International Business Economics

4. The Global Capital Market

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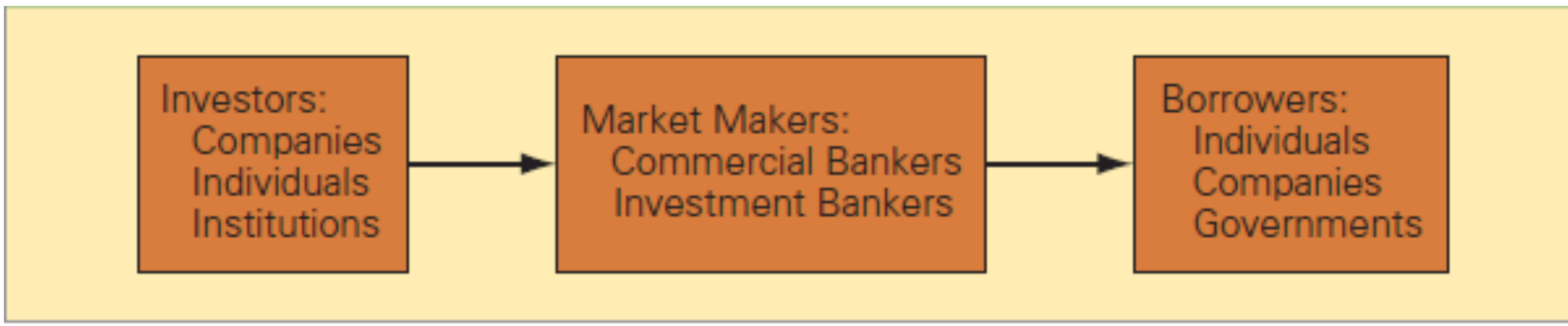
Capital markets

- Capital markets bring together investors and borrowers
  - **investors** - corporations with surplus cash, individuals, and non-bank financial institutions
  - **borrowers** - individuals, companies, and governments
  - **markets makers** - the financial service companies that connect investors and borrowers, either directly (investment banks) or indirectly (commercial banks)
  - capital market loans can be equity or debt

Main Players in Capital Markets

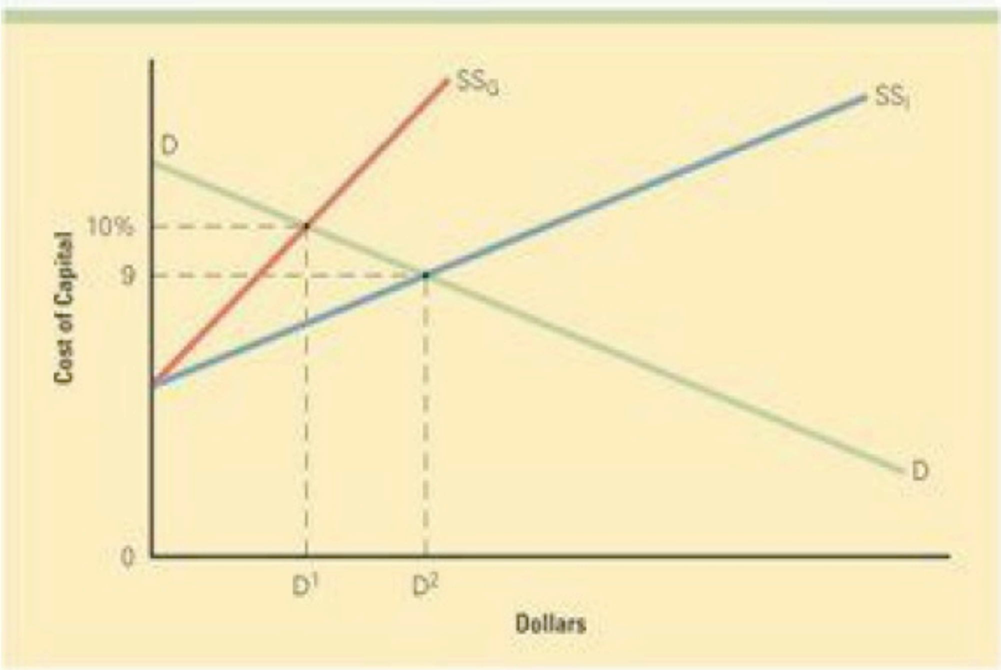


Source: Hill (2014)

