

MULTINATIONAL CORPORATIONS MANAGING EXPOSURE TO FOREIGN EXCHANGE RISKS.

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Introduction

The risk associated with currency rates results from movements in the currency's value. There is also a potential financial risk for multinational corporations (MNCs) that operate internationally. (Refer to Guest, 2021). Without managing those fluctuations, you might find yourself in the same position as a roller-coaster ride, which can be unexpected and unpleasant, eroding your profits and endangering your competitive position (Chris, 2024). MNCs face three primary types of foreign exchange risks: currency exchange risk, translation risk, and economic risk. Transaction risk may result from incomplete trade transactions, which might cause a sharp increase in import prices and a deterioration in profit margins. Translation risk is present due to the changing financial statements by converting the subsidiaries' assets and liabilities from the reporting currency (Michael, 2006). Economic risk is the peril of currency rates, which affects the rivalry and future profit returns.

To reduce these risks, MNCs make use of different strategies. Forward and future currency contracts offer exchange rate fixation for future transactions, which removes uncertainties and counteracts the negative influence of exchange rate fluctuations (Chris, 2024). Flexibility is one of the features of options contracts that make it possible to receive benefits from rate movements in favour of or limit the costs from rate movements on the contrary. Natural hedging is about matching the foreign currency cash flow to reduce the exchange rate exposure (Guest, 2021). In contrast, operational hedging utilises operational strategies such as sourcing or manufacturing locations to limit the exchange rate risk. This report explores the three major types of foreign exchange risk: translation, economic, and exposures. The topic of this report's foreign exchange risks section is how exposures affect Apple, a world-known technology company, and the challenges it causes. The report goes deep into Apple's financial reports. It ties them to the industry background to disclose how Apple can employ currency volatility to preserve long-term economic stability.

In **Figure 1**, the line graph reveals how the currency exchange rate between the US dollar (USD) and the Euro changed (EUR) in one year. The y-axis depicts the exchange rate, whereas the x-axis shows the month. The upward slope on the line means a stronger dollar than the euro, and the downward slope indicates a weakening dollar (Bloomberg, 2023). The graph shows that the exchange rate was not stable but fluctuated all year long. Such volatility might result in the appearance of financial risk for multinational corporations (MNCs) that operate internationally.

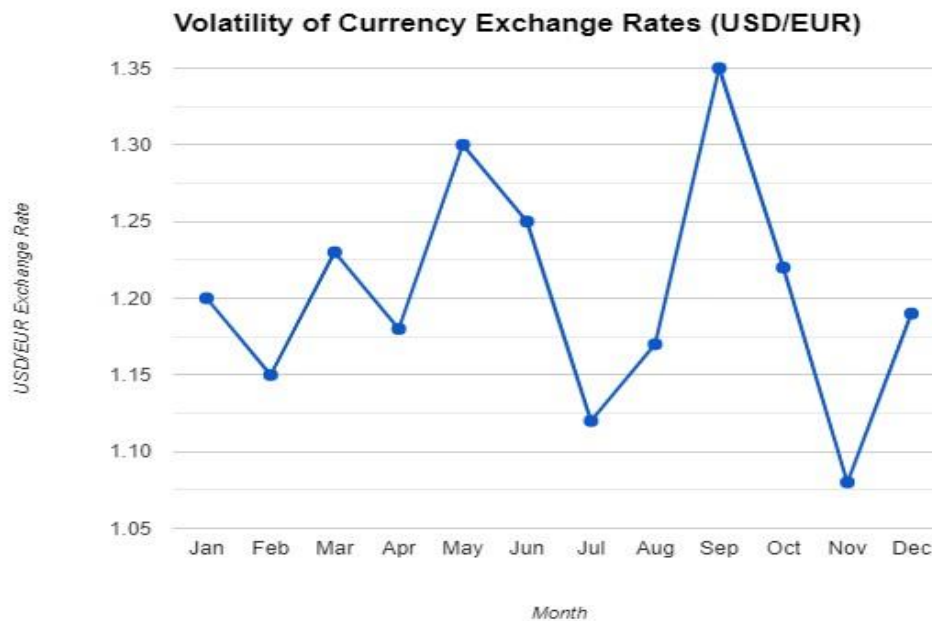


Figure 1: Volatility of currency exchange rates.

