

**Hong Kong University of Science and Technology
School of Business and Management**

**FINA 342
International Finance
Fall 2003**

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Office Hours: Friday 10:30 – 12:00;
14:00 - 16:00; or
by appointment

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**Class Time: (Tues & Thurs)
15:00 –16:20**

FINA342 Home Page: <http://teaching.ust.hk/~fina342/index.html>

Note: the Powerpoint slides for the lecture notes/ and solutions to the problem sets will be found on the Web page.

Course description:

FINA342 is designed to give students an overview of the concepts and theories used in multinational financial decision-making. The course will build on and extend the valuation framework provided by domestic financial management and investment analysis to account for dimensions unique to international finance. The goal is to provide the student with a framework for making financial decisions in an international context. The key financial decisions of the multinational firm will be examined and analyzed. Topics covered include foreign exchange risk, investment analysis, and financial arrangements in the unique context of multinational rather than single country activities.

Prerequisites:

The prerequisites for this course are FINA111 Financial Management and FINA221 Investment Analysis and Portfolio Management or equivalent.

Learning Outcomes:

By the end of this course, you will have done, or be able to:

- Understand why firms and nations seek out and benefit from international business activities.
- Analyze and identify factors that cause exchange rates to change.
- Identify the linkages between international financial prices.
- Identify and measure political risk associated with a sovereign nation.
- Measure the impact of exchange rate movements on the cash flows of a firm.
- Understand the basic mechanics of currency forwards, futures, options and swaps.
- Identify and implement a variety of different strategies to manage exchange rate risk.

Readings: The required text for this course is:

Multinational Financial Management, 7th Edition, by Alan C. Shapiro, John Wiley & Sons, Inc., 2003.

The text will be supplemented by relevant readings from a variety of sources, including the Wall Street Journal, Financial Times, The Economist, and Business Week. In addition, PowerPoint lecture notes will be posted on the course's website.

Grading: Course grades are based on:

Group Assignments:		25%
(i) Case studies: two case write-ups	10%	
(ii) Currency Project:	15%	
Class Participation		5%
Midterm examination		30%
Cumulative final examination		40%
Total		100%

Homework: Homework assignments with solutions will be available on the course home page. You are not required to turn in these problems. Note, however, that the homework is indicative of the problems you will see on an exam. Thus, failure to understand the homework assignment could jeopardize your performance at exam time.

Case Studies: Three case studies have been assigned, as noted in the class schedule. But you are required to turn in any TWO of them. The purpose of these case assignments is to give you the opportunity to apply the theories and concepts of international financial management. In a team of 4~5 students you are asked to prepare a three-page, typed and single-spaced executive summary for each of the cases plus exhibits. The executive summary should consist of your point of view about the problem, a recommendation, and an analysis to back up both of them. You may append any calculations, graphical illustrations, etc. to support your analysis. Be sure to address all the questions raised at the end of the case and/or provided by me. The specific due dates are noted in the class schedule. Note you will be expected to analyze the cases with your team and be ready to discuss them in class.

It is **required** that the cases are read and analyzed prior to class so that you can participate and understand what is going on in the class discussion. Your class discussion will reflect your ability to understand what is going on inside the cases. The case studies are placed at the end of a particular topic and are to be used as analytical and discussion tools. The objective in using case studies is to provide examples of companies or individuals that have faced the topic at hand and to apply theoretical tools to real problems. The content of the case write-up is as follows:

1. The written cases will be groups with all group members receiving the same grade for the write-up.
2. The case write-up should be a three-page single-spaced (maximum) report. The three-page maximum does not apply to exhibits such as graphs and tables, but please keep these to a minimum. You may use as many exhibits as necessary to make your but the exhibit must be referred to in your write-up. *The case write-up should be typed in 12-point type with one inch margins.*
3. The case questions are designed to help you streamline the issues to be addressed. If you believe that these questions do not effectively address the problems in the case, feel free to go outside the parameters of the questions.
4. It is **not** necessary to rehash the case situation in your write-up. Do not, however, assume that I know every single number and detail. Use your best judgment on how much of the case to include in your write-up.
5. Most importantly, you must take a position regarding the problem in the case and make specific recommendations on how to solve it. Support your recommendation as succinctly and as effectively as you can.

Currency Project. Each group is expected to complete a project with the objective of tracking and analyzing a country's currency during the course of the semester. Students will be required to collect background information on the country, gather relevant data and perform a detailed analysis of the economic and political environment, including the balance of payments, to explain the exchange rate behavior observed. Specific instructions for the project are attached. Please read these instructions carefully! Failure to submit the project by the due date and/or adhere to the format as specified will result in a lower grade.

