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DIPL 4556 Financial Aspects of International Relations

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DIPL 4556: Financial Aspects of International Relations

Governing Firms and Financial Markets

Seton Hall University
School of Diplomacy and International Relations
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Tuesdays and Thursdays 9:30-10:45

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Introduction

The last two decades have witnessed instability in international financial markets on a wide scale. In the early 2000s, when large North American and European firms like Enron, WorldCom, Global Crossing and Parmalat were engulfed in accounting and other financial scandals, thousands of workers lost their jobs, retirees lost their pensions, and many investors large and small lost substantial portions of their accumulated capital. In 2007, large numbers of homeowners faced sudden increases in their monthly mortgage payments as their low mortgage interest rates abruptly 're-set' to much higher rates. Many families, unable to pay the higher premiums, lost their homes and had to move. Many financial institutions, which owned bundles of these 'sub-prime' mortgage obligations, suddenly had to write off billions of dollars from their books as thousands of mortgages went into default. Weakness in large global financial firms like Citigroup, Bear Stearns, Merrill Lynch and AIG triggered a global credit crisis that has pushed the global economy into a significant recession. Governments were forced to choose whether or not to 'bail out' ailing financial firms at public (taxpayer) expense or allow them to fail, risking a crisis of confidence in the global financial system as a whole.

One result of the 2007 crisis was the subsequent inability of several nation-state members of the European Union's euro currency zone to meet their governments' sovereign debt obligations, raising the risk of sovereign default and forcing EU governments to decide whether to 'bail out' their fellow governments or risk a collapse of the euro currency altogether. Following on from the 'dot.com boom' and 'go-go' business culture of the 1990s, the crises of the 2000s are indicative of the social and political challenges facing contemporary global capitalism. They have led publics on both sides of the Atlantic to question how firms do business and how financial markets, upon which businesses rely to raise capital, operate. These are questions not just about corporate governance and business regulation: they address basic problems of ownership, governance and democracy.

This course prepares you to investigate how societies and polities create and structure a market economy at the national and global levels. How do we make and enforce the rules that businesses and financial institutions must follow? What parameters and incentives do we set for market actors? To what extent are we, and they, aware that we are doing so? What is shareholder democracy, and how well does it work? What happens when things go wrong? What are the politics of market regulation?

In order to develop tools for thinking about these questions, we shall learn about the fundamentals of central banking, the international monetary system, financial markets and corporate governance. We shall examine basic processes of investment research, sales and trading, with particular focus on equities (stocks). You will play the roles both of investors and of sellers of financial products. We shall come to understand the underlying idea of 'market society' in which norms of market behaviour are transmitted and absorbed in society.

Organization and Assessment of the Course

The course meets twice a week, on Tuesday and Thursday mornings. You are expected to attend each session, as you need to be in attendance to recéive credit for the course. Absences need to be approved in advance and are only allowed for legitimate and documented reasons of serious illness or significant family emergency. Note that if you miss too many meetings, you may be required to submit additional make-up work to be able to receive credit for the course.

The primary mode of instruction will be an interactive lecture/discussion format, of the week's topic, during which you will have a chance to raise issues and ask questions that arise from the readings, and which will include review of assigned quantitative problem sets when relevant. In addition, on Tuesdays we shall have a 'Buy Side' investor research meeting, during which we shall play the role of investors and discuss our fantasy portfolios. On Thursdays we shall hold our 'Morning Research Meeting', at which we shall play the role of 'sell side' equity analysts (see below).

Please note that you should do the reading for the week's topic *before* the session at which that topic is discussed.

All assessed written work for the course **must** be handed in **on time**. Coming to terms with deadlines and learning to accept what you able to do within the time that you allow yourself is part of the learning of the course. Requests for extensions may be made only in the event of significant illness or serious family emergency and must be made according to established university and departmental procedures.

All forms of dishonesty whether by act of omission, including but not limited to, cheating, plagiarism, and knowingly furnishing false information to the University are prohibited and may elicit University sanctions of suspension or expulsion. See University and school statements for academic conduct here: http://www.shu.edu/offices/community-development/community-standards/community-standards.cfm and http://www.shu.edu/academics/diplomacy/academic-conduct.cfm.

The course will be assessed as follows:

Equity research coverage journal – 15 percent
Fantasy portfolio – 15 percent
Mid-term collection – 15 percent
Final examination (quantitative section) – 20 percent
Final examination (essay section) – 35 percent

Each component of the assessed work of the course is discussed below.

