Note on Cross-Border Project Valuation

When considering how to value a potential cross-border investment project, several issues emerge that make the problem more complicated than the classical capital budgeting exercise described in finance textbooks (one country, one currency, one set of country and industry risk factors). Consider the following situations:

- Gerber, a U.S. based firm, is evaluating the purchase of a baby food factory in Poland. The manufacturing facility will sell to both the Polish and West European markets.
- Google sees that the online advertising sector in China is in tremendous flux—providing an opportunity to establish a first-mover advantage.
- InterGen, a global project-finance company, evaluates a power plant in the Philippines that will be used meet domestic demand. InterGen believes the country's long-term potential is promising, but is worried about a change in the regulatory regime.
- Motorola plans to open a research and development center in India that would support global product development. The firm is confident about the macroeconomic environment, but is cautious that the labor market for research scientists is overheated.

How should an analyst approach the valuation of these projects? A variety of questions inevitably arises. For example:

- Which currency should be used when creating pro-forma financial statements?
- How would changes in exchange rates affect the value of investment? How should this risk be accounted for in the project valuation process?
- How should a firm adjust its discount rate to reflect the various risks (country, regulatory, demand, currency, etc.) of operating across national borders?

Without confronting these issues in a cross-border valuation analysis, an analyst can easily undervalue or overvalue a potential project, which can lead to a poor allocation of investment capital.

Starting with the standard capital budgeting framework, it is important that business managers not only be aware of, but also account for, the cross-border issues that must be incorporated into the valuation process.