

**NBA 554, International Finance**  
**Warren Bailey**  
**Fall 2002**  
**Mondays and Wednesdays, 10:10am - 11:25am**

This course applies principles of finance to the international setting. International finance is different in two basic respects. First, the existence of multiple currencies adds risk to investment and financing decisions. Second, when corporations and portfolio investors cross international borders both problems and opportunities arise. We will focus on these issues and highlight how finance theory can be extended to address them. We will start with basic principles of international finance, then apply those principles to a variety of problems. The course will help you to understand the ideas and research results of international finance and to adapt what you learn to the practical problems of the increasingly global business world beyond the classroom.

The first part of the class outlines three basic themes: exchange rate volatility, barriers to international capital flows, and the value of international diversification. The second part of the class presents a variety of problems, examples, and applications from the three basic themes. These will range from corporate finance applications of capital budgeting to portfolio management strategies.

This subject has few clear-cut answers or cookbook solutions. Students should be prepared to confront ambiguity, apply independent thinking, and juggle conflicting concepts and solutions in approaching the course material, lecture style, term project, and exams.

**Course Materials:**

Course Packet (required)

Alan C. Shapiro, Foundations of Multinational Financial Management, Allyn and Bacon, Fourth Edition (2002), Boston (optional)

Other materials to be made available online or to be distributed in class

**List of Topics and Readings:**

**I. Introduction to International Finance**

Shapiro, Chapter 1

**II. The level and volatility of exchange rates**

**A. Background:** the gold standard, fixed exchange rates

Shapiro, Chapter 3, p. 68-77

**B. Basics of Exchange Rate Determination, Real Exchange Rates**

Shapiro, Chapters 6, 2, 8

### **C. Evidence, Implications, and Problems**

Pakko/Pollard, For Here or to Go: PPP and the Big Mac, FRB St. Louis Review, January/February 1996.

Wasserfallen, "The Behavior of Flexible Exchange Rates," Financial Analysts Journal 1988

Froot/Thaler, "Anomalies: Foreign Exchange," Journal of Economic Perspectives 1990

Hakkio, "Is PPP A Useful Guide to the Dollar?," FRBKC Economic Review 1992

### **III. Barriers to International Capital Flows**

#### **A. The nature of barriers:** prohibitions, restrictions, regulations

"Philippines," in IMF Exchange Arrangements and Exchange Restrictions 1989

"The Financial Rand Market," in The Mechanics of the South African Financial System 1989

Taran/Lee/Sevilla/Chin, "Capital Controls Can Strengthen Malaysia's Sovereign Credit Profile", 1998, p. 1-18 (Salomon Smith Barney publication).

#### **B. International Asset Pricing Models**

#### **C. Evidence:** does the cost of capital differ across countries?

Bonser-Neal/Brauer/Neal/Wheatly, "International Investment Restrictions and Closed-End Country Fund Prices," Journal of Finance 1990

Bailey, "U.S. Money Supply Announcements and Pacific Rim Stock Markets," Journal of International Money and Finance 1990

### **IV. The Value of International Diversification**

Shapiro, Chapter 15

Roll, "The International Crash of October 1987," Financial Analysts Journal 1988

### **V. Currency Futures and Options**

Shapiro, Chapter 7

## **VI. Capital Budgeting in the International Setting**

**A. Motivation:** motivation for investing overseas, strategies for creating value, relation to basic corporate finance principles

Shapiro, Chapter 16

### **B. Basics of International Capital Budgeting**

Shapiro, Chapter 17, 477-487

### **C. Complexities**

**Discount rate:** Shapiro, Chapter 14, 400-412

**Political risk:** Shapiro, Chapter 17, 496-498, Chapter 5; Dadush/Brahmbhatt, "Anticipating Capital Flow Reversals," Finance and Development 1995

**Real product and production options:** Shapiro, Chapter 17, 498-502

### **D. Practitioner viewpoints**

Abuaf/Carmody, "The Executive's Guide to International Capital Budgeting," Salomon Brothers publication, 1991

James/Koller, "Valuation in Emerging Markets", *McKinsey Quarterly*, 2000.

Hauptman/Natella, "The Cost of Equity in Latin America", CSFB Publication, 1997

## **VII. Hedging Corporate Economic Exposure to Exchange Rates**

Shapiro, Chapter 11

Garner/Shapiro, "A Practical Method of Assessing Foreign Exchange Risk," Midland Corporate Finance Journal 1984

Maloney, "Managing Currency Exposure: The Case of Western Mining," Journal of Applied Corporate Finance 1990

## Office Hours:

Ordinarily, I am available often on an "open door" basis. If you are having difficulty finding me, please email or call. Furthermore, fixed office hours may be used at busy times of the semester.

## Homework Exercises:

Several spreadsheet exercises are based on data stored in Excel files. They are intended to enhance and reinforce the lectures and strengthen your computing and data analysis skills. Each student is required to upload an electronic copy of his or her work on each such assignment to the campus-wide system, <http://courseinfo.cit.cornell.edu/courses>. Furthermore:

1. Each homework file must be named with course number, family name, given name, and assignment identifier. For example, NBA554\_Kim\_Jongil\_A.xls. The "subject" line (which appears in courseinfo's uploading dialog box) must also contain this filename.
2. I cannot accept spreadsheet assignments emailed to me directly.
3. Homeworks should be completed and uploaded prior to the class when they will be discussed. Late spreadsheets will, however, be accepted through the end of Friday of the last week of classes.

## Exams:

Exams are closed book and consist of computational, short answer, and short essay questions. The following rules and procedures govern the examinations:

1. The midterm exam will be held in class on **Monday 21st October 2002**.
2. Copies of old midterms are included in the course packet.
3. The final exam will be held during finals week and at the time set by the Johnson School Registrar.
4. Copies of old finals are **not** supplied.
5. For both the midterm and the final, there will be **no** specially scheduled exams, make-up exams, or other special arrangements under any circumstances other than those prescribed by Johnson School or University rules.

## Term Project:

Each student must independently complete and submit a term project. The paper is due by the end of class on **Monday 2<sup>nd</sup> December 2002**. Papers received substantially before the deadline will earn extra credit. The following rules govern the submission of the term paper:

1. Term papers must be submitted in hard copy (that is, paper) form only.
2. Submission on a diskette, by email, or by uploading to the "Courseinfo" system is not acceptable.
3. Late papers will not be accepted under any circumstances. Any paper received after the date and time indicated for the deadline will receive zero points.

A handout detailing term paper requirements, suggesting topics, and grading will be supplied. Each term project must be based on collection and statistical analysis of an original data set.

**Final Letter Grades:**

A rough guide to how final grades will be determined is as follows: midterm 30%, term project 30%, final 30%, and homework 10%. The instructor reserves the right to determine the final letter grade assigned to each student.

**Warning:**

**If you register for this class, you agree to accept all course requirements, deadlines, exam dates, and other procedures outlined in this syllabus, in the term paper description handout, and in class discussions. There will be no discussions, pleas, or arguments about these aspects of the administration of the course under any circumstances.**