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BA BUSINESS MANAGEMENT

INTERNATIONAL FINANCIAL MANAGEMENT LCBB6002

Assessment 1 Written Report

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Introduction

International Financial Management theories help in identifying the different factors that can help organisations to be equally effective and efficient in the business marketplace. In this context, this study is going to present a significant discussion on the significance of IFM theories. Hence, this study is going to evaluate different International Financial Management theories such as the Mundell-Fleming model and the International Fisher Effect. Additionally, it will highlight the common foreign exchange risks and their sources that help in undertaking the potential impact of such risks. Furthermore, this study will evaluate different strategies taken into account by international organisations in order to deal with foreign exchange risks. In this context, an effective understanding of the subject matter can be obtained.

International Financial Management (IFM) theories

International Financial Management is the management of finance in the international business environment. There are different theories associated with IFM that help in understanding financial activities in the most effective ways. According to Leightner (2024), “*Mundell Fleming Model*” or the IS-LM-BP model includes elements of Keynesian economics as well as a monetary approach in order to exchange rates. This particular theory helps in assuming degrees of capital mobility and also helps in building positive relationships between the domestic economies of countries. With the help of this site, it can be easier to analyse the way different exchange rates affect the economic policy options of countries. It also examines the impact of such changes on interest and exchange rates. It is seen that a fixed exchange rate can influence the exchange rate however it is ineffective in employment. Additionally, this model also shows the significance of coordinating fiscal and monetary policies in terms of achieving macroeconomic outcomes. However fiscal policy does not have any impact on employment however it can influence the trade balance as well as exchange rate.

“*The international Fisher Effect*” is yet another effective theory that discusses the relationship between the inflation rate, nominal rate and exchange rate in the international market. In this context, this IFF theory shows that capital can flow between different countries without any kind of restriction. As per the viewpoint of Joksimović, Joksimović and Grujić-Vučkovski (2020) IFE model is mainly based on the Fisher equation which means that the nominal rate of interest is equal to the real interest rate in addition to the expected inflation rate. Exchanges of interest between investors also highlight the unbiased expectation hence, it is stated that investors must have rational expectation. Additionally, this theory also suggests that those investors must arbitrage any kind of deviation from any equilibrium conduction that further can lead to the adjustment of the exchange rate. This theory depicts that the normative rates must be equal between different countries.

Foreign exchange risks and their sources

Types of risks

Foreign exchange risks are considered a critical aspect in business, governments and investors in international investment as well as transactions. **Transaction risks** are one of the most significant risks associated with foreign exchange, this risk can take place due to fluctuations in exchange rates. According to Hobbs (2020), transaction risk influences businesses related to export and import services. Apart from that, organisations associated with this field can go through losses while setting payments or placing orders. Organisations importing goods and services in foreign markets can face such issues that lead to cancellation of business deals which can further result in a negative business reputation. Apart from that, **economic risk** is yet another risk related to an exchange rate that hampers business activities as well as potential business outcomes from the competitive marketplace. Due to this, the price of products can be increased in different countries which may hamper the potentiality of the company in that country.

This risk can hamper organisations with competitive pricing strategies. Moreover, changes in exchange rates can result in poor competitiveness as well as the changing values of currency making the products more expensive which may not satisfy the customers as well. Kretschmer et al. (2020) stated that **strategic risk** due to exchange rate also hinder the business growth of organisations. It becomes difficult for the organisation to make currency-related decisions as well. Apart from that expansion plan of an organisation can also be stressed. **Translation risks** or accounting risks take place due to the impact of fluctuation of exchange rate on foreign currency. Apart from that, multinational organisations with foreign subsidiaries can be exposed to such risk at the time of dealing with financial statements to the reporting currency.

Sources of risks

The main sources of exchange risks include **economic growth, interest rate, inflation rate, market sentiment and geopolitical events**. As per the comment of Bussière, Gaulier and Steingress (2020), significant fluctuation in exchange rates leads to business losses as well. Apart from that, **investing in foreign assets** such as bonds, stocks, as well as real estate, also can result in exchange rates that further influx returns along with the values of investment. In present times **internationalisation or globalisation** is the most significant desire of each organisation that allows every company to invest such assets as they help in the economic stability of an organisation. However, changes in the identified factors can hamper the overall economic condition of the organisations. It is also observed that significant increases in globalization can lead to interconnectedness of economics.

Market risks lead to interest risks as well as equality risks that further affect industrial growth and development. These risks are associated with financial reliability and stability that lead to significant financial losses as well. Contingency planning is also important for identifying such risks. Moreover, such risk also may force the

organisation to change its trading partners as well (Obrenovic et al., 2020). Operational risks further come from human errors and system failure such sources also must be taken into account in the time of dealing with the identified Ignace risks. Therefore such organisations must identify the potential sources that can lead to the exchange risks that can further help it with their business growth.

Strategies that multinational corporations adopt in managing their exposure to foreign exchange risks

Multinational corporations face foreign exchange risks due to various reasons in the time of operating their business in the global marketplace. In this context, MNCs implement different strategies that can help them deal with the risks in the most effective ways. They match revenues as well as expenses in different currencies in order to avoid potential exchange risk. Tiwari (2019) identified that organisations with revenues in dollars and expenses in euros may hedge against such fluctuations mainly by aligning the inflows and outflows of currency. Apart from that the multinational organisation is always ready for flexibility as well as protection that may lead to favourable exchange rate movements. Moreover, with the help of purchasing currency options, organisations can avoid the potential risks associated with exchange rates. They use forward contracts to deal with exchange change risks, hence, at the time of entering into this kind of contract they easily secure exchange rates that further help them to mitigate the negative impact of the advance movement of currency.

MNCs also engage in activities mainly by offsetting different currency obligations that help organisations to minimize exposure to exchange risks apart from that it also helps in reducing transaction costs as well. Hence, it is believed that organisations can easily demonstrate such activities to manage foreign risks (Gebauer et al., 2020). Adapter from that they involve acceleration payments that lead to declining payments. Hence, appreciating currency as well as the sudden changes in exchange rates can help organisations to identify the potential risks as well. Multinational organisations also engage in currency swap activities that increase the value of their economic standards. Moreover, promoting local sourcing also can help MNCs to avoid risks associated with exchange rates. It is important to source locally as well as produce in the international market in order to gain more outcomes. Centralizing treasury management is vital for consolidating currency exposure and allows companies to streamline such risks.

Conclusion

International Financial management refers to the effective management of financial activities in the business context. There are a number of theories that help in demonstrating this management activity. Among them, the Mundell-Fleming model mainly demonstrates the relationship between exchange rates and economic policy. On the other hand, the International Fisher Effect mainly focuses on evaluating the relationship between the inflation rate, exchange rate and interest rate. These two theories provide effective insights in order to manage financial activities in the global marketplace. Foreign risk further poses challenges for international business, governors as well as investors. With the help of such activities, organisations can easily deal with the risks. Therefore organisations must navigate the significant impact of the suits and plan strategies accordingly. Multinational corporations implement a number of effective strategies to deal with exchange rate risks and their impact. Utilization of financial instruments, and identifying effective investment activities can help these organisations to be more effective while dealing with the business activities in the foreign market.

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