International Finance
Professor Laura Veldkamp

Course Description: The course examines important issues in international finance, both corporate and asset pricing, using a mixture of classes involving lecture/discussion and the analysis of cases. After a review of international finance fundamentals, we will examine international capital budgeting decisions, which require an understanding of exchange rates and the determination of an appropriate cost of capital. To do this, our valuations will use both discounted cash flow analysis, adjusted net present value analysis, and various multiples. We will also explore forecasting, currency risk and political risk. Finally, the course discusses various tools to manage these different types of cross-border risks.

Prerequisites: This is a quantitative finance course. Students should have taken Capital Markets and Investments or its equivalent prior/concurrent to enrolling in the course.

Connection with the Core: The class will utilize, build on, and extend concepts covered in the following core courses:

Corporate Finance:
- Present Value
- The Capital Asset Pricing Model
- Systematic vs. Idiosyncratic Risk
- Valuing a company with discounted cash flow analysis

Managerial Finance / Statistics:
- Means, variances, and covariances
- Normal distributions
- Linear regression

Global Economic Environment:
- Interest Rates and Inflation
- The Determination of Exchange Rates


Cases: Cases are available as PDFs on Canvas. Questions for the cases are also on Canvas.

Course Requirements:

Your grade will be based on class participation, which will assess both the quantity but more importantly the quality of what you contribute to class discussions. It will also reflect daily practice interview questions, a forecasting project, and a take-home final exam.
Class Participation: 40%;
Practice Interview Questions: 15%
Forecasting Exercise: 20%
Take-Home Final: 25%

When cases are discussed in class, we will typically first break out into groups to discuss the cases as a small group. You are expected to participate as an equal partner in your group, which can have as few as three and as many as five members. I will cold call both groups and individuals for answers.

Honor Code:

The Take-Home Final Exam is to be done individually and is open-book and open-note. Do not share your analysis of the questions with other classmates.

Schedule

All readings are required and should be done prior to the class, if possible. I realize that this block-week class is a very compact schedule, so time for case preparation will be allowed in class as well as breakout time for case discussion in groups. But there will not be time to read everything from the beginning, during class time alone.

Day 1:

Introduction to Foreign Exchange Markets and Transaction Exchange Risk

Spot and Forward Foreign Exchange Markets, Transaction Exchange Risks, and Interest Rate Parity

Bekaert and Hodrick, Chapter 2, The Foreign Exchange Market
Bekaert and Hodrick, Chapter 3, Forward Markets and Transaction Exchange Risk
Bekaert and Hodrick, Chapter 6, Interest Rate Parity

Forecasting and Hedging

International Forecasting and Leading Indicators

Hedging Transactions Risk with Foreign Currency Options

Bekaert and Hodrick, Chapters 20, Foreign Currency Futures and Options
Hedging Currency Risks at AIFS, HBS Case 9-205-026

Day 2:

FX Risk Premia
Bekaert and Hodrick, Chapter 7, Speculation and Risk in the Foreign Exchange Market

**Prices and Real Operating Exposure**

**Purchasing Power Parity and Real Exchange Rates**

Bekaert and Hodrick, Chapter 8, Purchasing Power Parity and Real Exchange Rates

**Managing Real Economic Exposure**

Bekaert and Hodrick, Chapter 9, Measuring and Managing Real Exchange Risk

**Day 3**

**Basic International Capital Budgeting**

**The International Cost of Capital**

Bekaert and Hodrick, Chapter 13, International Capital Market Equilibrium

**Adjusted Net Present Value in an International Context**

Bekaert and Hodrick, Chapters 15, International Capital Budgeting including the International Wood Products Case

**Day 4:**

**Political Risk**

Bekaert and Hodrick, Chapter 14, Political and Country Risk

Globalizing the Cost of Capital and Capital Budgeting at AES, HBS Case 9-204-109

**Valuation in Emerging Markets**

Brazilian Beer Negotiations: Companhia Cervejaria Brahma, S.A., UVA Case UV0277

Inbev and Anheuser-Busch, Thunderbird Case TB0251

**Risk Management and ANPV**

Bekaert and Hodrick, Chapter 17, Risk Management and the Foreign Currency Hedging Decision
Day 5:

Forecast Presentations

Risk Management at GM

Foreign Exchange Hedging Strategies at General Motors: Transactional and Translational Exposures, HBS Case 9-205-095
Foreign Exchange Hedging Strategies at General Motors: Competitive Exposures, HBS Case 9-205-096

Privatization

Jaguar plc, 1984, HBS Case 9-290-005