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Introduction

Developing prudent corporate and investment choices in a global business setting is a key part of international financial management. Financial management for businesses has been expanded to include those with international operations. Vulnerability to fluctuations in currency rates is a source of foreign exchange risk, or the possibility of a loss of capital as a result of unfavourable outcomes. The risk of currency fluctuations occurs when individuals and MNCs ship or bring in items and services or make international investments around the globe. If not managed properly, risk associated with exchange rates may harm firms' economic viability, financial results, and valuation. Large businesses take multiple actions to reduce their vulnerability to these risks. Using a lot of study and real-world examples, this report looks at the various tactics that MNCs typically utilize to handle the risks that come with foreign exchange.

Literature on IFM theories

The field of international financial management (IFM) has been developed upon a number of fundamental theories that provide information about the challenges of doing business on an international basis (Moşteanu, 2019). The concept of purchasing power parity examines the difference in cost between the same goods sold in various nations. The theory aims to clarify the impact of these pricing differentials on the reliability of the two nations' respective currencies along with exchange rates over the long run (Karagöz and Saraç, 2016). The purchasing power parity idea assumes that similar products sold under a specific currency will cost the same in numerous nations or markets. Many real-world studies have been done to determine the theory's accuracy, but most of them have found negative findings about how well the theory works in the actual world (Hoberg and Moon, 2017). Several of these analyses skipped over to look at how changes in foreign exchange rates affect the cost of goods produced throughout an economy over the long term. These analyses also used information gathered from advanced industrialized nations instead of impoverished countries, which led to varying results on the theory's practical applicability. By applying data on the KRW and USD exchange rates, Levich, (2011) performed a correlation and co-integration assessment to investigate the PPP hypothesis empirically.

Based on the assumptions made by the interest rate parity principle, the increase or discounting in forward rates among two countries' currencies ought to reflect the percentage variation in the interest rate difference between the two countries (Perera, Silva and Silva, 2018). If the parity association holds, then the return on two assets which are otherwise equivalent in terms of maturity, likelihood of default, vulnerability to capital restrictions and accessibility will be the same regardless of the currencies in which they are denominated. Variations from parity can be caused by a number of reasons, some of which were empirically studied in the second half of the 20th century (Anita, 2022). For an additional 50 years, studies of more frequent data, securities with maturities that were longer, and different currency pairs gave additional significance to the IRP connection. Changes from IRP can be considerable and unpredictable in the financial sector because of the mobility restrictions that exist there. Some nations are typical examples of this as they limit the freedom to convert their currency.

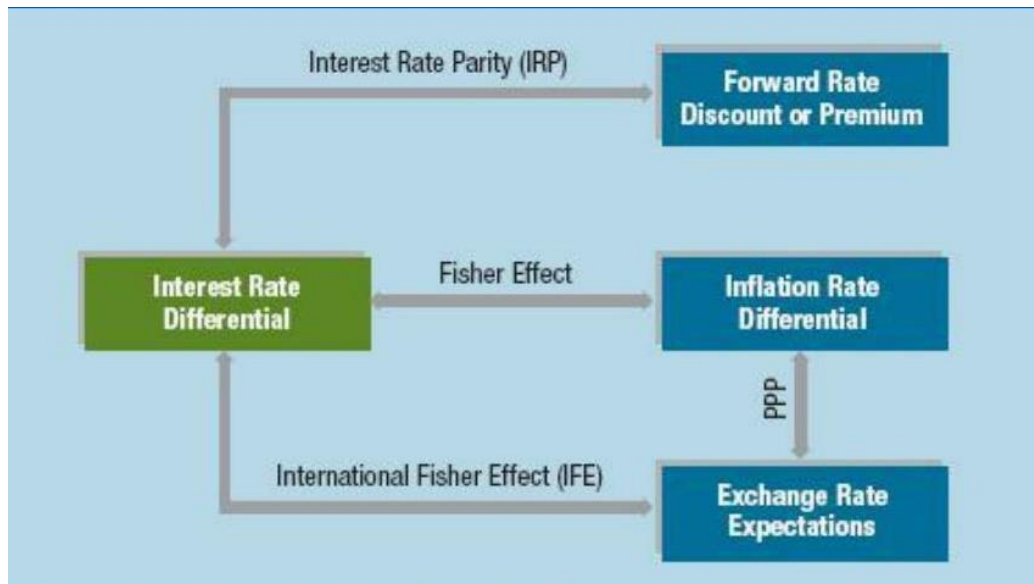


Figure 1: IFM Theories (Anita, 2022)

