

International Financial Management

Spring 2012

Tuesday, 14:50-17:45 (2:50-5:45 p.m.) in Vestergade 23-401

Instructor: Todd W. Johnson

B.A. (History, Bates College, 1979), M.Sc. (Business Administration, London Business School, 1983.) Director of the firm T.W. Johnson. Previously employed as portfolio manager at Dexia Bank Denmark and head of securities at Citicorp Investment Bank Denmark.

E-mail: tj@twjohnson.dk

Mobile telephone: +45 20 20 45 83

Objectives:

Removal of government controls and internationalization of firms have created, among other things, a vigorous global market in foreign exchange. These currency markets are the first contact most managers and investors have when venturing outside their own country. Other major financial markets, such as the money markets (short-term instruments) and capital markets (debt and equity securities) maintain important domestic features, but are in fact dominated by multinational players trading global products.

This course aims at providing students with a practical understanding of foreign exchange markets, international money markets, and international capital markets. Students will be introduced to international finance by means of looking at how firms and governments interact with these markets. The course will ask: Why is a country's currency policy important? What are a country's financial policy options? How do managers and investors determine their exposure, or risk? How do they control, or hedge, this exposure? How do they finance their operations and investments?

DIS contacts:

Susanne Goul Hovmand, Program Director, sg@dis.dk, tel: +45 33 76 54 30

Cheyenne Ellis, Program Assistant, c@dis.dk, tel: +45 33 75 54 25

Contents:

Students will study the concepts of arbitrage, risk management, cash management and capital market behavior. In the process, students will learn to use tools for foreign exchange determination and be introduced to the international securities markets. In addition, the course will describe the relevant aspects of European monetary/currency policy and financial market integration.

The course is divided into 4 parts:

- I. Foreign Exchange
- II. Foreign Exchange Risk Management
- III. Corporate Finance
- IV. European Context

Prerequisites:

A one-year sequence of courses in Micro and Macroeconomics, as well as an introductory course in Finance.

Requirements:

Written mid-term essay or examination (80 minutes), final paper or examination (2 hours), 1 quiz, 3 case study assignments (to be completed in groups).

Case write-ups are due at the beginning of class on the due date indicated. Late cases will not be accepted.

Cases:

The cases will be completed, and graded, in groups of 3-4 students. The first 2 cases will require approx. 3-4 pages of text with 2-3 pages of appendices. The last case will consist of a group presentation.

Course Evaluation:

Quiz	5%
Cases	30%
Midterm	20%
Final	30%
Participation	15%

Textbook:

Ahamed, Liaquat (2009), *Lords of Finance: The Bankers Who Broke the World*, Penguin Books
Madura, Jeff. (2007). *International Financial Management*. South Western. Ohio.

Relevant websites:

www.imf.org	International Monetary Fund
www.worldbank.org	World Bank
www.bis.org	Bank of International Settlements
www.oecd.org	Organization for Economic Co-operation and Development
www.ecb.int	European Central Bank
www.nationalbanken.dk	Danish National Bank
www.federalreserve.gov	U.S. Federal Reserve System
www.fese.be	Federation of European Securities Exchanges

Note on Use of Electronic Devices in the Classroom:

The use of electronic devices such as laptop computers, mobile phones, tablet devices etc. is discouraged. Unless I specifically request otherwise, the only acceptable use of such devices is to write notes on classroom material. Students found using electronic devices for other purposes will receive an F for their participation grade.

Course Policies

Academic Honesty: Plagiarism and Violating the Rules of an Assignment - DIS expects that students abide by the highest standards of intellectual honesty in all academic work. DIS assumes that all students do their own work and credit all work or thought taken from others. Academic dishonesty will result in a final course grade of "F" and can result in dismissal. The students' home universities will be notified. DIS reserves the right to request that written student assignments be turned in electronic form for submission to plagiarism detection software. See the *Academic Handbook* for more information, or ask your instructor if you have questions.

Attendance – You are expected to attend all DIS classes when scheduled. If you miss multiple classes the Director of Teaching and Learning, and the Director of Student Affairs will be notified and they will follow-up with you to make sure that all is well. Absences will jeopardize your grade and your standing at DIS.

Allowances will be made in cases of illness, but in the case of multiple absences you will need to provide a doctor's note.

Disability and resource statement: Any student who has a need for accommodation based on the impact of a disability should contact Sean Green (sgr@dis.dk) to coordinate this. In order to receive accommodations, students should inform the instructor of approved DIS accommodations within the first two weeks of classes.

Engagement – This course will be highly interactive. You will be expected to do the readings and participate in meaningful class discussions regarding their application to the issues addressed in class. You will also be expected to participate during the guest lecturers, through asking questions and applying the guest lecturers' inputs to future class discussions.

Detailed Schedule

Part I. Foreign Exchange

Tuesday, January 31

Class 1.