The Global Capital Market

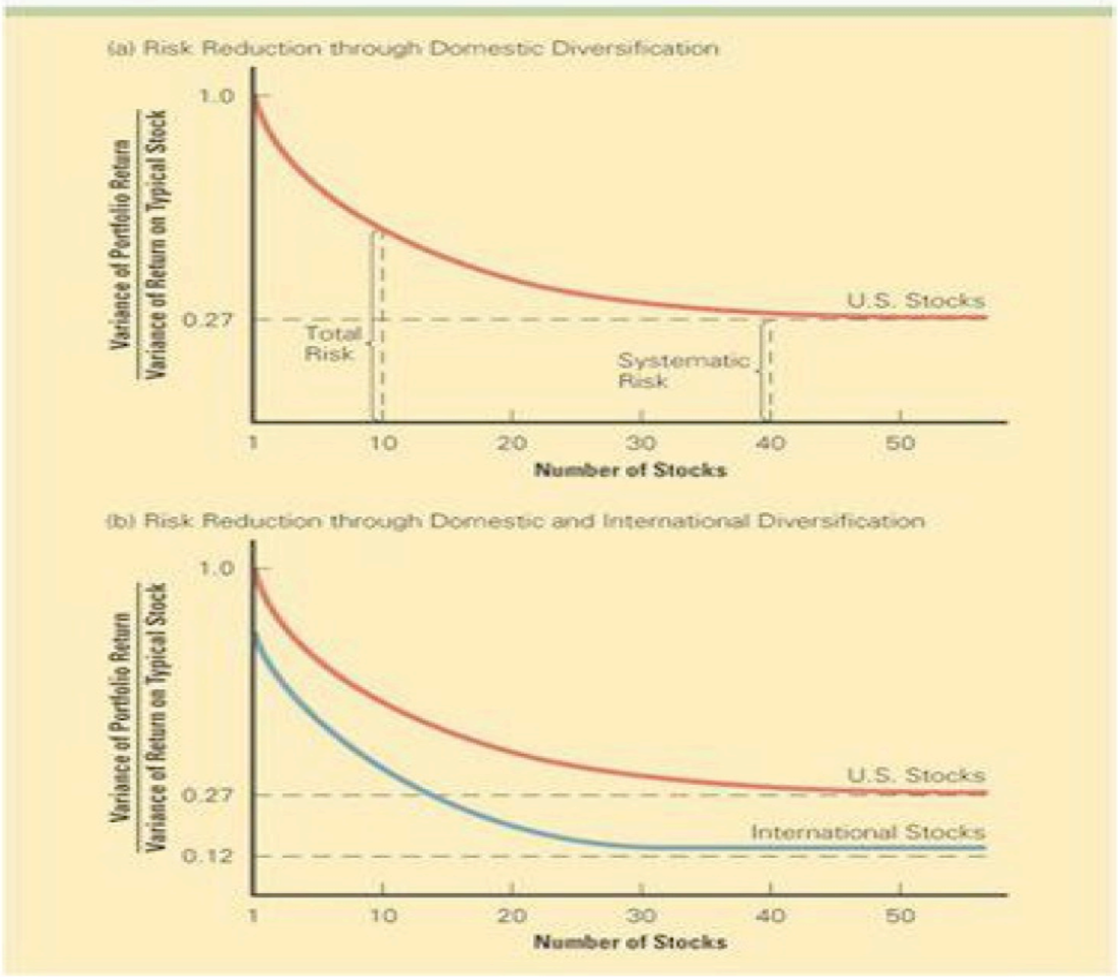
- Capital markets are now highly connected: free flow of financial assets
- Borrowers benefit from additional supply of funds (lower cost of capital).
- Investors benefit from more investment opportunities (hence potential diversified portfolios and, therefore, lower investment risk)

Market Liquidity and the cost of capital



Source: Hill (2014)