Class Participation: It is important that everyone come prepared to "*open the case*" and to discuss in detail the problem and its potential resolution. The ideal of case discussion is for the class to **interactively** come to an appreciation of the various avenues that can be explored to understand the case problem and its possible resolution.

You will also get some credit for class participation during the lectures. However most of the class participation credit will be for the case discussions as I will be especially on the lookout during the cases for an active and engaging class discussion.

Exams. One midterm examination and one in-class comprehensive examination will be given. The specific format of the exams will be determined later in the semester. You are allowed 1 4x6 index card for a crib card for the tests, back and front. However, only 1 card for each test. Given the final covers more material, you will have to know a larger amount of material as the card is not able to fit everything on it. As a general rule, there will be no make-up exam. Plan your other events in your schedule accordingly.

Late Submission Policy: Any work submitted after the deadline will lose 10% of its full credit *per day*.

Student Responsibilities:

1. *Be fully prepared for each class.* The level and structure of this class makes your individual study and preparation outside of class extremely important. The class discussions will focus on the major points introduced in the text. If you read and have at least some familiarity with the assigned chapter before you come to class, this will greatly assist you in understanding the chapter material. You will also be able to actively participate in class discussions by asking questions and sharing your experiences and point of views.
2. *Take responsibility for your learning of the course material.* Class discussions will focus on the more complex topics of each chapter and the problems, which deal with the material. To learn the course material, however, you need to practice it. Thus, after each class meeting, you should study your notes, review the PowerPoint slides and chapter objectives, and then work the relevant problems from the end of each chapter.
3. Submit all assigned cases and the currency project on the dates specified for each.
4. Check your email and the course homepage regularly for any updates, announcements or instructions concerning the course.
5. Familiarize yourself with the policies and procedures for this course (e.g., exams, currency project, case studies, grading) as well as those followed by the School and University.

Academic Integrity: The University's *Academic Regulations* are designed to ensure that the principles of academic honesty and integrity are upheld. All students are expected to adhere to this regulation. The School of Business and Management does not tolerate academic dishonesty. Academic dishonesty includes cheating, fabrication, facilitating academic dishonesty and plagiarism. Anyone suspected of academic dishonesty will be referred to the Department of Finance for disciplinary actions.

Students with special needs: Any student with special needs should bring this to my attention as soon as possible, and no later than the second week of class.

(Tentative) Class schedule

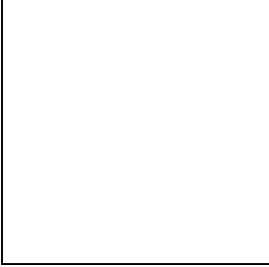
Class Date	Topics Covered	Textbook Chapters
September 2 & 4	<p><i>Topic:</i> Course Introduction and Overview of Multinational Financial Management and the Multinational Corporation</p> <p><i>Description:</i> As world economies become more integrated, the role of multinational corporations is increasing. We will examine the risks of multinational business, the reasons for the existence of the multinational corporation, and the goals of management.</p>	<p>Read: Chapter 1 Work: Questions 1.1, 1.3 and 1.8</p>
September 9 & 11	<p><i>Topic:</i> Corporate Strategy: Foreign Direct Investment and Country Risk</p> <p><i>Description:</i> Increasing global competition forces firms to not only think but also act globally. We will analyze the decision whether, where, and how to undertake foreign direct investment as well as examine the strategies for political risk management.</p>	<p><i>Read:</i> Chapters 6 (pp. 198-221) and 16 <i>Work:</i> Internet Exercise 6.2* and 16.1*-2</p>
September 16 & 18	<p><i>Topic:</i> Foreign Exchange Rate Determination: Balance of Payments Approach</p> <p><i>Description:</i> There are many potential determinants of exchange rates. One is the balance of payments, which records those cash flows that affect and are affected by exchange rates. We will review the accounts in the BOP and analyze the trends that have emerged.</p>	<p><i>Read:</i> Chapters 2 and 5 <i>Work:</i> Questions 2.3, 2.8-9; Problems 2.3-4; Internet Exercise 2.5*</p>
September 23 & 25	<p><i>Topic:</i> Foreign Exchange Rate Determination: Parity Conditions and Currency Forecasting</p> <p><i>Description:</i> Relative inflation rates have many implications for multinational financial decisions. We will examine the linkages among inflation rates, interest rates, and exchange rates in what is traditionally known as the parity conditions in international finance. They are sometimes</p>	<p><i>Read:</i> Chapter 4 <i>Work:</i> Problems 4.1-11 and 4.13</p>

