INTERNATIONAL FINANCING AND INTERNATIONAL FINANCIAL MARKETS

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INTERNATIONAL FINANCING AND INTERNATIONAL FINANCIAL MARKETS

I. CORPORATE SOURCES AND USES OF FUNDS

A. 3 General Sources of Funds:

1. Internally-generated cash
2. Short-term external funds
3. Long-term external funds

B. Forms of Securities

1. Equity
2. Debt: the most preferred form

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C. Debt Instruments Used

1. Commercial Bank Loans
2. Bonds
   a. Publicly issued
   b. Privately issued

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D. Financial Markets v. Financial Intermediaries

1. Securitization

a. Definition:

replacing bank loans with securities issued in public markets.

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b. Reflects reduction in access costs due to

1.) Technological improvements

2.) Globalization

E. Globalization of Financial Markets

-has led to

1. Global center competition
2. Regulatory arbitrage

II. NATIONAL CAPITAL MARKET AS INTERNATIONAL CENTERS

A. Principal Functions of Financial Centers

-between savers and borrowers

1. To transfer purchasing power
2. To allocate funds

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B. International Financial Market

1. Development of most important:
   a. London
   b. New York
   c. Tokyo
2. Other Centers for Intermediaries
   a. Singapore
   b. Hong Kong
   c. the Bahamas

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3. Prerequisites to be a financial center
   a. political stability
   b. minimal government interventions
   c. legal infrastructure
   d. financial infrastructure

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C. Foreign Access to Domestic Markets

1. The Foreign Bond Market
   a. Extension of domestic market
   b. Issues floated by foreign cos. or governments
   c. Examples:
      yankee bonds, samurai bonds

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c. Three Major Types of Foreign Bonds

1.) Fixed rate

2.) Floating rate

3.) Equity related

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2. The Foreign Bank Market
   a. Extension of domestic markets
   b. Important funding source:
      Japanese banks for U.S. firms
3. The Foreign Equity Market
   a. Cross listing internationally can
      1.) diversify risk
      2.) increase potential demand
      3.) build base of global owners.

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D. Downside of Global Financial Markets

-abrupt shifts in capital flows

II. THE EUROMARKETS

-the most important international financial markets today.

A. The Eurocurrency Market

1. Composed of eurobanks who accept/ maintain deposits of foreign currency
2. Dominant currency: US$

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B. Growth of Eurodollar Market caused by restrictive US government policies, especially

1. Reserve requirements on deposits
2. Special charges and taxes
3. Required concessionary loan rates
4. Interest rate ceilings
5. Rules which restrict bank competition.

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C. Eurodollar Creation involves

1. A chain of deposits
2. Changing contol/usage of deposit
3. Eurocurrency loans
   a. Use London Interbank Offer Rate: LIBOR as basic rate
   b. Six month rollovers
   c. Risk indicator: size of margin between cost and rate charged.

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4. Multicurrency Clauses
   a. Clause gives borroweers opton to switch currency of loan at rollover.
   b. Reduces exchange rate risk
5. Domestic vs. Eurocurrency Markets
   a. Closely linked rates by arbitrage
   b. Euro rates: tend to lower lending, higher deposit

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D. Eurobonds

bonds sold outside the country of currency denomination.

1. Recent Substantial Market Growth

-due to use of swaps.

a financial instrument which gives 2 parties the right to exchange streams of income over time.

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2. Links to Domestic Bond Markets

   arbitrage has eliminated interest rate differential.

3. Placement

   underwritten by syndicates of banks

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4. Currency Denomination
   a. Most often US$
   b. “Cocktails” allow a basket of currencies
5. Eurobond Secondary Market
   -result of rising investor demand
6. Retirement
   a. sinking fund usually
   b. some carry call provisions.