Risk reduction

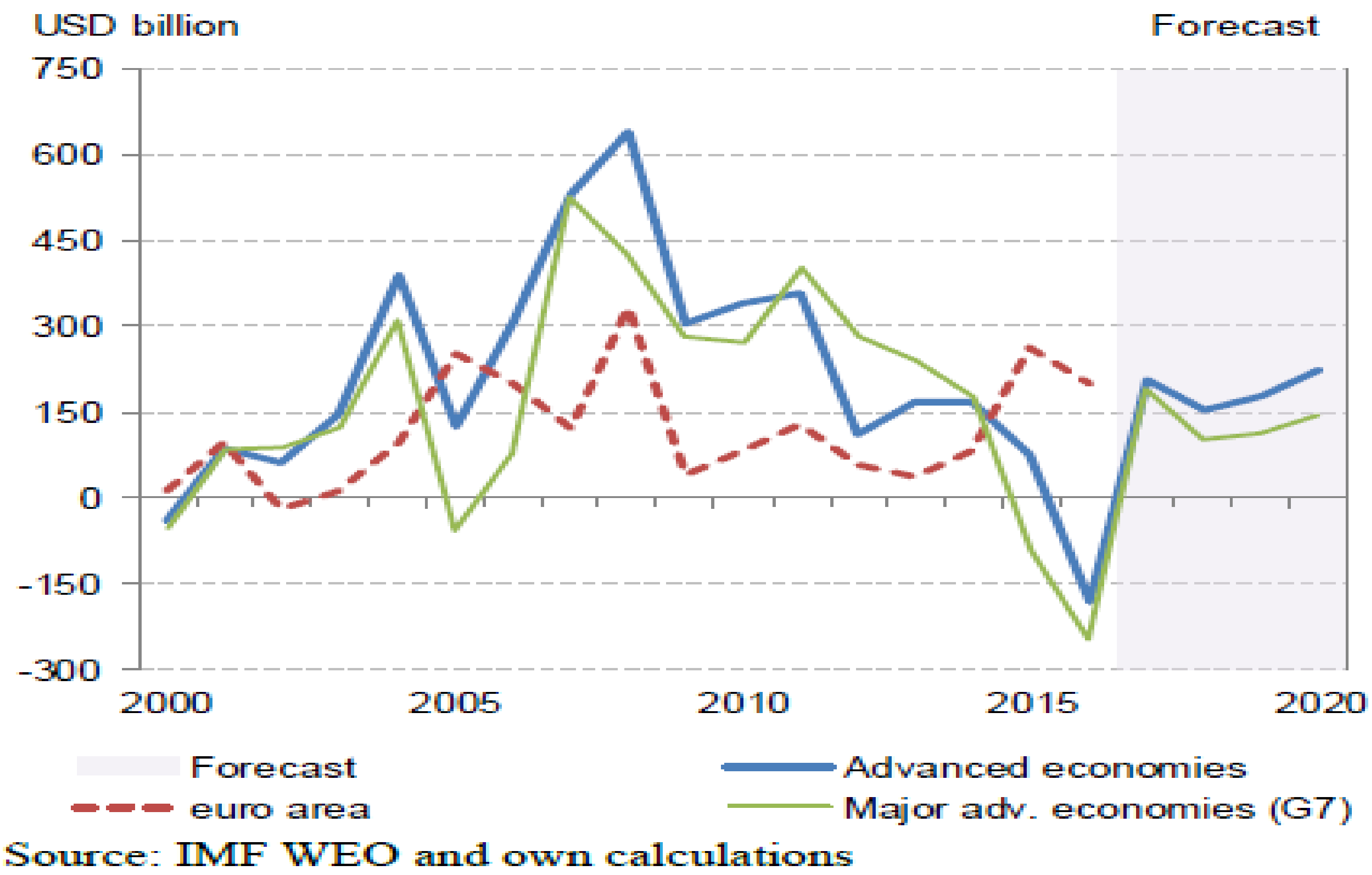


Source: Hill (2014)

EU presence in the global capital markets

- EU regulatory activity in capital markets began in the late 1980s (single market programme).
- Financial markets are key to the EU economy (critical role in mobilising savings and in allocating them to investment).
- The EU is one of the main actors in international financial markets (along the US and Japan).