Exchange Rate Risk for MNCs

Fluctuations in foreign exchange rates pose significant challenges for multinational corporations (MNCs), which may be classified into three main categories of financial exposure. The currency risk stems from incomplete trade transactions, which hurt import prices and profit margins (Bloomberg, 2023). Translation exposure involves changes in MNCs' income statements due to translating foreign subsidiaries' assets and liabilities into the reporting currency (Wahlen et al., 2018). Economic exposure, which can be seen as a primary strategic risk, is associated with fluctuations in the exchange rate, affecting competitiveness and future returns (Guest, 2021). For example, a currency with high strength at home might discourage foreign consumers from buying exports, leading to fewer sales. On the one hand, a weak home currency may be viewed as a source of competitive advantage but may, in turn, create pressure on the profit margins of the foreign subsidiaries (Shapiro et al., 2024). Such knowledge allows MNCs to formulate strategies and operational adjustments to move successfully through the turbulent currency waters.

Figure 2 plots out eight currency pairs along with their exchange rates at that moment in time. It displays the exchange rate of main currencies such as the USD, EUR, GBP and JPY. The table further indicates the movement in the exchange rate since the previous date (Investing.com n.d.).

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MNCs may collect such information to know the effect of exchange rate fluctuations on their operations outside their country. An illustration of this is a USD (as demonstrated by a positive percentage change for the currency pair USD/JPY) that increases the cost of goods imported from Japan by a US-based MNC.

Currency market at a glance

Pair ↕	Last	Open	High	Low	Chg. ↕	Chg. % ↕	Time ↕
↕ EUR/USD	1.0789	1.0786	1.0799	1.0783	-0.0002	-0.02%	05:18:39
↕ GBP/USD	1.2622	1.2629	1.2643	1.2616	0.0000	0.00%	05:18:39
↕ USD/JPY	151.38	151.31	151.43	151.22	+0.03	+0.02%	05:18:37
↕ USD/CHF	0.9010	0.9017	0.9024	0.9005	-0.0009	-0.10%	05:18:33
↕ AUD/USD	0.6526	0.6510	0.6539	0.6514	+0.0005	+0.08%	05:18:31
↕ EUR/GBP	0.8550	0.8576	0.8550	0.8538	+0.0009	+0.11%	05:15:42
↕ USD/CAD	1.3529	1.3543	1.3551	1.3515	-0.0008	-0.06%	05:18:32
↕ NZD/USD	0.5982	0.5981	0.5993	0.5974	+0.0005	+0.08%	05:18:39
↕ EUR/JPY	163.31	164.09	163.43	163.13	+0.18	+0.11%	05:18:39
↕ GBP/JPY	191.05	191.34	191.36	190.94	-0.01	-0.01%	05:18:18

Figure 2: Currency rate chart

MNC and Foreign Exchange Risk

As a large multinational American corporation, Apple faces all three categories of foreign exchange risk. They are the market leaders for iPhones, MacBooks, and other excellent technology items. Nevertheless, most of their devices, including those in China, are manufactured in Asia. This exposure to transactions compels them to be dependent on offshore production. Changes in the exchange rate fluctuations between the US dollar and the Chinese Yuan (CNY) can increase import costs.

Furthermore, Apple's global operations, foreign sales, and branches worldwide may trigger a translation risk (Apple Inc., 2024). When the financial statements of these subsidiaries are converted to USD, currency movements can influence the results. This could distort their actual economic performance.

The most significant issue is economic exposure, a crucial factor for Apple's future competitiveness (Wahlen et al., 2018). A strong USD may increase the cost of their products in international markets, lowering sales volume since they would be more expensive than domestic or foreign competitors (Guest, 2021). On the other hand, a weaker USD may improve their export competitiveness but could cause a tighter profit margin if production costs in China are higher. These exchange rate risks are significant for Apple since they impact its financial stability and dominance in the global market in the long run.