- Introduction to the course
- International flow of funds (national accounts)
Looking at economic and financial statistics.

Reading:

- Madura Ch. 1, Ch. 2.
- Text of the S&P Downgrade of the US (DIS Blackboard)
- Interest Rate Market, example (DIS Blackboard)
- Euro Spot Forward Against the Euro, example (DIS Blackboard)
Questions 1, 2, 4, 7, 9 13 in Madura Ch. 2 (pp. 64-65)

Question: What is the difference between a nation's current and capital account?

Class 2.

- International financial markets
- Looking at exports and imports, the World Bank and World Trade Organization.

Reading:

- Madura Ch. 3
- "China and the World Economy: From T-shirts to T-bonds" (Compendium pp.1-3)
- Imperial Nature: "The World Bank and Struggles for Social Justice in the Age of Globalization" (Compendium pp. 4-16)
Questions 1-4 in "Blades Inc." case in Madura Ch. 1 (pp. 35-36)

Question: Is a trade surplus always a "good" economic objective?

Wednesday, February 1 (8:30-12:30pm)

Field Study

Tuesday, February 7

Class 3.

- Exchange rate determination and Government influence on exchange rates
- Looking at options for a nation's currency policy: fixed or floating?

Reading:

- Madura Ch. 4, Ch. 6.
- Monetary History of Denmark 1990-2005: "Introduction" pp. 7-23 (DIS Blackboard)
- "The Foreign Exchange Market 2010" (Compendium pp.18-27)
- "Fix or Float?" (Compendium pp. 29-31)
- "The ABC of a Currency Board" (Compendium pp.32)
- "Economic Focus: The Domino Effect" (Compendium pp. 33)
- "A Reconsideration of the 20th Century" (Compendium pp. 34-52)

Question: Why would a country like Denmark want to arbitrarily peg its currency to the Euro?

Class 4.

- International arbitrage and interest rate parity (IRP)
- Looking at time value: spot versus forward currency rates.

Reading:

- Madura Ch. 7.

- Note on Currencies, Interest Rates and Arbitrage (Compendium pp. 330-335)
Questions 4, 6 (NB: rates shown not p.a.), 21, 27, 30 in Madura Ch. 7 (pp. 275-277)
Question: Why must arbitrage profit be either minimal or very seldom?

NB: Election of 2 Class Reps.

Short Study Tour to Western Denmark (February 9-11)

Tuesday, February 14 – Happy Valentine’s Day

Class 5.

- Relationships among inflation, interest rates and exchange rates

Looking at the longer term: purchasing power parity theory (PPP) and its limitations.

Reading:

- Madura Ch. 8
- Lords of Finance pp. 1-95 and pp. 99-176
- The Big Mac Index by *The Economist* (DIS Blackboard)
- A Short History of Inflation (Compendium pp.17)
Questions 4, 5, 8, 13, 18, 20, 24 in Madura Ch. 8 (pp. 306-307)

Question: Why does PPP theory not seem to hold?

Class 6.

- Currency Derivatives

Looking at forwards, futures and options.

Reading:

- Madura Ch. 5.
Exercises 1 + 2 on Forwards and Interest Rate Parity formulae (DIS Blackboard)

Question: What are the similarities and the difference between futures and options?

Part II. Foreign Exchange Risk Management

Tuesday, February 21

Class 7.

- Measuring exposure to exchange rate fluctuations

Looking at hedging calculations (Intel example)

Reading:

- Madura 10.
- Post Bretton Woods Currency World (DIS Blackboard)
Exercise on Forwards and IRP: Intel example – question (DIS Blackboard).

Quiz. (On material from classes 1-6).

Class 8.

- Managing transaction exposure

Looking more at hedging calculations (GMC example)

Reading:

- Madura Ch. 11.
Exercise on Forwards and IRP: GMC example – question (DIS Blackboard)

Wednesday, February 22

International Career Night (6 -9pm)

DIS, V23-201

Tuesday, February 28

Class 9.

- Managing economic and translation exposure

Looking at structural hedging.

Reading:

- Madura Ch. 12.
- Lords of Finance pp. 179-304

Case 1 Due.

Class 10.

- Foreign direct investment (FDI).

Looking at capital movements; revisiting the International Monetary Fund.

Reading:

- Madura Ch. 13
- “Liberalizing Capital Movements: Some Analytical Issues” (Compendium pp.96-108)
- Unholy Trinity: “The Washington-Wall Street Alliance” (Compendium pp.109-115)
- Unholy Trinity: “The History of the IMF” (Compendium pp.116-123)

Question: Why do countries seek FDI from foreign companies? Why must a country be cautious in liberalising its capital controls?

Please share any concerns you have about the course with your class reps.

Friday, March 2, Deadline to drop courses/declare pass-fail

Long Study Tours with Academic Programs (March 5-10)

Part III. Corporate Finance

Tuesday, March 13

Class 11.