Source: European Commission (https://ec.europa.eu/info/system/files/efir-report-2007-13122007_en.pdf)



Source: European Commission (https://ec.europa.eu/info/sites/info/files/european-financial-stability-and-integration-review-2018_en.pdf)

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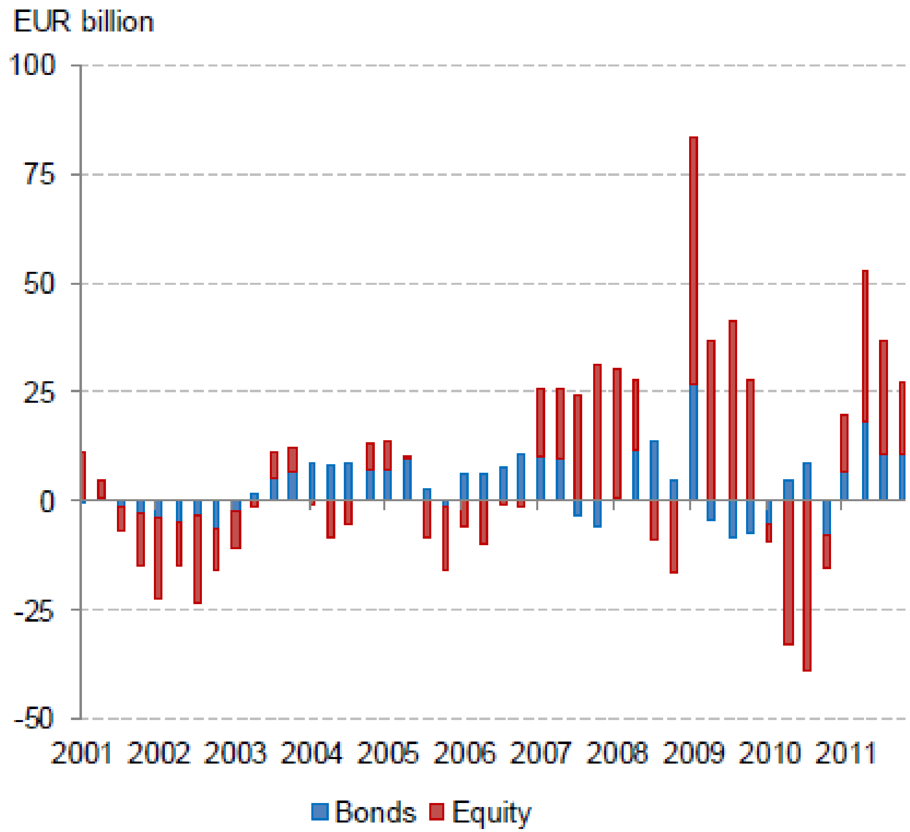


Source: EPFR and own calculations

Source: European Commission (https://ec.europa.eu/info/sites/info/files/european-financial-stability-and-integration-review-2018_en.pdf)

Global capital market instruments: Eurocurrency

- A eurocurrency is any currency banked outside its country of origin
- Important source of low-cost funds for international companies
- Not regulated by governments (hence not reserves needed, possibility to offer higher interest to investors and lower rates to borrowers).

Drawbacks of the Eurocurrency market

- Lack of regulation, hence much higher risk due to potential bank failures
- Foreign exchange risk

The Global Bond Market

- Bonds are securities that represent a debt owed by the issuer to the investor.
- Bonds obligate the issuer to pay a specified amount at a given date, generally with periodic interest payments.
- There are two types of international bonds
    1. Foreign bonds
    2. Eurobonds

Foreign bonds and Eurobonds

- **Foreign bonds** are sold outside of the borrower's country and are denominated in the currency of the country in which they are issued.
- Thus, when Telefónica issues bonds in Japanese yen and sells them in Japan, it is issuing foreign bonds.
- Many foreign bonds have nicknames;

