

## **GOVERNANCE & COUNTRY RISK ANALYSIS**

Republic of Solvencia and the International Financial Markets

## **Eurobond Request to Casino Bank**

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## Pedagogical Support Note

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# Pedagogical Support Note for Solvencia Case Study

The **Solvencia Case Study** combines international finance, capital markets and country risk features that enable the professor to tackle a wide range of issues. The case can be used in a Country Risk Course, an International Finance course, and an International business and strategy course, as well as an Investment Banking course. The case discussion could be presented and dealt with at the end of the first semester, when the professor has addressed such issues as balance of payments, international finance strategy, risk management and capital markets.

## 1. Case Summary

The case study deals with an emerging market country's request for financial advisory services with regard to the launching of a €500 million Eurobond issue on international capital markets. The students must work on the case from the standpoint of an investment banker who has to perform a country risk assessment. The end-product of the case is an in-depth risk analysis report with a clear-cut recommendation to the bank's Risk Committee. The case can combine a written report (group work or personal work) as well as an oral presentation of the analysis' salient points.

## 2. Case material

The case study comprises the following seven elements:

- Pedagogical note
- Case study presentation
- Background information for the students regarding country risk components, eurobond syndication, and other international finance issues.
- Excel spreadsheet with macroeconomic and balance of payment data, including a number of "blanks" to be filled in with liquidity and solvency ratios
- Case correction
- Excel spreadsheet correction
- Case presentation with Power point slides

## 3. Student target audience

The target student audience is mainly Master in International Finance, "Majeure Finance de Marché" in business schools, Country risk analysis as well as International Finance courses in business schools, IEP and University.

## 4. Case Objectives

### 3.1. General Objective

Country risk is a broad concept that comprises an underlying combination of economics, finance, geopolitics, sociology, and history issues. As the global market integration increases the risk of crisis contagion and spill-over, the level of uncertainty and complexity gets larger for the international firm's cross-border strategy. Hence country risk analysis has become today an essential component of strategy decisions regarding export, investment, partnership, mergers, as well as takeovers. The main purpose of this case study is thus to help the students to understand the framework of country risk analysis based on an hypothetical emerging country. However, although the country used in this case does not really exist, all the political, economic and financial background given in this case is typical pattern of a developing country's economic and socio-political challenges.

### 3.2. Specific Objectives

- Helping the students to understand the key parameters of country risk, including political, economic and financial issues of a country's development process.
- Analysing the balance of payment and its large role in country risk analysis.
- Understanding the impact of macroeconomic policies on a country's external financing requirements;
- Identifying the key international finance and economic intelligence sources, both official and private;
- Focusing on the most important liquidity and solvency ratios to gauge a country's debt serving capacity and creditworthiness.
- Writing a succinct and well articulated risk strategy note.

#### 5. Responsibility of the professor:

- Present and explain the case to the class
- Briefly describe the bond issuance process and its main risks;
- Identify the key parameters of country risk (economic, financial, socio-political, regional, and systemic);
- Spell out the main steps in a country risk assessment note;
- Organize the class in various groups to help the students focus on the most important issues (economic, financial, socio-political, balance of payments, external indebtedness issues, as well as liquidity and solvency indicators)

#### 6. Responsibility of the students

- Understand the problems in the case study;
- Identify the critical points of analysis and the step-by-step country risk assessment;
- One week after the case study being distributed, each group shall submit to the professor an Excel-based quantitative analysis of the case study;
- Two weeks after the case study being distributed, each group shall present its final analysis in a formal oral group presentation. Each group will get 20 mns to address the Casino Bank's "Risk Committee" and provide a clear-cut recommendation regarding Solvencia's Eurobond request.

#### 7. Problem solving objectives:

The Solvencia-Casino Bank case study leads the students throughout the hypothetical case of an emerging country with large external financing requirements. The students must assess the country's country risk situation from the standpoint of an investment banker, focusing on the economic, financial, and socio-political components of sovereign risk.

