

FINOPMGT 413 International Finance
Prof. Nikunj Kapadia

SOM 106 Tue/Thu 4:00 to 5:15

Spring 2008

Office Hours: Wed 1:30 to 2:30 and by appointment

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Overview

This is an upper level course in International Finance. In this class, we focus on the special risk faced by firms when they operate in an environment subject to changes in exchange rates. The course combines class lectures with case discussions. The class lectures, roughly in the first half of the course, will provide the necessary tools and theory that will then be useful for analyzing the cases in the second half of the course. Each case focuses on a problem faced by top executives of the firm that stems from the international environment that the firm operates within. We will discuss possible solutions, focusing considerably on the quantification of the risk and the different ways in which the risk can be managed. The objective of the class is to get students to develop the ability to distil the major issues, develop alternative strategies to deal with them, and evaluate pros and cons of each alternative in a coherent manner.

Class Preparation & Participation

Class preparation and participation is a must. It is expected that each student has read the case and is prepared to start the discussion. I will call upon a student to summarize the case. The cases will typically be discussed over two days. I will discuss the case and analyze the main issues on the first day. On the second day, there will be case presentations by student groups.

Grading

The course grade will be based on the following requirements - one mid-term, four group write-ups of cases, and a final. The final element of the grade is linked to class participation and the group work required in the course.

30% - Mid-term

There will be only one mid-term exam.

40% - Write-ups

Each group must turn in *four* case write-ups, and present *two* of these cases in class. You decide which four cases you want to write up, and which of these four you want to present in class. The write-ups should be professional,

addressed to the CEO/CFO as an internal or consulting report. This means you must be precise *and* comprehensive. The write-ups should be no longer than 2 pages, plus a few appendices or tables as needed.

No detailed background is needed in the write-up – a few lines should suffice (in other words, don't repeat the material from the case except to the extent that you want to focus on a particular number). On the other hand, do not assume I am intimately familiar with every number in the case. Exercise judgment on what is necessary to make the write-up coherent. In any event,

- Take a clear stand on the central case problem
- Provide a recommended course of action.

20% - Final Exam

There will be a final exam which will test the analytical skills developed by the case analyses..

10% -- Peer Evaluations and class participation

Towards the end of the semester, each student will evaluate every other group member individually. Use participation and attendance in group meetings, contribution to group preparation, write-ups and the term project, and the overall rating as a team player as criteria to grant these grades. In addition, I will also take into account the class participation and attendance of the student in determining this portion of the grade. Please note that this portion of the grade can significantly change the overall grade.

Course Package

The course packet consists of 12 Harvard Business School cases and notes.

1. HBS # 9-799-088 Currency Crises
2. HBS #9-799-089: Note on Currency Crises
3. HBS #9-205-016 Note on Foreign Exchange Markets
4. HBS #9-288-016 Note on Fundamental Parity Conditions
5. HBS #9-288-017: Note on Transaction and Translation Exposure
6. HBS # 9-288-018: Note on Operating Exposure to Exchange Rate Changes
7. HBS #9-205-026: Hedging Currency Risk at AIFS
8. HBS #9-295-047 Tiffany & Co. 1993
9. HBS #9-284-019: Hintz-Kessels-Kohl A.G.
10. HBS# 9-286-006: Universal Circuits, Inc.
11. HBS #9-290-005: Jaguar plc, 1984
12. HBS #9-205-096: Foreign Exchange Hedging Strategies at GM: Competitive Exposures

DETAILED CLASS SCHEDULE

February 18th is Presidents' Day, and Monday schedule will be followed on Tue, February 19th.

Spring Break begins Saturday March 15th.

Last day of class is May 13th.

Week 1: January 28 and 30

Introduction and Overview of Class

The risks imposed by exchange rates, and the challenge faced by corporations:
Exchange Rates and Currency Crises

HBS Case # 9-799-088 Currency Crises

Reading:

HBS Case # 9-799-088 Currency Crises

HBS #9-799-089: Note on Currency Crises

Week 2: February 5 and 7

Student Case Presentation: Exchange Rate Crises

Exchange Rate Markets

Reading:

HBS Case # 9-799-088 Currency Crises

HBS #9-799-089: Note on Currency Crises

HBS #9-205-016 Note on Foreign Exchange Markets

Week 3: February 12 and 14

The Parities: Purchasing Power Parity, Interest Rate Parity

Reading:

HBS #9-205-016 Note on Foreign Exchange Markets

HBS #9-288-016 Note on Fundamental Parity Conditions

Week 4: February 21

Hedging Instruments: Forwards and Options

Reading:

Class Notes

HBS #9-205-016: Note on Foreign Exchange Markets

HBS #9-288-016 Note on Fundamental Parity Conditions

Week 5: February 25 and 27

Hedging Instruments: Forwards and Options

Thursday: Review for Mid-Term

Week 6: March 4 and 6

Tuesday: MID-TERM is on Tuesday, March 4.

