required to

1. Calculate net present value from both a project and a parent company perspective.
2. Recommend to CPC corporate management whether or not to accept the proposal.