In **Figure 3**, the pie chart illustrates that Apple's sales are regionally limited, as most of the business comes from the Americas (50.43%) and Europe (29.12%). These occurrences increase the company's vulnerability to foreign exchange risk (Apple Inc., 2024). For instance, if the USD is strong, it can hamper sales in both regions because Apple products will be more expensive than local competitors.

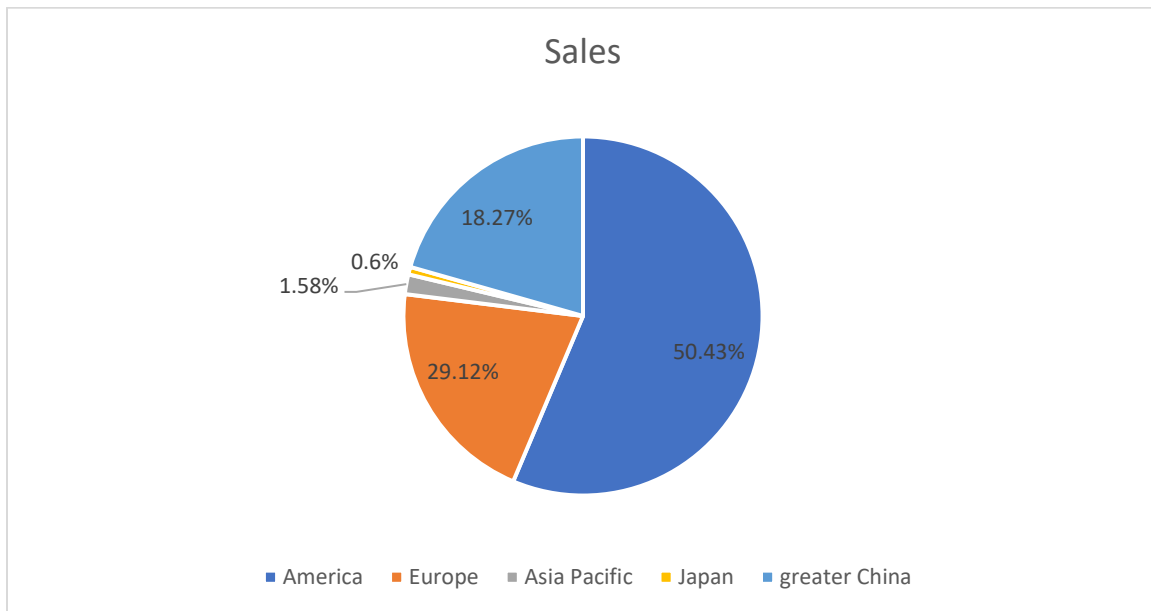


Figure 3: Apple's Geographic Sales

Foreign Exchange Risk in Apple

Apple Inc.'s 2023 Annual Report sheds light on the current company's economic risk exposure, which contains three main categories: trade, translation, and economics. The reality that the USD, EUR, and CNY are among the "significant exposure" currencies accepted indicates that the multinational corporation undertakes foreign currency transactions (Apple Inc., 2024). Sales in Europe, the most significant geographic market at 29% of net sales, reflect how valuable the Euro (EUR) is to Apple's revenue flow. Besides, the changing currency environment in China makes the foreign currency issue for Apple's global business even more complicated because manufacturing costs are denominated in Chinese Yuan (CNY).

The foreign currency translation impact and revenue-profitability are the factors that the Management Discussion and Analysis (MD&A) section emphasises, especially the portion that stresses that a stronger US dollar reduces non-USD-denominated revenue and profitability (Wahlen et al., 2018). Furthermore, the IAS 21 Notes to the Financial Statements have been used to illustrate the translation method in detail and, thus, make clear the potential risks that currency movements can bring.