The 'Morning Research Meeting' and Research Journals – The 'Sell' Side

One of the main purposes of the course is to encourage you to find, use and evaluate critically a wide range of media that cover financial markets. In doing so you will learn how information drives the perceptions of investors of the expected future values of securities (stocks, in this case). Each week you should explore the range of media sources that are available on line, on television and in print to find out what journalists and commentators are writing and saying about markets, regulation and corporate governance. You should read/watch/listen from a critical perspective, seeking to detect the presuppositions, positions and political and economic preferences being articulated in each story. How does coverage of the same story in different newspapers differ and why?

For the course we have access to the proprietary equities research website of Oppenheimer & Co., a major Wall Street securities firm. At the beginning of term you will choose an industry sector than an Oppenheimer analyst covers and 'shadow' the analyst's coverage of his/her sector and the 'universe' of stocks in it. Over the course of the term, we shall learn how equity research analysts cover stocks and issue recommendations to investors about when to buy, sell and hold stocks. Your objective will be to understand how information affects a particular sector and the perceived value of companies (and their stocks) within it. At each Thursday class we shall hold a 'morning research meeting' in the manner of equities trading firms. At each 'morning research meeting', you will brief the class on major developments affecting your sector and stocks.

[As you monitor media coverage of your sector, you should keep a research journal. Write a paragraph each week, summarizing the information that you found about your sector and companies, and why you think the information is significant. With each week's entry you should cite the articles or stories that you consulted: title or topic, author if available, media source (including website if appropriate), date. Keep your journal entries together. I shall check them before the mid-term break and at the last session of term to verify that you are recording your research satisfactorily. You must keep a complete research journal over the weeks of the course to complete this portion of the assessment satisfactorily.

Fantasy Portfolios – The 'Buy' Side

Your fantasy portfolio is a way for you to experience what investors have 'at stake' in markets, at least vicariously, and thus to develop an experiential perspective of market culture. The exercise is intended to be simple and accessible to everyone – those of you who are already familiar with these tools will have to restrain yourselves. Each of you is allotted US $ 100,000 to invest in listed stocks (and options, if you wish) (see below). At the end of term, a modest prize will be awarded to the investor amongst you who 'wins' by increasing your capital the most. Trading on 'insider' information naturally is not permitted. Anyone who attempts to cheat will receive no credit for this portion of the course assessment!

You will set up your fantasy portfolios on the Investopedia website and participate in the 'Investopedia game (unlimited)'. You should follow the rules of the Investopedia game. As investors, again use as many media resources as possible for guidance as to what to buy and when to sell it. For each Tuesday 'buy side' meeting you should print and save your Investopedia portfolio spreadsheet showing your portfolio as a pdf file and post it to Blackboard (instructions to follow). The last portfolio sheet with your closing positions is due to be handed in **Thursday, 23rd April**. I shall announce the winner at the session on 30th April.

Mid-term Collection

There will be a collection that will take place in March soon after the mid-term break. The collection consists of some quantitative problems and short answer questions that draw upon the topics of the first part of the course. The collection will also serve as a 'practice' for the final exam. The purpose of the collection is to encourage you to draw the themes of the course together in your minds in the middle of term and to give you feedback on your quantitative skills and writing.

Final Examination

The final examination will consist of two parts. The first part will be an exam containing quantitative problems, which you will sit during the last course meeting. The second part will be a two-hour, two-question 'take home' final examination, which will begin as you leave the last class meeting. You will have 24 hours to complete and submit your exam script, both in hard copy and via Safe Assign. On the exam paper there will be a choice of questions, from which you will choose two to answer. Your answers should be in the form of an argument. You *must* take both parts of the exam at the time that it is administered (again except in documented cases of significant illness or serious family emergency), or you will receive no credit for the exam in your final assessment.

Course Resources

Course Website

There is a website for the course on Blackboard. On the site you will find a copy of the course outline/syllabus/reading list, many of the readings and copies of the slide presentations that accompany the lectures.

Principal Texts and Resources *(available for purchase in bookshop except as noted)*

The texts in this list will all be useful throughout the course. You should consider purchasing them, as they should serve as useful references both during the course and later.