The professor will spell out the major differences between the role of a commercial bank and that of a merchant or investment bank. The former will lend money and it will mitigate the risk (1) through a Eurobond syndication including a large number of underwriting banks, and (2) it might securitize the loan to sell it on the secondary market as a liquid and tradeable financial instruments. The securitization process will free capital on the bank's balance sheet and will shift the risk to other economic agents, for instance, institutional investors. The latter does not lend any money but acts rather as an intermediary providing fee-based financial advisory services.

The professor will then tackle country risk from the standpoint of uncertainty, i.e., a deficit of information and economic intelligence; hence the need to identify a wide range of country risk information sources, both official and private.

Then the professor will aim at focusing the students' attention on the four main causes of cross-border investment pitfalls, namely, economic, financial, socio-political, and regional spill-over. He/she will emphasize the usefulness of in-depth balance of payments analysis to cast light on liquidity and solvency indicators. Regarding the socio-political analysis that requires qualitative assessment, he/she will illustrate the usefulness and limits of ratings and rankings (Asian crisis, LTCM, Enron, US subprime crisis...).

## 8. Length and case organization

Typically the case runs over two to three weeks

- Week 1: (1 hour) case presentation by the professor, team work organization
- Week 2: Debriefing: each group submits to the professor an Excel-based quantitative analysis of the case study, presenting the key liquidity and solvency ratios; (each group will get 20 mns for a succinct presentation of its calculations)
  - Week 3: Debriefing: each group holds an oral presentation of its overall country risk analysis of Solvencia, in a Board Meeting format, using PPT slides, leading to a class wide debate (20 mns each). Alternatively, the professor will split the class in two groups; one group will tackle Solvencia's Eurobond request with a view to turn it down, hence emphasizing the negative points of the country's situation, while the other group of students will emphasize the positive points leading to Casino Bank's support of the country's Eurobond request. The debate will lead to a confrontation of the two stances concerning the bank's strategy with regard to the emerging market country.
    - An additional step in the case discussion can be to ask students how to structure a €800 Eurobond issue to facilitate the launching of the bond while mitigating the risk from the bondholders' side. The students might consider various collateralization options, using the gold holdings of the country's central bank, shortening the bond maturity, or including an equity conversion option into the upcoming privatization program of the country.
    - The professor will ask each group to submit a written report to the Bank's Risk Committee. The report should be short, well articulated and with a clear-cut conclusion (three pages).
    - The professor then presents and distributes a correction of the case study while casting light on the salient features of the correction using Power Point slides.

## 9. How can the Solvencia case study fit in with an International Finance course and a Country risk assessment training seminar?

The Solvencia case study is useful in that it brings together a wide number of international finance and economic issues pertaining to country risk analysis and management. The overall objective is to lead the students from an in-depth analysis of the country's macroeconomic and financial situation to an investment strategy which can be a **Yes/No decision**, or even a **Yes/But** decision, i.e., using various risk mitigation instruments.

## 10. To sum up the key steps in the country risk assessment work, the student should:

- Read the case thoroughly while writing down the salient features, both *pros and cons*, of Solvencia's current economic situation
- Once he/she gets the story clear, the student should look at the **Excel spreadsheet** that presents Solvencia's macroeconomic and financial situation over the 2012-2025 period. Pay close attention to the relation between economic data (GDP, inflation, budget and trade deficit, exchange rate....) and financial data (capital account, external borrowing requirements, international reserve assets, external indebtedness, debt servicing payments...)
- Then, the student should fill all the blank cells while calculating a range of ratios and risk indicators as wide as possible: GDP growth rate, GDP per capita, liquidity and solvency ratios, debt servicing ratios, trade openness ratios, current account and budget deficits ratios...
- The student will need to make up his/her mind regarding the upcoming Eurobond issue. What should be the adequate **amount** of the Eurobond floating given Solvencia's large external borrowing requirements? Will the country be able to meet its obligations given the large amortization payments looming on the horizon? The key question is **whether or not he/she will recommend the bank's key Risk Strategy Committee to go ahead or not!**

- Writing a well-articulated and concise 4-5-page note summarizing the main positive and negative points, before concluding with a clear-cut recommendation, while adding an annex with ratios, graphs and tables over the 2012-2025 period.
- Then the student will inform Mr. Solvent, Solvencia’s finance minister, who is waiting in his Monaco hotel’s “senior suite”.

