

The Study Program

Classes:

International Business Management	Winter	4 SWS = 6 Credits
International Corporate Governance	Winter	2 SWS = 3 Credits
International Financial Management	Summer	2 SWS = 3 Credits
Western European Business	Summer	2 SWS = 3 Credits

Seminars:

International Business Research	Winter	2 SWS = 8 Credits
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Various classes and seminars offered by Professor Backhaus, but also other colleagues.

Syllabus Summer 2009

Tuesday 16:15 – 17:45, J 498 + 18:15 – 19:45, J 498 (except 4/21)
Wednesday 14:15 – 15:45, J 498

Part 1: The Foreign Currency Environment

- 14.04.: Ch. 2: Introduction, The International Financial System, The Balance of Payments
- 14.04.: Ch. 3+4: Terminology, International Parity Conditions
- 15.04.: Ch. 6: Transactions Exposure
- 21.04.: Ch. 7+8: Operating and Translation Exposure
- 22.04.: Ch. 9+5: Interest Rate Exposure + Options
- 28.04.: Ch. 5+23+24: F/X Options and Risk Management
- 28.04.: Risk Management and Financial Instruments: Cases and Practice

Part 2: The Financial Policy of the MNE

- 29.04.: Ch. 1+13: International strategy, foreign direct investment, political risk
- 05.05.: Ch. 17+18: Tax Issues and Financial Management; Fund Repositioning
- 05.05.: Ch. 11+12: Sourcing Debt and Equity Internationally
- 12.05.: Ch. 10, 14-16: Cost of Capital, Capital Budgeting, Int'l Acquisitions, Risk Analysis
- 12.05.: Case: Cemex and P.T. Semen Gresik

- 19.05.: Examination (S8, Schloss)

Credit Points and Student Work Load

The class earns students 3 credit points

One credit point should be equivalent to 25 – 30 hours of work

The class should involve some **75 – 90 hours** of student work

12 classes 90 minutes each:	18 hours
Reading assigned literature before class: (2 hrs. per class)	24 hours
Clarifying remaining problems after class (1/2 hr. per class)	6 hours
Preparing for the examination (re-reading and practicing) (4 days 8 hours)	32 hours
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Total	80 hours

Universal Principles versus Cultural Norms in Financial Management

Finance lies at the heart of a battle between economic systems and philosophies: Whose interest does the corporation serve?

- **Shareholders?** ⇒ The goal of the firm is to maximize shareholder value.
 - **Stakeholders?** ⇒ The goals of the firm are defined by a negotiating process among stakeholders.
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There is no “right” system to define corporate objectives, since contracts and legislation are alternative mechanisms to influence the corporation.



Corporate governance structures found in various countries are a *result of cultural norms*, not necessarily universal principles.



This translated into different perceptions of concepts fundamental to financial management, such as returns and risks. Hence, financial practice may differ fundamentally in different cultural environments (e.g. Islamic Banking).

Corporate Governance and the Financial Sector

Different cultures define different governance mechanisms that place *different weights on the different stakeholders*, including the investors.



Financial institutions of a particular country are shaped around the prevailing governance philosophy. The relevant institutions include:

- **Tax system (for internal finance)**
- **Stock market legislation and practice, including**
 - Disclosure rules
 - Minority shareholder protection
 - Stock exchange listing requirements
 - The takeover code
 - Definition and protection of non-voting stock
 - Proxy voting rules
- **Banking System** (Regulation, Supervision, Contract Enforcement)
- **Bankruptcy Laws**
- **Legislative environment for out-of-court restructurings**

Managers from different countries thus face different sets of financial institution, and correspondingly, perceive **different costs of capital!**

The Role of Money in the Economy

Cultural norms also determine the attitude of people and government towards money.

In particular, different countries seem to have different tolerances for *inflation*.



Inflation represents a hidden (undemocratic) tax imposed by the government.

⇒ Inflation differentials between countries affect:

- The relative competitiveness between imports and exports
- The real interest rate earned by investors

Thus, inflation differentials determine the relative valuation of the respective currencies.

Governments have differing attitudes towards the valuation of their currencies.



These are determined by governmental attitudes towards the stability of import prices, sovereign debt, and central bank reserves. To understand the connection between these things, we need to understand the **Balance of Payments**.

The Balance of Payments

... systematically summarizes for a specified time period the economic transactions of residents of an economy with residents of the rest of the world.