Peter K. Cornelius and Bruce Kogut, eds., *Corporate Governance and Capital Flows in a Global Economy*, Oxford: Oxford University Press, 2003.
J.D.A. Wiseman, *Pricing Money*, Chichester: John Wiley, 1998.
Margaret M. Blair, *Ownership and Control*, Washington: The Brookings Institution, 1995.
John Cassidy, *How Markets Fail*, New York: Farrrar, Straus and Giroux, 2009.
Investopedia, www.investopedia.com - a comprehensive site for looking up explanations and definitions, mini-tutorials, investment calculators, etc.
Oppenheimer & Co. equities research website - http://opcolibrary.bluematrix.com/ext/library.jsp

Secondary texts *(available on reserve in the Library, via interlibrary loan, and/or on Blackboard)*

John Braithwaite and Peter Drahos, eds., *Global Business Regulation*
Brealey, Myers, Allen, *Principles of Corporate Finance*
John C. Bogle, *The Battle for the Soul of Capitalism*, New Haven: Yale University Press, 2005.
Niall Ferguson, *The Cash Nexus*, New York: Basic Books, 2001.
Financial Times, *Mastering Finance*, London: Pitman Publishing, 1998.
Charles Gasparino, *The Sellout*, New York: HarperCollins, 2009.
Charles R. Geisst, *Wall Street; A History,*, Oxford: Oxford University Press, 1997.
Miles Kahler and David Lake, eds., *Governance in a Global Economy.*
Michael Lewis, *Liar's Poker.*
Jay McInerney, *Brightness Falls*, New York/London: Penguin Books, 1992.
Robert B. Reich, *Supercapitalism; The Transformation of Business, Democracy, and Everyday Life*, New York: Alfred A. Knopf, 2007.
Bethany McLean and Peter Elkind, *The smartest guys in the room: the amazing rise and scandalous fall of Enron*, New York: Portfolio, 2003.
Paul A. Samuelson and William D. Nordhaus, *Economics,* 14th edn., New York: McGraw Hill, 1992.

Andrew Ross Sorkin, *Too Big To Fail*, New York: Viking, 2009.
David M. Weiss, *Traders: The Jobs, the Products, the Markets*, New York: New York Institute of Finance, 1990.

Media Websites

The Financial Times www.ft.com (access via the Library search engine to avoid 'paywall')
The Wall Street Journal www.wsj.com (access via the Library search engine to avoid 'paywall')
Bloomberg Radio, Bloomberg TV, www.bloomberg.com
The Economist www.economist.com
Business Week www.businessweek.com
CNBC.com, www.cnbc.com
CNBC TV
Yahoo Finance finance.yahoo.com
Google Finance finance.google.com
The Journal of Commerce www.joc.com (access via the Library search engine to avoid 'paywall')
Barron's Magazine (access via the Library search engine to avoid 'paywall')
Investors Business Daily www.investors.com
The Motley Fool www.fool.com
MSN Money moneycentral.msn.com/INVESTOR/finder/predefstocks.aspx
StockCharts.com stockcharts.com/def/servlet/SC.web?c=swft
Dow Jones Market Watch www.marketwatch.com/news/default.asp?siteid=&avatar=seen
Business Insider www.businessinsider.com
Zero Hedge www.zerohedge.com

Official Websites of Market and Regulatory Institutions

Securities and Exchange Commission www.sec.gov/edgar/searchedgar/companysearch.html
Federal Reserve System ('The Fed') www.fed.gov
Office of the Comptroller of the Currency (OCC) www.occ.gov
Federal Accounting Standards Board (FASB) www.fasb.org
National Association of Securities Dealers (NASD) www.nasd.com
www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&nodeId=5
New York Stock Exchange (NYSE Euronext) www.nyse.com
Bank of England www.bankofengland.co.uk

Film, Video and Television

The following films, videos and television programmes are recommended viewing. Most of the films and documentary DVDs are available in the library or via interlibrary loan.

Wall Street (DVD)
Trading Places (DVD)
The Smartest Guys in the Room (DVD)
The Corporation (DVD)

Squawk Box, CNBC, 6-9 am weekdays.
Squawk on the Street, CNBC, 9-11 am weekdays.
Fast Money, CNBC, 5 pm and repeated at Midnight weekdays.
Mad Money, CNBC, 6 pm weekdays.
Money and Politics, Bloomberg TV, various times, including weekends.

Lecture and Seminar Topics

Topic 1 – Course Overview: What is a Market?

Introduction to the Course: 'Before the Market Open'. What is a market? How are markets governed? Legislation, regulation, public opinion, popular legitimacy.

Topic 2 – Money and Banking, Monetary Governance, and Accounting Basics

What is money? How does banking work? What do central banks do? Why is accounting important? Why is accounting controversial?

Financial Times, *Mastering Finance*, ch. 1 ('Value'), pp. 5-12, 43-48; ch. 3 ('Accounting').
Wiseman, *Pricing Money*, ch. 1 ('Money markets').
Samuelson and Nordhaus, *Economics*, pp. 496-535.
Braithwaite and Drahos, *Global Business Regulation*, chs. 1-3.
Investopedia, tutorials, 'The Federal Reserve'; tutorials, Fundamental Analysis, 'Introduction to Fundamentals Analysis' (particularly intro to financial statements, income statement, balance sheet, cash flow statement)
Ferguson, *The Cash Nexus*, Section Two: Promises to Pay.