Moreover, Apple depends significantly on foreign customers, like the Americas, which provide more than 60% of its net sales. Exposed to changes in product demand as may occur in foreign markets (Bloomberg, 2023). This dependence highlights the hazards associated with shifting economic conditions and volatility in exchange rates, particularly given that the global

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supply chain is mostly dependent on China's industrial sector (Guest, 2021). Due to the complexity of the worldwide currency market, Apple is exposed to a variety of foreign exchange risks. Effective risk management systems are needed to maintain financial stability (Darvas, 2022). The measures to be taken for this purpose are identifying and controlling Apple's significant exposure in terms of its profitability and the continuity of its growth in the international market.

Figure 4 illustrates that Apple deals with foreign exchange risk since it works in several currencies. The Euro (EUR), US Dollar (USD), and Chinese Yuan (CNY) are mentioned as the currencies to which Apple has sizable exposure (Apple Inc., 2024). The dollar's strength led to a decrease in foreign currency revenues and Apple's profitability.

Operating Expenses

Operating expenses for 2023, 2022 and 2021 were as follows (dollars in millions):

	<u>2023</u>	<u>Change</u>	<u>2022</u>	<u>Change</u>	<u>2021</u>
Research and development	\$ 29,915	14 %	\$ 26,251	20 %	\$ 21,914
Percentage of total net sales	8%		7%		6%
Selling, general and administrative	\$ 24,932	(1)%	\$ 25,094	14 %	\$ 21,973
Percentage of total net sales	7%		6%		6%
Total operating expenses	\$ 54,847	7 %	\$ 51,345	17 %	\$ 43,887
Percentage of total net sales	14%		13%		12%

Figure 4: Foreign exchange risk exposure

Strategies for Managing Exchange Rate Risk

Multinationals (MNCs) like Apple use different methods to manage exchange risk effectively. Currency forwards and futures contracts fix the exchange rate for future commercial transactions, thus giving certainty and reducing the risk of exchange rate fluctuations (Apple Inc., 2024). These tools generally work well for managing transaction risks and stabilising costs for imports or exports (Ghosh, 2020). However, they come with costs like premiums and maintenance margins that complicate management. Options contracts provide flexibility whereby companies benefit from favourable exchange rate movements and limit the risk of losing money (Apple Inc., 2024). Although the expenses related to options are lower than those of forwards and futures agreements, they are complex to manage and require an in-depth understanding of the market dynamics (Shapiro et al., 2024). One of the most effective natural hedging methods includes matching foreign currency cash flows. This is an easy way for businesses to reduce the cost of risk management (Wahlen et al., 2018). For example, a company like Apple, which lines up revenue and expense streams in the same currency, reduces its risk of exposure to currency fluctuations (Michael, 2006). Operational hedging strategically uses materials sourcing or manufacturing sites to reduce currency volatility (Darvas, 2022). Although this strategy implies initial expense and organisational difficulties, it delivers lasting benefits and promotes self-sufficiency without financial tools.

In the context of Apple's strategy effectiveness assessment, elements such as cost, intricacy, and industry particulars should be considered. For example, currency forwards and futures contracts suit consistent, more significant transactions but may need to be more affordable for smaller transactions. (Shapiro et al., 2024) Options, in turn, give flexibility while strengthening the managerial expertise (Apple Inc., 2024). As a multi-country enterprise, natural hedging has an added advantage alongside operational hedging, supporting financial instruments by giving strategic options beyond financial risk management (Ghosh, 2020). A total approach that entails using economic tools and operational adjustments is needed for Apple to successfully deal with exchange rate risk (Wahlen et al., 2018). By integrating these methods and considering the particular requirements of its sector, Apple may steer clear of currency fluctuations and maintain a steady income in the worldwide market.

Conclusion

Risk management of exchange rates is crucial for MNCs like Apple trying to secure the financial stability of their global operations. Currency fluctuations can lead to considerable changes in income, costs, and profits, which, in turn, require a well-thought-out risk prevention strategy. Although Apple's product diversification and global presence offer resilience, it still burns for being dependent on foreign markets and manufacturing in countries with unstable currencies. Hence, a comprehensive FX risk management strategy perfectly fits Apple's currency exposure situation is essential. Using natural and operational hedging instruments, Apple can wade through exchange rate fluctuations efficiently, improving profitability and competitiveness in the global market.

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