useful in explaining and forecasting the long-run trend in an exchange rate.		
September 30 & October 2	<p><i>Topic:</i> Foreign Exchange and Derivatives Markets (I)</p> <p><i>Description:</i> The volume of currency trading and financial institutions' involvement in currency markets has grown rapidly. We will explore the foreign exchange market and how it functions as well as the currency derivatives markets used by multinational corporations to manage their currency risk.</p>	<p><i>Read:</i> Chapters 7, 8 and 9 (pp.307-310)</p> <p><i>Work:</i> Questions 7.1,8.4,8.5,9.3,9.4,9.5; Problems 7.1-10, 8.1-6, 9.1, 9.3</p>
October 7 & 9 No School		
October 14 & 16	<p><i>Topic:</i> Foreign Exchange and Derivatives Markets (II)</p> <p><i>Description:</i> The volume of currency trading and financial institutions' involvement in currency markets has grown rapidly. We will explore the foreign exchange market and how it functions as well as the currency derivatives markets used by multinational corporations to manage their currency risk.</p>	<p><i>Read:</i> Chapters 7, 8 and 9 (pp.307-310)</p> <p><i>Work:</i> Questions 7.1,8.4,8.5,9.3,9.4, 9.5; Problems 7.1-10, 8.1-6, 9.1, 9.3</p>
October 21 & 23	Review Session (Oct. 21) + Midterm examination (Oct. 23)	Chapters 1-4, 6-9
October 28 & 30	<p><i>Topic:</i> Measuring and Managing Translation and Transaction Exposure</p> <p><i>Description:</i> A traditional area of concern that is receiving even more attention today is foreign exchange risk management. We will discuss the likely impact that exchange rate changes will have on a firm from both an accounting and economic perspective and then analyze the costs and benefits of alternative hedging strategies.</p>	<p><i>Read:</i> Chapter 10</p> <p><i>Work:</i> Questions 10.3, 10.9 and 10.15; Problems 10:1-4 and 7-9</p>
November 4 & 6	<p><i>Topic:</i> Measuring and Managing Foreign Exchange Exposure</p> <p><i>Case Study:</i> Rolls-Royce Limited (pp.417-418)</p>	<p><i>Read:</i> Chapter 11</p> <p><i>Work:</i> Questions 11.1,</p>

	<i>Case analysis (I) due on Nov. 6</i>	11.9, 11.10; Problems 11.7, 11.10.
November 11 & 13	<p><i>Topic:</i> The Cost of Capital for Foreign Investments <i>Description:</i> Multinational corporations can utilize the global capital markets to minimize their cost of capital and maximize funds availability. We will examine the issues central to determining the cost of capital for a multinational corporation and how to establish and manage a consolidated worldwide capital structure.</p> <p><i>Case Study:</i> Multinational Manufacturing, Inc. (pp. 510-512)</p> <p><i>Case analysis (II) due on Nov. 13</i></p>	<p><i>Read:</i> Chapter 14 <i>Work:</i> Questions 14.8, 14.10; Problems 14.1-3</p>
November 18 & 20	<p><i>Topic:</i> International Portfolio Investment <i>Description:</i> International investment offers a much broader range of opportunities than domestic investment alone. We discuss the benefits of international equity investing and barriers to international diversification.</p>	<p><i>Read:</i> Chapter 15 <i>Work:</i> Questions 15.1, 15.3, 15.4, 15.10; Problems 15.2, 15.4, 15.5 and 15.9.</p>
November 25 & 27	<p><i>Topic:</i> Capital Budgeting for the Multinational Corporation <i>Description:</i> Foreign investment opportunities available to firms need to be evaluated in terms of whether they will increase the value of the firm. We will analyze the foreign investment decision-making process, which includes techniques for evaluating foreign investment proposals and how to adjust cash flows for the various economic and political risks encountered abroad.</p>	<p><i>Read:</i> Chapter 17 <i>Work:</i> Question 17.6; Problems 17.2 and 17.4.</p>
December 2 & 4	<p><i>Topic:</i> Multinational Capital Budgeting <i>Case Study:</i> Euro Disneyland (pp. 605-608)</p> <p><i>Case analysis (III) due on Dec.2</i></p> <p>Course Summary and Final Exam Review (Dec. 4)</p> <p><i>Currency project due on Dec. 4</i></p>	
December 11-20 (TBA)	FINAL EXAM Cumulative Exam Based on the Entire Course	

*** = the internet exercises marked with an asterisk relate to the currency project and may be incorporated into your currency project.**
TBA = To be announced.

