What is International Strategic Financial Planning (ISFP)?

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IVEY

Why do we need ISFP?

What do we study in Finance?

- We evaluate and manage the timing and predictability of cash in- and outflows related to a corporation's activities.

- We balance firm profitability and other strategic goals with the risk of financial distress. Our goal is to:
  - maximize stakeholders' utility.
  - optimally invest excess funds and raise funds (short-term or long-term) for new or ongoing projects.
  - understand and, as desired, hedge financial risks.

➢ The choices depend on firm objectives as well as business and financial constraints.

What is the goal of ISFP?

- Extend the relationships discussed in other courses between financial choices and firm objectives with respect to both domestic and international alternatives.

- Understand the pros and cons of access to various financial markets and instruments around the world:
  - Markets: Stocks, Bonds, Derivatives, etc.
  - Pros/Cons: How risky are the assets? Liabilities? When are they risky? What cash flows will they produce? What cashflows will they require?
    - Is it a worthwhile use/source of corporate funds?

➢ ***Develop a logical framework linking firm decisions and financial markets***

Administrative Issues

- Materials
  - Assigned readings: the case packet, and a class web page (www.ivey.uwo.ca/faculty/ssapp/Teaching/EMBA_ISFP_TO.htm

  or

  www.ivey.uwo.ca/faculty/ssapp/Teaching/EMBA_ISFP_HK.htm).
- Grades
  - 1) Case brief on Geeli due at the beginning of the class in which we cover the Geeli case, 2) final project due two weeks after our last class and 3) class contribution.
  - Case brief is to be done individually and the final project can be done individually or in groups.
  - Contribution based on:
    - My evaluation of each participant's class-by-class contribution and peer evaluation of contribution.
    - Please email if you have to miss a class.

Case Analysis: Review

Steps to follow:

- Who is the decision maker?
- What is the decision?
- What are the criteria?
  - Maximizing shareholders' wealth? Corporate wealth? Management's wealth? NGO's?
  - Limiting risk? What type of risk(s)? How significant are each of these risks?
- Key alternatives to consider?
- Analysis and discussion of the alternatives.
- Decision and action plan.

Major Topics in the Course

1. ***Risk Management*** - Identifying and characterizing the risks faced by firms in trying to accomplish their goals. What financial tools exist to manage these risks and how may they impact the achievement of organizational goals.

2. ***Raising Capital*** - Understanding the costs and benefits to raising funds for operations in various markets.

3. ***International Investments*** - Evaluating the costs and benefits to purchasing and/or operating assets in different markets (e.g., domestic/foreign or emerging/developed).

Risk Management

Risk Management

- The sources of risk must be identified. This is more difficult than frequently acknowledged. Just ask AIG, UBS, Citibank, S&P, Moodys, DBRS, …

"A culture of irresponsibility took root from Wall Street to Washington to Main Street. A regulatory regime basically crafted in the wake of a 20th century economic crisis, the Great Depression, was overwhelmed by the speed, scope and sophistication of a 21st century global economy"

Barack Obama, June 2009

"… As Enron should have taught us seven years ago, the most deceitful words in the English language are not "the cheque is in the post" … but rather "off balance sheet". … As a result no one, including banks themselves, knew where the risks lay nor how large they were."

FT September 1, 2009

Risk Management

When identifying risks we start with the major types of risk:

1. *Business Risk*
   – The risk associated with manufacturing and marketing the firm's products.

2. *Financial Risk*
   – The risk associated with ensuring the firm has adequate cashflows to meet its commitments.

- How do these risks depend on our actions? Others' actions? Financial markets?
- Are they something we should try to hedge? What tools exist to perform the desired function?

Where Do These Risks Originate?

- Increased global trade of goods, services (including financial goods and services) has increased risks and opportunities for firms.
  - Global supply and demand have increased dramatically over the past 30 years. This has provided both increased risks and opportunities.
- The most obvious sources of risk:
  - Importing inputs requires buying different currencies (e.g., selling Canadian dollars for Euros to buy German machinery)
  - Exporting our goods/services requires people buy Canadian dollars.
  - What happens to Chinese exporters as the value of the Yuan increases?
  - What about borrowing/lending in different countries?
- Can this impact your competitive position? Domestically? Internationally?