### Succinct bibliography:

#### ENGLISH

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<https://www.palgrave.com/la/book/9783319897516>  
[http://a-online.fr/skema/21-09-2018/life\\_fr.html#article2](http://a-online.fr/skema/21-09-2018/life_fr.html#article2)
2. Bouchet, MH, Clark E., and Gros Lambert B. 2003. *Country Risk Assessment: A Guide to Global Investment Strategy*. John Wiley & Sons: England.
3. Bouchet Michel-Henry: “Country risk in the age of Globalization and Donald Trump”, *World Financial Review*, October 217
4. Bouchet, *Country Risk and Governance : CIFE GEGPA seminars 2024-25*  
<https://developingfinance.org/courses/2024-2025-english>
5. Bouchet, Michel Henry. 2017. *International Finance Lectures Series*. SKEMA Business School.
6. Fabozzi, Frank J. 2000. *Bond Market Analysis and Strategies: 4<sup>th</sup> Edition*. Prentice Hall: New Jersey.
7. Clark Ephraim, *International Finance, 2<sup>nd</sup> edition*, Thomson, 2002.
8. Madura, Jeff. and Fox, Roland, 2013. *International Financial Management: 5<sup>th</sup> Edition*. International Thomson Publishing: Ohio.
9. BIS *International Banking and Financial Market Developments*, BIS Quarterly Review.

#### French, and Spanish:

1. Bouchet et alii : « *Gestion et Finance Internationales*” (Pearson 2004)
2. Bouchet, “*La Globalisation, Introduction à l’Economie du Nouveau Monde*” (Pearson 2005),
3. Bouchet, “*Intelligence Economique et Gestion des risques*” (Pearson 2007, with Alice Guilhon)
4. Bouchet : “*Riesgo-Pais: un enfoque latino-americano*” (ESAN 2007). (with Sarmiento y Lumbreras)

#### Websites:

1. <https://developingfinance.org/>
2. [www.iif.com](http://www.iif.com)
3. [www.ny.frb.org/education](http://www.ny.frb.org/education)
4. [www.clubdeparis.org](http://www.clubdeparis.org)
5. [www.imf.org/external](http://www.imf.org/external)
6. [www.economist.com](http://www.economist.com)
7. [www.eiu.com](http://www.eiu.com)

8. [www.worldbank.org](http://www.worldbank.org)

9. [www.bis.org](http://www.bis.org)

### **Standard Country Risk Assessment Fact Sheet**

#### **1. Introduction: Map and graphs**

(History, political system, ethnical features, culture and religion)

#### **2. Survey of geographical features, raw material, human and natural resources**

UNCTAD: [www.UNCTAD.org](http://www.UNCTAD.org)

UNDP [www.undp.org](http://www.undp.org)

World Bank [www.worldbank.org](http://www.worldbank.org)

CIA <https://www.cia.gov/library/publications/the-world-factbook/>

#### **3. Macro-economic analysis**

Sector analysis, macroeconomic adjustment, trade strengths and weaknesses (partner/product composition),

Inflation, savings/investment ratios

GDP growth, underground economy, public sector expenditures...

IMF/WB/regional development banks: IADB/AfDB:AsDB/EBRD

<http://www.ntu.edu.sg/library/statdata.htm>

#### **4. Balance of payments analysis**

Trade balance, current account, reserves, E&O

[www.imf.org](http://www.imf.org)

[www.iif.com](http://www.iif.com)

#### **5. Debt Flows & Stock Analysis**

Debt servicing burden, liquidity and solvency indicators

World Bank/OECD/BIS/IMF

[www.bis.org](http://www.bis.org)

Secondary market discounts: Bradynet, EMTA/IFR

#### **6. Legal and regulatory framework conducive to private investment**

World Bank Doing Business <http://www.doingbusiness.org/economyrankings/>

Heritage Foundation: index of Economic Freedom <http://www.heritage.org/index/>

#### **7. Ratings**

[www.Euromoney.com](http://www.Euromoney.com)

[www.fitchibca.com](http://www.fitchibca.com)

[www.moodys.com](http://www.moodys.com)