CURRENCY PROJECT



An important objective of studying “International Finance” is your ability to read about and understand developments in the global economy, which in turn will affect the international financial sector. Exchange rates affect the economy by making domestic and foreign goods more or less expensive. In addition, changes in exchange rates have a major impact on financial institutions. To understand the causes and effects of exchange rate changes, it is necessary to study the underlying factors that determine and cause changes in currency values. Thus, reading the business or international section of a newspaper or magazine will keep you informed about current events, and reinforces many theories and concepts learned in class.

To meet this objective, your group is asked to select a foreign currency of your choice (ideally an exotic currency other than Hong Kong dollar) and perform a detailed analysis of the economic and political environment, the balance of payments, exchange rate behavior, and currency forecast. Divide your analysis into the following five parts:

- **Part 1:** Perform an analysis of the country’s economic and political environment for the latest 5 years. Your analysis should include:
 - Economic conditions, incl. interest rates, inflation rates, growth rates, unemployment, etc.
 - Political conditions, incl. upcoming elections, recent changes in political power, etc.
 - Exchange rate regime and foreign exchange market intervention (if applicable).
- **Part 2:** Analyze the country’s balance of payments for the latest 5 years. You can find data by using the Google search engine (www.google.com) and typing in “Balance of Payments data.” The analysis must include examinations (presentation of **annual** statistical data with discussion) of the trade balance, current account balance, financial account balance, basic balance, and overall balance. Your analysis should also address the following issues:
 - What accounts for swings in the various balances over time?
 - What is the relationship between shifts in the current account balance and changes in savings and investment? Include an examination of government budget deficits and surpluses, explaining how they are related to the savings and investment and current account balances.
- **Part 3:** For the country selected, analyze the exchange rate against the dollar during the same time period. You can find exchange rate data from www.oanda.com or <http://pacific.commerce.ubc.ca/xr>. The analysis must include a graphical illustration with numerical calculations of the currency changes and a table with the exchange rates used (**monthly** data).
 - Is there any observable relationship between the balance of payments accounts and the exchange rate?
 - Provide a possible explanation for your observations.
- **Part 4:** Extend your economic and foreign exchange rate analysis to include the latest 15 weeks of the semester. The analysis must include a graphical illustration, numerical

calculations of the currency changes, and table of exchange rates for the latest 15 weeks (using **daily** data).

- Part 5: Prepare a forecast of your foreign currency for the next year based on Purchasing Power Parity (PPP) and the International Fisher Effect (IFE), as discussed in class. If desired (and for extra credit), you may perform the forecast using regression analysis.
 - Compare your forecast against a published forecast available from www.oanda.com or forward rates available from www.ozforex.com.au/fxoptions/optiondynamics.htm.
 - Provide a possible explanation for your observations.

The project must be typed and *double-spaced, paginated*, checked for correct grammar and spelling, and properly quoted. All the sources used (including web sites) must be listed in a **bibliography** appearing at the end of the analysis. It is expected that you use a computer software package for graphical illustrations, calculations, and table presentations. The final grade for the project, which is due on **December 4, 2003**, depends on the overall quality and presentation of your analysis.

Organization and Form of the Written Report

Your written report should conform to the following format:

- The report must have a cover page, which will include the title of your study and your name
- Include a table of contents, indicating the major topics and sub-topics addressed. Corresponding page numbers should be given in the right-hand column. If tables, charts, figures, exhibits etc. are used, they should also be indicated in the table of contents.
- The table of contents should be followed by the report's introduction, the main body of the paper consisting of the balance of payments analysis, economic and political analysis, 15-week update and currency forecast, and then a conclusion or summary.
- Include **references** throughout the paper by noting the name(s) of the author(s) followed by the publication year enclosed in parentheses without punctuation: e.g., Walters (1990). When a specific page, section, or quote is referenced, the reference should also be placed in parentheses: (Economist (1990), p. 56). You can also use footnotes to cite your sources. Remember that information obtained from the Internet must also be cited with the complete Internet address; e.g., <http://www.ust.hk/kkk/part1.htm>.
- Include a bibliographic reference section at the end of your report.
- Your report should be no longer than 20 pages (a shorter report is fine, as long as it is complete). **Just make sure all information and calculations that are required are included.**
- The report should be typed and double-spaced, checked for correct spelling and grammar, and **include page numbers**.
- The report should be clearly written, well organized, well researched, and adhere to an appropriate form of presentation.

- **Include copies of all data you have used to do your analysis in an appendix at the end of the report as supporting documents as well as a disk with the electronic version of your paper.**

Note: This report should reflect your own work. Please refer to the University's Academic Regulations regarding plagiarism before you start work on the project.

Due Date: This report is due in class on **December 4, 2003**. Your grade will be dropped by 10% for each day that your report is late. In addition, failure to adhere to this format will result in a lower grade.