Eurobonds

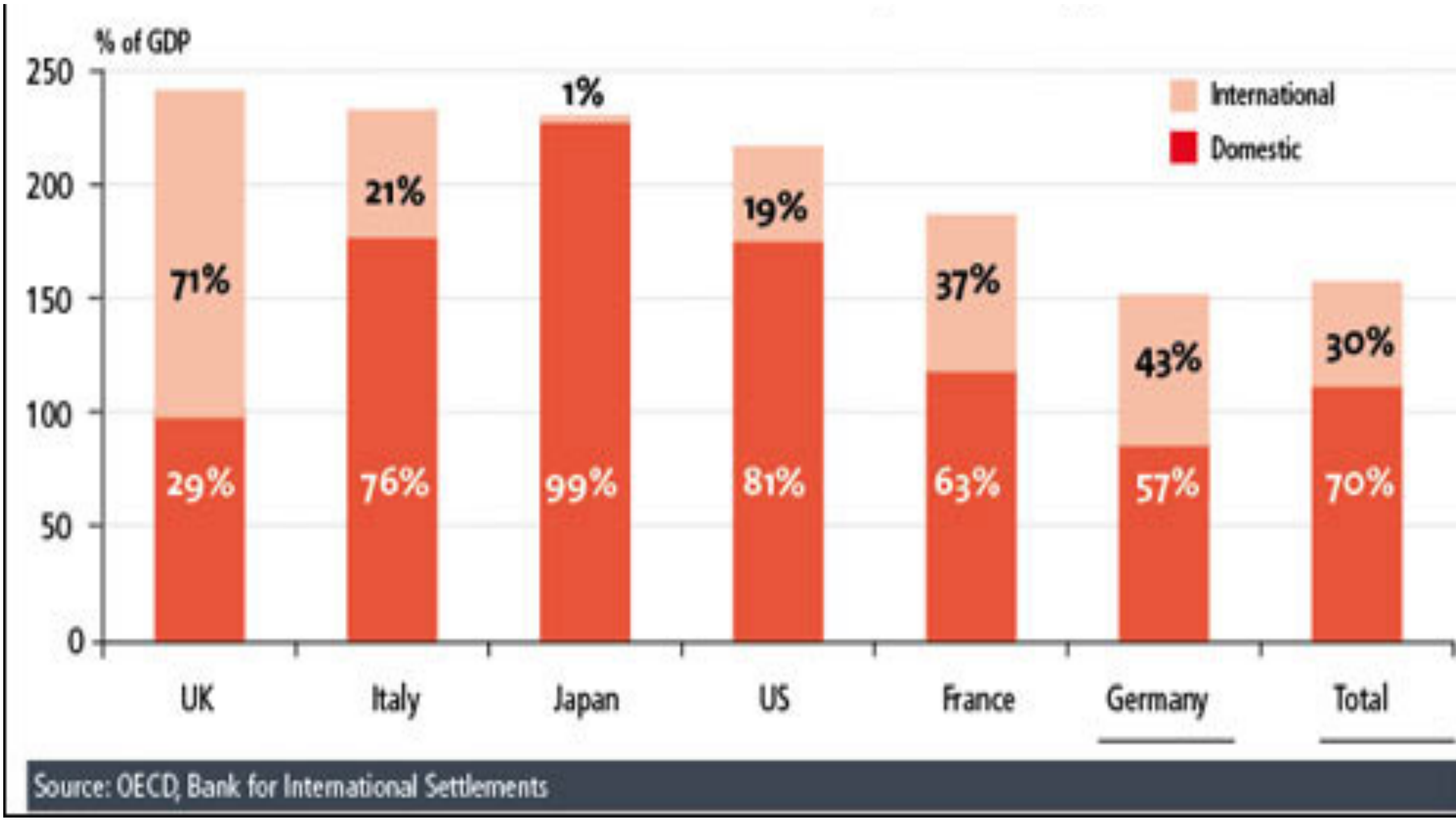
- **Eurobonds** are normally offered by an international syndicate of banks.
- For example, a bond may be issued by an Spanish corporation, denominated in U.S. dollars, and sold to investors outside of the United States.
- Eurobonds are normally issued by MNCs, large domestic corporations, etc

Eurobonds

The Eurobond market might be a good form of investing/borrowing because:

- Lack of regulation: the cost of issuing bonds is lower.
- More favourable terms from a tax perspective.

Domestic vs International Bond Market (2009)



The Global Equity Market

- A share of stock in a firm represents ownership.
- Investors can earn a return from stock in one of two ways:
- Either the price of the stock rises over time, or the firm pays the stockholder dividends.
- Frequently, investors earn a return from both sources.

The Global Equity Market

The global equity (stock) market allows companies to:

- Attract capital from international investors (investors commonly buy stocks from different markets to diversify their portfolios)

- List their stock on multiple stock markets (internationalization of firm's ownership)

In sum…what Do Global Capital Markets Mean For Managers?

- The growth of global capital markets has created opportunities for firms to borrow or invest internationally
- Investments diversification and risk reduction

References

- Hill, Charles W. L. (2014): *International Business. Competing in the global marketplace, 10th edition*. Emerald Group Publishing Limited.