Examples of Risks and Opportunities

- Need to identify sources of risk, magnitude of the risk, ability to manage the risk and desirability of managing the risk:

- Financial Risk
  - Capital risk – debt or equity values
  - Currency risk – value of inputs and outputs
  - Liquidity risk – the ability to easily buy or sell financial securities
  - Market segmentation – different pricing across markets

- Political Risks
  - Difficulty enforcing contracts or "rule of law".
  - Changes in regulation or differences in regulation, expropriation.
  - Legal restrictions on market access.

- Expanded Opportunity Set
  - Move production overseas. Economies of scale
  - Diversification of market risk.
  - Global investment opportunities and financing alternatives.

Steps to Managing Risk

- Identifying the risk?
  - Is it a financial or business risk?
  - Is it a *cash* risk or an *accounting* risk?

- How large are the risks?
  - Are the opportunities large enough to offset these risks?
  - When are these risks largest?
  - What happens in a “worst case” scenario? “best case”?
  - What are the direct and indirect costs and benefits?

➢ ***Are these risks we should be bearing?***

➢ ***How effectively can we manage them?***

Example: Identification of Risks

- McDonalds (MCD – NYSE). Extracted from their Annual Report.

- Examples of some tools and identification of risks:

- Comparable sales, comparable guest counts, constant currency reporting for revenues and costs and explicit breakdowns of currency gain (loss).

- 65% of Operating Income and 40% of debt is in foreign currencies.
    - In their forecasts they present the impact of a 10% change in value of the US dollar on results and a 1% change in interest rates.

- Detailed agreements with all counterparties

Example: Identification of Risks

- Discussion of Foreign Exchange Risk:
  - In 2010, foreign currency translation had a positive impact on consolidated operating results driven by stronger global currencies, primarily the Australian Dollar and Canadian Dollar, partly offset by the weaker Euro.
  - In 2009, foreign currency translation had a negative impact on consolidated operating results, primarily driven by the Euro, British Pound, Russian Ruble, Australian Dollar and Canadian Dollar.
  - In 2008, foreign currency translation had a positive impact on consolidated operating results, driven by the stronger Euro and most other currencies, partly offset by the weaker British Pound.

Example: Management of Risks

- "The Company does not use derivatives with a level of complexity or with a risk higher than the exposures to be hedged and does not hold or issue derivatives for trading purposes. All exchange agreements are over-the-counter instruments."

- "The Company uses foreign currency debt and derivatives to hedge the foreign currency risk associated with certain royalties, intercompany financings and long-term investments in foreign subsidiaries and affiliates. This reduces the impact of fluctuating foreign currencies on cash flows and shareholders' equity. Total foreign currency-denominated debt was $4.7 and $4.5 billion for the years ended December 31, 2010 and 2009. In addition, where practical, the Company's restaurants purchase goods and services in local currencies resulting in natural hedges."

- In August, 2010 McDonalds issued a 200 million yuan bond in HK.

Financing Strategies

- There are many costs and benefits to using global financial markets to meet capital needs.
  - Decreased cost of capital, diversification of capital sources, hedging currency and interest rate risks, managing political risk.

- Alternatives:
  - The standard choices you should always consider:
    - Internal versus External? Debt or Equity (or Preferred)? International or Domestic? What currency? What maturity? Private or public?

➢ ***How can we minimize the after-tax costs with an acceptable risk?***

International Investments

- Is this an investment worth taking?
  - Standard valuation methodologies from previous courses …
- Are there differences in the risks and thus valuation between foreign and domestic projects?
  - Business risks? Political risks? Economic risks? Financial risks?
- How do we account for these in making our decision?
  - What is the required return for this type of investment? Comparables? Growth rates?

➢ ***Should we do it and, if so, how to finance it and manage the associated risks?***

Optimizing Global Financial Decisions

In this course we will:

- Identify and characterize the financial (and business) risks and opportunities faced by a firm to determine how to best manage its cashflows.
- Determine the significance of the risks associated with the financial instruments available to improve the firm’s competitive position and pursue its opportunities.
- Evaluate the value created by different alternatives around the world.

→ ***Want to choose the best alternative(s) to increase value for the firm’s stakeholders***!

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