Topic 3 – The International Monetary System and Regional Monetary Integration

How do fixed and flexible exchange rate systems differ? What are the economic and political advantages and disadvantages of regional monetary integration? Why was monetary integration seen as an important component of creating a European single market? Was the political process of adopting the Euro sufficiently popularly legitimated? Has the European single currency been a success thus far?

Desmond Dinan, *Ever Closer Union*, ch. 13, 'The Internal Market and Monetary Union'.
Mario Draghi, 'Stability and Prosperity in Monetary Union'.

Topic 4 – Firms, Capital, Debt and Equity

What is a firm? How does a firm raise capital? Stocks and bonds. How is a firm valued? Discounted cash flow (DCF) model.

Wiseman, *Pricing Money*, chs. 2 ('Government bonds') and 7 ('Players').
Brealey, Myers and Allen, *Principles of Corporate Finance*, chs. 1-4.
Investopedia, tutorials, investing, 'Stock Basics' & 'Beginner's Guide to Trading Fixed Income'; tutorials, investing, 'Discounted Cash Flow Analysis'

Topic 5 – The Financial Services Business and Equities Markets

How do financial services firms operate? How does investment banking work? How are stocks sold to and bought by investors? How is equities research done? How do the media and markets affect each other?

David M. Weiss, *Traders: The Jobs, the Products, the Markets*, introduction, chs. 1,2.
Financial Times, *Mastering Finance,* ch. 11 ('Financial Institutions'), ch. 2 ('Corporate Finance').

Wiseman, *Pricing Money*, ch. 8 ('People').
optional – additional information on financial products: Wiseman, *Pricing Money*, chs. 3-6

Recommended Fiction: Michael Lewis, *Liar's Poker* OR Jay McInerney, *Brightness Falls*.

Topic 6 – Corporate Governance Basics; Trading Options

How are firms governed? What are the implications for their shareholders and stakeholders? How do derivative contracts affect financial markets? How are options traded?

Cornelius and Kogut, 'Corporate Governance and Capital Flows in a Global Economy,' in Cornelius and Kogut, *Corporate Governance and Capital Flows in a Global Economy*, ch. 1.
Margaret M. Blair, *Ownership and Control*, ch. 1 (Introduction), ch. 2 ('A Primer on Corporate Governance')
Margaret M. Blair, 'Shareholder Value, Corporate Governance and Corporate Performance', in Cornelius & Kogut, ch. 3.
Wiseman, *Pricing Money*, ch. 5 ('Options')
Investopedia, tutorials, more advanced topics, 'Options Basics'

Topic 7 – Banking and Financial Regulation

Where and why did banking regulation evolve? What are the advantages and disadvantages of different institutional structures? What has been the impact of globalization? How effective has the Basel capital adequacy regime been?

Braithwaite & Drahos, ch. 8 ('Financial Regulation').

Topic 8 – Financial Regulation: Corporations and Securities

How and why did the corporation emerge as an institution? Why did the emergence of securities require regulation by government? How did regulation of securities and corporations evolve in the United States? How has globalization affected regulation of securities and financial firms?

Braithwaite & Drahos, ch. 9 ('Corporations and Securities').
Charles R. Geisst, *Wall Street; A History*, ch. 7 ('Wall Street Meets the New Deal').
Ferguson, *The Cash Nexus*, chs. 9, 10.

Topic 9 – Regulating Corporate Governance

How do the perspectives on corporate governance of institutional investors differ from those of speculators? Should fund managers sit on corporate boards? How do corporate governance models differ between the United States and Europe? Does globalization make convergence inevitable?

Blair, *Ownership and Control*, ch. 5 ('Institutional investors')
Mark Mobius, 'Corporate Governance', in Cornelius & Kogut, ch. 17.
Burger-Calderon, Gusinde & Hoffmann, 'Corporate Governance and Private Equity Investments', in Cornelius & Kogut, ch. 18.
Peter Gourevitch, 'Corporate Governance; Global Markets, National Politics', pp. 305-331 in Miles Kahler and David A. Lake, *Governance in a Global Economy*, Princeton: Princeton Univ. Press, 2003.

