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INTRODUCTION

In this time of globalization and economic market, the multinational corporations, called also MNCs, are facing lot of financial risk, caused by the foreign exchange the most threat. International Financial Management, called also IFM, provides with theories and tools to control these risks. Foreign exchange risk can be increased from fluctuations in the currency exchange rates, which can impact the financial performance of the companies (Harmse, 2024).

This essay critically analysing the strategies and theoretical methods that MNCs usually have for control the exposure to the risk. Examine the company's financial interests and strategy such as Natural Hedging, Balance sheet adjustment and Working Capital management, Efficient Market Hypothesis to evaluate the positivity and negativity. This essay highlights the concrete demonstration of understanding of foreign exchange risk in an International financial context.

FOREIGN EXCHANGE RISKS

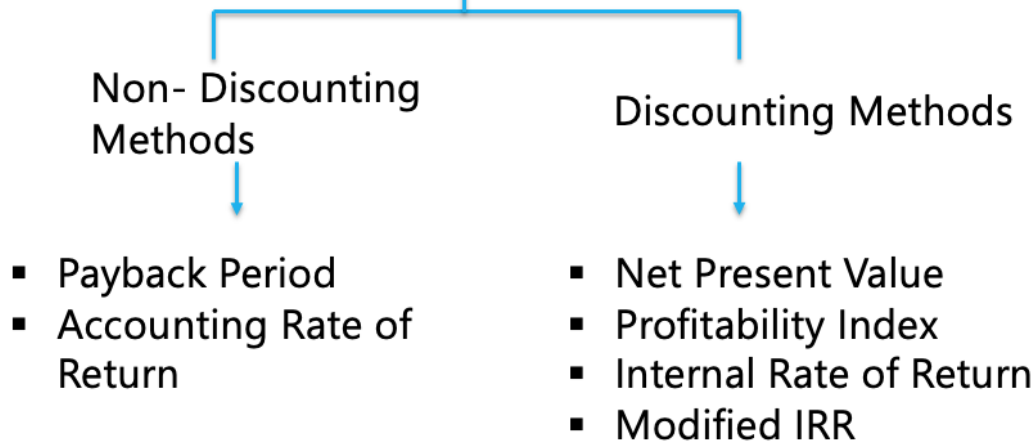
One of the causes of the foreign exchange risk is the company's financial performance can be affected by the continuous changing in exchange rates (Rauen,2023). These risks can be divided into Transactions risk, Translation risk and Economic risk.

- Transaction risk is when the consequences of the exchange rate trend on the value of future cash flow, mainly the time delay between transactions and settlement is the origin of the transaction risk (CFI Team, 2022).
- Translation risk, also called translation exposure, is when a home-based company start operating in foreign countries, and this risk can be higher if a company holds the economic aspect in a foreign country (CFI Team,2022).
- Economic risk, also called forecast risk, is a long-term risk, the exposure of the exchange rate fluctuations can impact the company's value market, and this can be increased by the geopolitical instability or government regulations (CFI Team, 2022).

MNCs Project Appraisal Methods

Investment Decision

Evaluation Techniques



The multinational corporations utilise Project appraisal methods to assess the permanence of the international investments. Techniques such as **Net Present Value**, also called NPV, and **Internal rate of return**, also called IRR, are both used to use to adjust the expected exchange rate movements, ensuring that the financial decisions are made after a deeply evaluations of the potential foreign exchange impacts (Madura & Fox,2011).

NPV is a discounting cash flow method, calculating the currency value of the cash flow of a possible investment using the cost of capital as discounting

rate, and take consideration the currency rate when analysis financial aspects.

DISCOUNTING VALUE OF MONEY

The concept of this strategy is fundamental element in finance, showing that the money available today is value more than the same amount of money in the future, it is called Time Value of Money.

$$\text{Present Value} = \frac{FV}{(1 + r)^n}$$

where:

FV = Future Value

r = Rate of return

n = Number of periods

(Fernando,2024)

Net Present Value (NPV) is a discount solution, calculating the Net Present Value of an investment. It is the result of the present values of all the future cash flows included in the investment cost (Fernando,2024).For MNCs this discounting is very important when operating in different countries and currencies, depending on the locations of the investment.