It is possible to think of the International Fisher Effect (IFE) as a hybrid of the PPP (Purchasing Power Parity) and the Fisher's Effect (FE). Based on the Fisher theory, the level of an economy's actual rate of interest is unaffected by the characteristics that apply to its monetary system (Wang, Wu and Yang, 2015). If nominal interest rates were levelled among countries, the nation with the smaller nominal rate of interest would additionally face a smaller rate of price inflation, and its exchange rate would strengthen in real terms over time (Karagöz and Saraç, 2016). Using an extensive collection of data, this research backed up the reliability of the Fisher impact. Quy et al. (2023) conducted a co-integration analysis to demonstrate the Fisher effect in Turkey's financial system. It was found that the effect of Fisher is accurate in the course of time but inaccurate in short-term situations. David Ricardo initially introduced the concept of comparative advantages around 1817 (Levich, 2011). An organization's or nation's comparative advantage lies in its capacity to generate a product or service at less cost than its competitors. Also, the extent to which countries are able to trade with one another in free-trade regions is affected by their comparative advantages, as discovered by Barney, (2012). There is more hope about the potential for new trade relationships to be developed during the context of the free trade period the more different the trends of comparative advantage are among member nations.

Foreign exchange risks and analysis

Foreign exchange risks are capable of having a significant impact on a company's bottom line, so it's essential to be conscious of them while doing business in the modern global marketplace. The risk of financial loss incurred by an organization as a result of foreign exchange movements in trade between nations (Moşteanu, 2019). It refers to the chance that the worth of an investment will go downward because of fluctuations in the relative values of the foreign currencies engaged (Perera, Silva and Silva, 2018). It is also called currency risk, foreign exchange risk, as well as exchange rate risk. It has implications for capitalists and any company involved with cross-border commerce (Aslam et al. 2020). As a result of doing business in multiple nations, MNCs are frequently impacted by currency fluctuations (Das and Palit, 2019). Large multinational companies use a variety of strategies to deal with this issue:

- **Forward Contracts:** Companies with a global presence can utilize forward contracts for purchasing or transferring a particular currency at a specified future date and exchange rate (Madura, Hoque and Krishnamurti, 2018). Currency-related risks can be minimized with this strategy.
- **Futures Contracts:** Futures contracts are standardized contracts that are exchanged on a marketplace, just as much as forward contracts. They represent a contractual agreement to exchange one currency for another at an undetermined date and price.
- **Money Market Hedging:** The purpose of this is to secure a favourable currency exchange rate during an upcoming transaction by a combination of financing and lending between two currencies (Hoberg and Moon, 2017).
- **Strategies of Operation:** Some examples are switching the currency of invoices, utilizing lead and lag methods, and netting out exposure. Multinational corporations (MNCs) can benefit from these approaches for managing their vulnerability to foreign exchange issues in everyday activities (Barney, 2012).
- **Netting:** Multinational corporations with several subsidiaries are able to decrease their overall exposure by offsetting receivables as well as payables denominated within the comparable currency.
- **Natural Hedging:** Multinational corporations could decrease the risk they face by balancing their currency imports and exports (Engel, 2016). For instance, a multinational

corporation can align its financial obligations services and income by borrowing in the same foreign currency as its foreign holdings.

- **Strategic Hedging:** Multinational corporations can lower their reliance on fluctuations in the value of just one currency by spreading their activities and sustaining across a variety of nations and currencies (Anita, 2022).

There are benefits and drawbacks to each approach, and the final choice regarding which to take on ultimately relies upon the individual MNC, while taking into account factors such as size, activities, and tolerance for risks (Das and Palit, 2019). It's also helpful to remember that these approaches can be mixed and matched to form a flexible and adaptable plan for foreign exchange risk management.

Evaluating the points

These approaches may be beneficial but their success is dependent on a number of conditions, and they all come with costs and benefits that must be weighed carefully. Risk tolerance, company focus, size of business, and geographic distribution are among the significant factors when deciding on an approach for a multinational corporation. Furthermore, due to the ever-changing structure of the forex market, it is essential that risk management measures be continuously evaluated and modified (Madura, Hoque and Krishnamurti, 2018). It is also essential to assess the benefits of each tactic against their costs and drawbacks. The success of hedging instruments is dependent on precise forecasting, which can result in the incurring of expenses (Quy et al. 2023). Sometimes, natural hedging just isn't feasible because of practical considerations. Factors like labour expenses and accessibility to markets must be carefully considered when deciding on a tactical approach for localization (Aslam et al. 2020). Debt segmentation and other financial practices can place a company at risk from things like rate of interest variations. Organizations with a wide range of activities can find it difficult to adopt internal netting. Therefore, there is empirical evidence to back up the efficiency of these methods.

Conclusion

The development of global trading and exchange rates for currencies emphasizes the need for effective international finance management. Through entering new markets, all stakeholders benefit from increased economic development and financial stability. In addition, multinational corporations (MNCs) must effectively manage foreign exchange risks if they are to stay financially stable and competitive in worldwide marketplaces. Multinational corporations can reduce their vulnerability to foreign exchange concerns by implementing a mix of natural hedging, hedges, operational, and financing techniques.

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