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7. Ratings
    a. According to relative risk
    b. Rating Agencies
       Moody's, Standard & Poor
8. Rationale For Market Existence
    a. Eurobonds avoid government regulation
    b. May fade as market deregulate

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E. Eurobond vs. Eurocurrency Loans

1. Five Differences

   a. Eurocurrency loans use variable rates

   b. Loans have shorter maturities

   c. Bonds have greater volume

   d. Loans have greater flexibility

   e. Loans obtained faster

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F. Note Issuance Facility (NIF)

1. Low-cost substitute for loan
2. Allows borrowers to issue own notes
3. Placed/distributed by banks

G. NIFs vs. Eurobonds

1. Differences:
   a. Notes draw down credit as needed
   b. Notes let owners determine timing
   c. Notes must be held to maturity

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IV. INTEREST RATE AND CURRENCY SWAPS

A. INTEREST RATE SWAPS

1. Definition

an agreement between 2 parties to

exchange US$ interest payments

for a specific maturity on an agreed notional amount.

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a. Notional principal: a reference amount used only to calculate interest expense but never repaid.

b. Maturities: less than 1 to over 15 years

2. Types

   a. Coupon swap

   b. Basis swap

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3. Usage:

   to reduce risk potential and costs.

B. Currency Swaps

1. Definition

   two parties exchange foreign-currency-denominated debt at periodic intervals.

2. Purpose: similar to parallel loan

3. Differences of a Currency Swap:
   a. Currency swap is not a loan
   b. No interest expense; no balance sheet entry
   c. The right to offset any non-payment is more firmly establish

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4. Similarities between Interest Rate and Currency Swaps
   a. Avoid exchange rate risk
   b. Exchange rate is only a reference to determine amounts exchanged
5. Economic Benefits of Swaps

   when arbitrage prohibited, they provide long-term financing.

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V. DEVELOPMENT BANKS

A. General Purpose

founded by governments to help finance very large infrastructure projects.

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B. Types of Development Banks

1. World Bank Group includes

   a. International Bank for Reconstruction and Development

   b. International Development Association

   c. International Finance Corporation

INTERNATIONAL FINANCING AND INTERNATIONAL FINANCIAL MARKETS

B. Types of Development Banks (con't)

2. Regional Development Banks finance industry, agricultural, and infrastructure projects
3. National Development Banks concentrate on a particular industry or region.

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INTERNATIONAL BANKING TRENDS AND STRATEGIES

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INTERNATIONAL BANKING TRENDS AND STRATEGIES

I. RECENT PATTERNS

rapid growth in risk and complexity over the last 2 decades

A. The Era of Growth (Causes)

1. Growth in international business
2. Energy Crisis of 1973
3. Loans to developing economies

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INTERNATIONAL BANKING TRENDS AND STRATEGIES

2. International Banking Crisis(1982)
   a. Energy Crisis (1973)
      OPEC nations accumulated huge (petro) dollar balances
   b. Loans went to developing nations.
   c. OPEC funds dried up (1982)

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INTERNATIONAL BANKING TRENDS AND STRATEGIES

d. Interest rates began to rise

e. Mexico: August, 1982 announced its inability to make loan payments

f. By spring, 1983 25 developing nations also defaulted - banking crisis!

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INTERNATIONAL BANKING TRENDS AND STRATEGIES

3. Baker Plan (1985)

   Goal: to support 15 developing nations through economic growth

   Failed.

4. Brady Plan (1989)

   Goal: debt relief through forgiveness

INTERNATIONAL BANKING TRENDS AND STRATEGIES

4. Brady Plan options:
   a. Banks given two
      1.) Make new loans
      2.) Write off portions of existing loans in exchange for "Brady"bonds.
      3.) "Brady" bonds IMF backed
   b. Bank crisis ends by July 1992.

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INTERNATIONAL BANKING TRENDS AND STRATEGIES

B. International Bank Regulations

1. Needed:

   well-defined supervisory structure

2. Basle Agreement (1992)

   set risk-based banking standards

   a. Banks must have minimum 8% ratio capital to assets

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INTERNATIONAL BANKING TRENDS AND STRATEGIES

b. Capital adequacy standards revised to incorporate market risk

c. Banks must focus more on profit growth

C. Japanese International Bank Expansion

1. Recent expansion overseas
2. Lately, retrenchment due to new Basle standards.

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INTERNATIONAL BANKING TRENDS AND STRATEGIES

II. ORGANIZATIONAL FORMS AND STRATEGIES IN BANK EXPANSION OVERSEAS

A. Bank's Foreign Market Approach depends on

1. Overall financial resources
2. Level of market experience
3. Int'l business volume
4. Bank's strategic plans

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INTERNATIONAL BANKING TRENDS AND STRATEGIES

B. Correspondent Banking

1. Definition:

   a bank located elsewhere that provides a service for another bank.