[www.standardandpoors.com/ratings](http://www.standardandpoors.com/ratings)

[http://www.cofacerating.fr/portail/chaineeco\\_international/notationpays.asp?metier=ALL&geo=ALL](http://www.cofacerating.fr/portail/chaineeco_international/notationpays.asp?metier=ALL&geo=ALL)

<http://www.weforum.org/en/initiatives/gcp/Global%20Competitiveness%20Report/index.htm>

[http://www.transparency.org/policy\\_research/surveys\\_indices/cpi](http://www.transparency.org/policy_research/surveys_indices/cpi)

<http://hdr.undp.org/en/statistics/>

### **Main Sources of Country Risk Intelligence –I-**

- Bradynet Info and data on emerging fixed income markets.
  - COFACE, SACE, HERMES, DUCROIRE
  - Davos World Economic Forum
  - Dr. Harvey Campbell 's site (Duke University)
  - Dr. Nouriel Roubini's web site (NYU)
- Economist Intelligence Unit (London) [www.eiu.com](http://www.eiu.com)
  - Euromoney Magazine (Country risk indices).
    - Frost & Sullivan
    - Global Finance Magazine
- Global Risk Assessment, Inc. - Country Risk Services [www.grai.com](http://www.grai.com)
  - Harvard Institute for International Development (Boston)  
IFC Emerging Stock Market Factbook
  - Institute for International Economics (Washington)
- Institute of International Finance Inc. (Washington, D.C.) [www.iif.com](http://www.iif.com)
  - Institutional Investor Magazine
- ICRG Index <https://www.prsgroup.com/explore-our-products/international-country-risk-guide/>
- International Finance Corporation Data (World Bank: source for emerging markets data)
  - International Finance Review (London): secondary market prices & bond issues
    - Morgan Stanley Capital International Data
  - Oxford Analytica Inc. On-line daily analysis and custom country risk services.
- Political and Economic Risk Consultancy, Ltd.- PERC Gateway to news & country data
  - Political Risk Services (country risk indices).
- Rabid Tiger Project Jeff Deutsch's Political Risk Consulting and Related Research
  - Transparency International (corruption & governance)
    - UNCTAD (trade and FDI data)
      - PRS-ICRG
  - UNDP (HDI, life expectancy, and GDP per capita PPP)
    - World Bank Governance indicators

### **Useful WEBSITES –II-**

[www.imf.org](http://www.imf.org)

[www.worldbank.org](http://www.worldbank.org)

[www.cia.us](http://www.cia.us)

[www.ifc.org](http://www.ifc.org)

<http://www.iadb.org/>

(Handbook of Economic Statistics. Washington, DC: Central Intelligence Agency):

<https://www.cia.gov/library/publications/the-world-factbook/>

Web sites of central banks (<http://www.zagury.com/cbanks.htm>)

[www.bis.org](http://www.bis.org)

<http://www.ntu.edu.sg/library/statdata.htm>

[www.globalfinance.org](http://www.globalfinance.org)

[www.ny.frb.org/education](http://www.ny.frb.org/education)

[www.clubdeparis.org](http://www.clubdeparis.org)

[www.economist.com](http://www.economist.com)

### **RATINGS –III-**

[www.Euromoney.com](http://www.Euromoney.com)

[www.fitchibca.com](http://www.fitchibca.com)

[www.moodys.com](http://www.moodys.com)

[www.standardandpoors.com/ratings](http://www.standardandpoors.com/ratings)

[http://www.cofacerating.fr/portail/chaineeco\\_international/notationpays.asp?metier=ALL&geo=ALL](http://www.cofacerating.fr/portail/chaineeco_international/notationpays.asp?metier=ALL&geo=ALL)

<http://www.doingbusiness.org/economyrankings/>

<http://www.heritage.org/index/>

<http://www.weforum.org/en/initiatives/gcp/Global%20Competitiveness%20Report/index.htm>

<http://www.imd.ch/research/publications/wcy/index.cfm>

[http://www.transparency.org/policy\\_research/surveys\\_indices/cpi](http://www.transparency.org/policy_research/surveys_indices/cpi)

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