Syllabus
Emerging Markets Finance
Darden Graduate School of Business
Spring First Half 2002

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Course Description

This course explores direct investment and valuation (corporate finance) issues that are unique to emerging economies. These economies, with low per capita income, will likely provide substantial growth opportunities in the world economy. But the risks of investing in these economies are not only substantial but also qualitatively different from those in developed economies. In this course, we introduce a set of tools and models that help future financial managers manage risks and value risky projects in emerging markets. This course covers both theoretical and practical sides of direct investments in emerging markets through cases, articles, homework exercises. While the focus is not on portfolio investments in emerging markets, the models developed in the course will also be useful to portfolio managers in emerging markets.

Specifically, the course consists of the following four modules:

1. Risk identification, assessment and management; project finance and the process of risk management
2. Incorporating country risk in valuation; a modified CAPM framework
3. Downside risk approach to valuation
4. Real options

The course has the following objectives:

1. To develop an understanding of risks in emerging markets, such as world market risks, country macroeconomic and political risks, country-level market risks, institutional and regulatory risks (such as capital control, financial market segmentation, and investment restrictions), and industry and project risks.
2. To develop an understanding of how to identify, assess and mitigate risks in emerging markets; and how to allocate risks and returns to achieve greater efficiency (low-cost financing) and effectiveness (optimal behavior).

3. To expand on the knowledge of CAPM and introduce alternative models on how the cost of capital is estimated in emerging markets. Why do we need new frameworks for estimating the cost of capital? What makes valuation in emerging markets different from that in the US? How do we estimate the cost of capital that incorporates the time value of money and the risk premium commensurate with a particular emerging market investment?

4. To construct and use DCF models for valuing assets in emerging markets. In addition to using alternative approaches to estimating the discount rate for emerging market projects, we will also consider how currency risks and other risks should be handled in a DCF framework.

5. To develop an understanding of the value of using real options in making investment decisions in emerging markets. Given the high volatility in investment returns in emerging markets, real options are valuable and should be exploited to create value.

This course builds on the knowledge and analytical skills that students have acquired from economics and finance courses, and from their work experience. It assumes that students have some background in valuation models or have taken Valuation in Financial Markets. It is targeted for students who wish to pursue careers in investment banking, international finance and consulting.

Reading Materials/Cases

The materials in this course will be delivered through cases and publications in leading practitioners' journals (e.g., Journal of Applied Corporate Finance and Emerging Market Quarterly), supplemented by a guest speaker with extensive experience in investing in an emerging market (China). I will have weekly assignments posted on the internet and handed out in hardcopy. Some of the cases/assignments include excel data, which can be downloaded from the course website.

Grading and Course Requirement

The grading in the course has three components. They consist of class participation (40%), two sets of homework/data exercises (10%), and a final exam (50%). The homework can be done in groups of no more than three (3) people per group. You should form your team after the first week of classes. Homework problems are important to your learning and you should try them on your own before discussing them with your team. You are expected to prepare the cases in advance and participate in class. Unexpected absences from more than two classes will materially affect your grade. Please call or email me to explain absences. For the final exam, questions will be drawn from the case materials included in the course. Your analyses should go beyond the case discussions that have occurred in class.

Internet

The course website is at http://faculty.darden.edu/liw/em/
Course Outline

Session 1, January 17
Topic: Emerging markets and finance
Case: Gerber Products Company: Investing in the New Poland, HBS #793-069

Module 1. Risk identification, assessment and mitigation

Session 2, January 18
Topic: Political risks
Case: Busang (A): The River of Gold, HBS #798-002

Session 3, January 24
Topic: Project vs corporate finance

Session 4, January 25
Topic: Project finance and the process of risk management.
Case: Poland’s A2 Motorway, HBS #202-030.

Module 2. Incorporating country risk in valuation

Session 5, January 30
Topic: Valuation challenge in emerging markets
Case: Hostile Bid for Red October, HBS #296-084.

Session 6, January 31
Topic: Incorporating country risk in valuation
Read:

Session 7, February 6
Topic: Joint venture and cross-border valuation
Case: Continental Cablevision/Fintelco Joint Venture, UVA-F-1149

Session 8, February 7
Topic: Estimating the cost of capital
Case: Paginas Amarelas, UVA-F-1210
Session 9, February 13
Distinguished Speaker, Jack Perkowski, CEO and President, Asian Strategic Investment Corporation (ASIMCO).

Session 10, February 14
Guest Speaker, Jack Perkowski
Case: ASIMCO/Nanyue Joint Venture, New Darden Case.

Module 3. Downside risk approach in valuation
Session 11, February 20
Topic: Emerging financial markets
Case: Chinese Financial Markets, New Darden Case (to be distributed)

Session 12, February 21
Topic: Downside risk framework in valuation
Read:

Session 13, February 22
Topic: M&A and privatization
Case: Structuring Repsol’s Acquisition of YPF S.A., UVA-F-1282

Module 4. Real options

Session 14, February 27
Topic: Capital projects as real options
Capital Projects as Real Options: An Introduction, HBS #295-074.
Brealey and Myers, Principles of Corporate Finance, Chapter 21, Real Options.

Session 15, February 28
Topic: Identifying and valuing real options in emerging markets
Case: Dragon Beer, New Darden Case (to be distributed).