2. Main function:

   to provide financing for affiliates of MNCs.

INTERNATIONAL BANKING TRENDS AND STRATEGIES

3. Advantages of Correspondent Banking
   a. Low cost market entry
   b. Minimal staffing expense
   c. Multiple business sources
   d. Local banking opportunities
   e. Network of local contacts

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INTERNATIONAL BANKING TRENDS AND STRATEGIES

4. Disadvantages of Correspondents
   a. U.S. customers may be given lower priority
   b. Some credit forms prohibited
   c. Irregular, not extensive credit results

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INTERNATIONAL BANKING TRENDS AND STRATEGIES

C. Representative Offices

1. Functions:

   a. to provide advisor services

   b. to speed up services

   c. to help loan generation

   *d. not authorized to directly accept deposits/make loans

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INTERNATIONAL BANKING TRENDS AND STRATEGIES

2. Advantages of Representative Offices
    a. Low-cost market entry
    b. Efficient delivery
    c. Attracts additional business
    d. Maintains existing business

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INTERNATIONAL BANKING TRENDS AND STRATEGIES

3. Disadvantages of Representative Offices
   a. Inability to more effectively penetrate markets
   b. Expensive
   c. Qualified personnel difficult to attract

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INTERNATIONAL BANKING TRENDS AND STRATEGIES

D. Foreign Branches

-true international presence

1. Functions:

   a. Same as rep. office

   *b. Authorized to accept deposits/make loans

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INTERNATIONAL BANKING TRENDS AND STRATEGIES

2. Advantages of Foreign Branches
   a. Greater control over foreign operations
   b. Greater ability to offer direct, integrated customer services
   c. Better customer relations

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3. Disadvantages of Foreign Branch
   a. High-cost
   b. Difficult and expensive to train managers.

E. Edge Act and Agreement Corporations: U.S. bank subsidiaries that may carry on international banking activities

INTERNATIONAL BANKING TRENDS AND STRATEGIES

1. Edge Act Banks
   a. Physically located in U.S.
   b. Authorized to handle only international business
   c. Customers: foreign or U.S.
   d. Authorized to accept foreign currency deposits/make loans.

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INTERNATIONAL BANKING TRENDS AND STRATEGIES

G. International Banking Facilities (IBFs) can conduct international banking due to U.S. government exemption.

IBFs:

a. Bookkeeping entries

b. Major Activities:
accept deposits/make loans

c. Exempt from Fed's Regulation Q

d. Closely linked to eurocurrency markets.

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INTERNATIONAL BANKING TRENDS AND STRATEGIES

III. VALUE CREATION IN INT'L BANKING

A. Capital Adequacy

1. If well-capitalized, competitive advantage in

a. underwriting securities

b. reducing cost of funding

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INTERNATIONAL BANKING TRENDS AND STRATEGIES

B. Human Resources and Banking Organization

1. Competitive advantage:
   have an organization to exploit information to learn and to innovate quickly
2. Prepare/enable employees to recognize/respond to problems

INTERNATIONAL BANKING TRENDS AND STRATEGIES

C. Information Systems
   1. To create competitive advantage
      a. requires large investment in information technology

D. Transaction-Processing Services
   1. Demand for seamless services in
      a. funds movement
      b. foreign exchange
      c. cash management

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INTERNATIONAL BANKING TRENDS AND STRATEGIES

IV. COUNTRY RISK ANALYSIS

-country-risk assessment predicts potential debt-repayment problems

A. Country Risk analysis

1. Involves an examination of

a. Economic factors

b. Political factors

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