Credit = Foreign Exchange Earned
 Debits = Foreign Exchange Expended

	Credits	Debits
Current Account:		
Balance on Goods and Services	Exports	Imports
Income receipts and payments on investments	Nanny remittances	
Capital Account:		
Transfers of ownership of non-financial assets		Vac.homes
Cancellation by creditors of liabilities	Debt forgiveness	
Financial Account:		
Balance of Direct, Portfolio, and other investments	Incoming FDI, loans	
Net Errors and Omissions		Capital flight
Reserve Items		
Balance of Reserve Assets and Liabilities	Decr. CB f/x reserves	

Note: All trade deficits must be *financed* by the rest of the world, or reserves are run down!

Exchange Rate Regime, Trade Deficit and Balance of Payments Equilibrium

1. Fixed Exchange Rate Regime

- Prices for domestic goods are “too high”
- Imports are more attractive than domestic goods
- Foreigners hold excess of our currency
 - a) They invest in domestic financial assets
 - b) They exchange our currency in their central bank for their currency
 - Increase in foreign money supply
 - More inflation abroad
 - Increasing prices of foreign goods
 - Trade equilibrium restored
 - c) The foreign Central Bank doesn't want to increase its money supply
 - It trades its holdings of our currency for their currency
 - Our Central Bank reserves are reduced

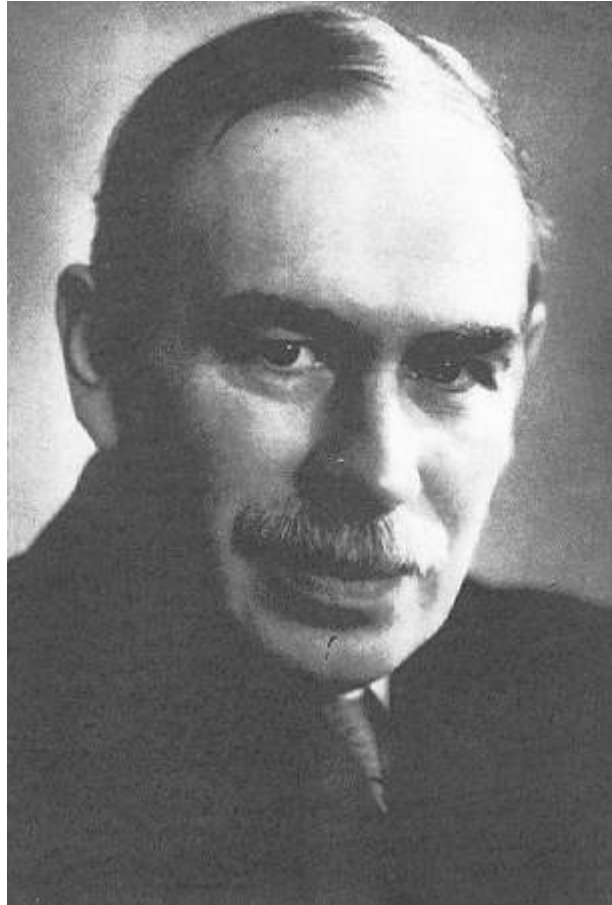
2. Floating Exchange rate Regime

- Foreigners hold excess of our currency
 - a) They invest in our financial assets
 - b) They sell our money, and drive down its price

A History of Exchange Rate Regimes

- The Gold Standard: 1876-1913
- The (Inter-) War Years: 1914-1944
- Fixed Exchange Rates: 1945-1973
- Eclectic Regime: 1973-now
 - Flexible Exchange Rates (US\$, the Euro, the British Pound, the Japanese Yen)
 - Various Forms of Pegging
 - Managed Floats
 - Cooperative Agreements (European Monetary System)
 - Common Currency Areas (European Monetary Union)

John Maynard Keynes



JM Keynes



Financial Management in the Multinational Enterprise

The Multinational Enterprise (MNE) faces *segmented financial markets* with:

- Differential costs of capital
- Different types of financial institutions
- Different tax regimes
- Different Currencies with
 - Varying exchange rate regimes
 - Thus, varying degrees of exchange rate predictability
 - Therefore different types of exchange rate risks
- Varying degrees of political risks

The financial manager of the MNE should:

- Try to arbitrage across segmented national financial markets to lower the cost of capital
- Limit the exposure of the firm to foreign exchange risk
- Manage the unavoidable exposure to foreign exchange risk
- Optimize the firm's tax exposure
- Quantify and possibly manage political risks