- Financing international trade.

Looking at export payment methods and trade finance

Reading:

- Madura Ch. 19.
- Lords of Finance pp. 307-448

Questions 1, 3, 5, 10 in Madura Ch. 19

Question: What are Letters of Credit and why are they so important for international trade?

Class 12.

- International cash management

Looking at subsidiaries, blocked funds and transfer pricing

Reading:

- Madura Ch. 21.

Question: Why is transfer pricing and how can it get a company into trouble?

Tuesday, March 20

Class 13.

- Country risk analysis

Looking at politics, globalization, and methods of risk assessment

Reading:

- Madura Ch. 16.
- Lords of Finance pp. 452-504
- “The Overstretch Myth: Can the Indispensable Nation Be a Debtor Nation?” (Compendium pp.127-132)
- “Sinking Globalisation” (Compendium pp. 133-146)

Question: What are the major economic risks of a sovereign country? How can you measure and monitor risk?

Case 2 Due.

Class 14.

- Long-term financing

Looking at debt and equity finance

Reading:

- Madura Ch. 18
- *KommuneKredit* excerpt (Compendium pp.147-153)
- “The Mystery of Corporate Debt” (Compendium pp. 124)
- “Choosing the Right Mixture” (Compendium pp.125-126)

Question: Why do companies issue debt? What are “terms” and “covenants” of a bond issue?

Part IV. European Context

Tuesday, March 27 (14:50 – 17:45)

Class 15.

- European Union financial markets

Looking at infrastructure and integration.

Reading:

- “Securities Market Infrastructures” (Compendium pp.154-165)
- “The State of Financial Integration in the Euro Area: ECB Monthly Bulletin” (Compendium pp.166-172)

Question: What is meant by the “infrastructure” of the securities market? How does ECB measure integration?

Class 16.

Midterm Exam

DIS Study Break (April 2-13)

Tuesday, April 17

Class 17.

- History of European Monetary System (EMS) and Economic and Monetary Union (EMU).
Looking at the road to the Euro and roadblocks to integration.

Reading:

- “A History Lesson for Today’s Eurofederalists” (Compendium pp.173)
- “The case against EMU” (Compendium pp.174-181)
- “A Theory of Optimum Currency Areas” (Compendium pp.182-190)
- “A Canadian Lesson for EMU” (Compendium pp.191)
- Madura Ch. 6 Appendix 6: “Economic Considerations of the Euro”

Question: What does Mundell mean by an Optimal Currency Area? What would strengthen the Eurozone?

Class 18.

- The European Central Bank (ECB).

Looking at the role of the ECB vis-à-vis the Federal Reserve

Reading:

- “A Bank is Born - The ECB” (Compendium pp.192-195)
- “A Decade in the Sun” (Compendium pp. 228-230)
- “Deflation: Making Sure “It” doesn’t Happen Here” (Compendium pp. 231-241)
- “Reform of Economic Governance in the Euro Area–Essential Elements” (Compendium pp.336-356)
- “Glossary” in *The Monetary Policy of the ECB*, European Central Bank (Compendium pp. 212-227)

Question: Who is the President of the ECB? Who makes monetary policy decisions? What is ECB’s objective?

Please share any concerns you have about the course or the IBE program with your class reps.

Wednesday, April 18 (14:50-17:45pm)

Normal class session. Our class on 24 April will be used as a field study.

Class 19.

- The international equity markets.

Looking at investment analysis, stocks, private equity and investment bubbles

Reading:

- “The South-Sea Bubble” (Compendium pp.53-76)
- “Liar’s Poker - Two Cities, True Greed” excerpt (Compendium pp.77-95)
- “The Business of Making Money” (Compendium pp.242-244)
- Review Equity Market Statistics at www.fese.be

Question: How is today’s stock market different than London’s in 1720? What are EU’s 3 largest equity markets?

Class 20.

- The international debt markets.

Looking more at investment analysis, debt and issues of sovereign credit

Reading:

- “Why US of AA Matters” (DIS Blackboard)
- Review bond market statistics at www.fese.be

Question: What are EU’s 3 largest bond markets? What is meant by liquidity risk in the credit markets?

Tuesday, April 24

Field Study: 14:50-16:30

Denmark’s National Bank, Havnegade 5 (Meet at the bank at 14:50)

FILM EVENING: 18:00-20:30

- *Inside Job (Film)*

Meet: In designated classroom unless otherwise informed

Topic: Investment Banking and the Financial Crisis of 2008

NB: Food and refreshments will be served

Tuesday, May 1

Class 21-22.

Case 3 Due.

- Oral presentations of Case 3

Reading: “Note on Financial Ratios” and “Financial Analysis Worksheet” (Compendium pp.357 & 361)

Tuesday, May 8 (last class)

Class 23.

- Review for final exam/paper.

FINAL EXAM WEEK: May 14-18