Thursday: Hedging Currency Risk at AIFS

Reading: HBS #9-205-026: Hedging Currency Risk at AIFS

Week 7: March 11 and 13

Tuesday: Student presentation of AIFS Case

Thursday: Transaction and Translation Exchange Rate Exposure

Reading:

HBS #9-288-017: Note on Transaction and Translation Exposure

Spring Break – March 15 to March 23

Week 8: March 25 and 27

Tuesday: Operational Exposure

Reading:

HBS # 9-288-018: Note on Operating Exposure to Exchange Rate Changes

Thursday: Tiffany & Co. 1993

Reading: HBS #9-295-047 Tiffany & Co. 1993

HBS # 9-288-018: Note on Operating Exposure to Exchange Rate Changes

Week 9: April 1 and 3

Tuesday: Student Presentation of Tiffany Case

Thursday: Hintz-Kessels-Kohl A.G.

Reading: HBS #9-284-019: Hintz-Kessels-Kohl A.G.

Week 10: April 8 and 10

Tuesday: Student Presentation of Hintz-Kessels-Kohl Case

Thursday: Universal Circuits, Inc

Reading: HBS 9-286-006: Universal Circuits, Inc.

Week 11: April 15 and 17

Tuesday: Student Presentation of Universal Circuits Case

Thursday: Jaguar plc, 1984

Reading: HBS 9-290-005: Jaguar plc, 1984

Week 12: April 22 and 24

Tuesday: Student Presentation of Jaguar Case

Thursday: Competitive Exposure: General Motors

Reading:

HBS #9-205-096: Foreign Exchange Hedging Strategies at GM: Competitive Exposures

Week 13: April 29 and May 1

Tuesday: Student Presentation of GM Case

Thursday: Review of main concepts

Week 14: May 6 and 8

Wrap up and review for final.

Week 15: May 13

Final Exam

Case Questions

1. Currency Crises

- a. For each of the unidentified country, discuss whether the country is on the verge of a crisis.
- b. Suppose you were in charge of the financial policies of the country that you think is most likely to be subject to a crisis. What would you do to prevent it?

2. Hedging Currency Risk at AIFS

- a. Recommend a hedging strategy for AIFS. Specifically, state what percentage of the costs should be covered, and whether the firm should use options or forward contracts.
- b. What are the risks of your hedging strategy? Please quantify the risk.

3. Tiffany and Co.

- a. Should Tiffany actively manage its yen-dollar exchange rate risk? Why or why not?
- b. If Tiffany were to manage exchange rate risk activity, what should be the objectives of such a program? Specifically, what exposures should be actively managed? How much of the exposures should be covered and for how long? What instruments should be used - options or forward/futures?

4. Hintz-Kessels-Kohl A. G.

- a. How attractive would the Costa Rican contract be to HKK assuming alternatively, (i) no change in the \$/As exchange rate, and (ii) a depreciating dollar. For simplicity, assume no OKB financing at this stage.
- b. How much OKB financing could be potentially be made available in connection with the Costa Rican contract? How much more attractive might the contract be because of such financing.
- c. Would you cover the currency exposure? Why or why not?
- d. Given your analysis, evaluate the possible choices faced by the firm for this project. In addition, provide long-term recommendations of any changes that the firm should make.

5. Universal Circuits

- a. Does Universal Circuit's Irish controller have a convincing argument for the weakness of the dollar? Why or why not? How do you interpret the evidence?

- b. In view of the fact that the dollar is the Irish subsidiary's "functional currency," should the controller be worried about its exchange value? What is the nature of the foreign exchange exposure(s) faced by the Irish subsidiary? Why isn't the Irish subsidiary's functional currency the Irish punt?
- c. Would you approve the controller's request to buy the punt forward? What considerations factor into your decision?
- d. What policies would you recommend so that you do not face similar problems in the future?

6. Jaguar plc, 1984

- a. Consider Jaguar's exchange rate exposures. To which currency is Jaguar exposed? What are the sources of these exposures? How would the company be affected by a 25% decline in the real value of the dollar?
- b. How should investor's value Jaguar's shares? In particular, should they be concerned with foreign exchange risk?
- c. Given investor's concerns, what should management do before the IPO?

7. Foreign Exchange Hedging Strategies at GM: Competitive Exposures

- a. Quantify the impact of Yen exchange rate risk on GM.
- b. Should bond-holders worry about this exchange rate risk? Specifically, assess the probability of default after accounting for management's optimal response to Japanese competitors.
- c. What recommendations would you give to the management? In particular, what are the feasible policy options that are available, given the special circumstances of GM?