Topic 10 – The Case of Enron and the Sarbanes-Oxley Act

Why did the 'Kleptogate' scandals (Enron, Arthur Andersen, WorldCom, Adelphia, HealthSouth, Parmalat, etc.) happen? Was it a case of a few bad apples, or was the system rotten to the core? Who set out to institute market reforms following the scandals? What regulatory and legislative processes were used? To what extent were they successful? Did the Sarbanes-Oxley Act and Reg FD solve the problems they were intended to address?

John Coffee, 'What Caused Enron?' in Cornelius and Kogut, ch. 2
Dyck & Zingales, 'The Bubble and the Media', in Cornelius & Kogut, ch. 4.

Topic 11 – The Sub-prime Mortgage Crisis and the 2008 Financial System Instability

What caused the subprime mortgage crisis? What rôle did collateralized debt obligations (CDOs) and credit default swaps play? Why did the crisis endanger the financial stability of major financial institutions in the United States and United Kingdom? Are some financial institutions 'too big to fail'? Did governments act effectively to mitigate systemic instability?

Centre for Finance and Credit Markets, Current Issue Briefing, 'Subprime Mortgage Lending and the Credit Crunch', undated (2008).
John Cassidy, *How Markets Fail*, New York: Farrrar, Straus and Giroux, 2009, ch. 16 (Minksy) and Part Three.
Lawrence H. White, 'How Did We Get Into This Financial Mess?', Cato Institute Briefing Papers, 16 November 2008.

Topic 12 – Reforming the Financial System

What proposals for regulatory reforms have the crisis and its aftermath generated? Have reforms been perceived as effective thus far? Why or why not?

Elizabeth Warren, *A Fighting Chance*, chs. 3,4.

Topic 13 – Governance and Stakeholders: The Politics of Markets and Society

How might corporate governance be reformed to take greater account of stakeholder interests? To what extent is globalization a problem or a potential solution to the regulatory dilemma?

Cornelius & Kogut, chs. 13, 24
Braithwaite & Drahos, ch. 23.
Blair, *Ownership and Control*, chs. 6-9

Course Timetable

This is a projected timetable for the course. It may have to be adjusted to reflect the pace at which we cover the material and other unforeseen events. As term progresses, topics covered *may diverge* from the days shown on the time table.

Day	Month	Topic or Activity	Activity	Work Due
Tues. 13	January	Intro: 'Before the Market Open' –Topic 1		
Thurs. 15		Topic 2		
Tues. 20		Topic 2	Register for fantasy portfolios, make initial purchases	
Thurs. 22		Topic 3	Choose equity research sectors.	
Tues. 27		Topic 3	First 'buy side' research meeting (fantasy portfolios)	Post your portfolio to Blackboard.
Thurs. 29		Topic 4	First morning 'sell side' research meeting	Post equity research notes to Blackboard.
Tues. 3	February	Topic 4	buy side' research meeting	Portfolio.
Thurs. 5		Topic 4	'sell side' research meeting	Equity research notes. Worksheet #1
Tues. 10		Topic 5	buy side' research meeting	Portfolio. Worksheet #2
Thurs. 12		Topic 5	'sell side' research meeting	Equity research notes. Worksheet #3
Tues. 17		Topic 6	buy side' research meeting	Portfolio.
Thurs. 19		Topic 6	'sell side' research meeting	Equity research notes. Worksheet #4
Tues. 24		Topic 7	buy side' research meeting	Portfolio.
Thurs. 26		Topic 7 Mid-term Collection		
Tues. 3	March	Topic 8	buy side' research meeting	Portfolio.
Thurs. 5		Topic 8	'sell side' research meeting	Equity research notes.
Tues. 10		Spring Break	**No meeting.**	
Thurs. 12		Spring Break	**No meeting.**	
Tues. 17		Topic 9	buy side' research meeting	Portfolio.

Thurs. 19		Topic 9	'sell side' research meeting	Equity research notes.
Tues. 24		Topic 10	buy side' research meeting	Portfolio.
Thurs. 26		Topic 10	'sell side' research meeting	Equity research notes.
Tues. 31		Topic 11	buy side' research meeting	Portfolio.
Thurs. 2	April	Easter Break	**No meeting.**	
Tues. 7		Topic 11	buy side' research meeting	Portfolio.
Thurs. 9		Topic 12	'sell side' research meeting	Equity research notes.
Tues. 14		Topic 12	'buy side' research meeting	Portfolio.
Thurs. 16		Topic 13	'sell side' research meeting	Equity research notes.
Tues. 21		Topic 13	Final 'buy side' research meeting	Post final portfolio.
Thurs. 23				
Tues. 28			Portfolio winner announced	
Thurs. 30		Final examination – quantitative section		