For example, of a MNC is considering operating in a foreign country where the currency is low and unstable, the total cash flow might be worst less in the foreign currency exchange. By discounting future cash flow, the companies

can make right decision in investment and facing to the exchange currency risks (Fernando,2024)

THEORIES IN INTERNATIONAL FINANCIAL MANAGEMENT

One of the best ways to analyse the Financial Management in the Multinational Corporations start with an understanding of correlate theories. The Financial management has important duties and responsibility of making essential decision regarding capital budget, investment and evolving in the market, all with the threat of the difficulties of International Market (LSBF,2023). In according to Jensen and Meckling's, researcher theories, the potential conflict of interest can be discovered between managers and shareholders, highlight the importance of ownership and the financial management.

In the content of international market with foreign exchange risk management, the financial department must balance the limit against the currency fluctuations with an extend financial MNCs strategy.

- The **Stakeholder Theory**, emphasize the importance of all stakeholders in laws of governance. MNCs must consider the impact of the exchange rate fluctuations and be aware of the translation risk, if they are operating in different countries (Keup,2022)
- Another important theory is the **Efficient Market Hypothesis**, also called the EMH, which suggests the asset prices reflect and combine with the available information. This theory applies to the MNCs, suggested that exchange rate trend is unpredictable, brace the need of strong and effective safeguard strategy (Downey,2023)

EMH is essential for the importance of using proactive measures to reduce foreign exchange risks, as depend on market timing or forecast might not be accurate and give consistent results. The integration of these theories based

the essential of understanding how MNCs face the risks in management foreign exchange (Downey, 2023).

The use of forward contracts, options, and swaps are very used to protect the brand value against the unexpected currency fluctuations (Segal,2021).

- **Forward Contracts** are one of the most commons strategies, these contracts allow MNCs to manage to ensure the exchange rate for a future transaction, eliminating the transaction risk. For example, if a company waiting for a payment from a different currency, this contract can fix the sell in the determinate currency in the fixed rate
This will help the company knows exactly how much they will receive, despite the future exchange rate and fluctuations (Segal,2021)
- **Options Contracts** offer different approaches to exchange currencies at a specific rate before a set date. This flexibility allows MNCs to control the negative currency movements and choose to move in a favourable trend (Segal,2021)
- **Currency Swaps** involve the principal exchanging and interest payments in a different currency in a specific period of time, making them useful and productive for a long-term financing strategy (Segal,2021).

OPERATIONAL STRATEGIES

Natural Hedging refers to the use of structuring a company's operation to reduce foreign exchange risk without affect financially, involving matching revenue and expenses in the same currency (Ainsworth,2019).

For example, an American MNCs with subsidiary in Europe, might find the raw material locally, in order to align cost in euro currency, reducing the impact of currency fluctuations on the profitability.

This strategy includes also a very important management tool, called **Working Capital**. Is an essential aspect of the MNCs financial strategy, when dealing with foreign currency. This strategy shows the difference between a company's current cash flow and its current liabilities, such a short-term debt. An effective management in working capital make sure that the company can still use its assets while having a short-term debt. Exchange rate can impact negatively the working capital management, if the MNCs work across different countries with different currencies, and impact on decreasing the current assets and liabilities.

HOW TO CALCULATE WORKING CAPITAL

In according with British Business Bank website there is a simple formula for calculate the working capital, either the result can be positive or negative :

- Working capital= current assets-current liabilities

Another formula for calculate the working capital ratio; it will show how many times the company can pay off the current liabilities by using its current assets. If the final ratio result is less than one, with very probability the company are facing financial problems. (British Business Bank,ndr)

- Working capital ratio = current assets / current liabilities

Some MNCs using **Multi-Currency Cash Pooling**, a tool that improves the managing cash balances between different countries (Eckhoff and van Bijsterveldt, 2022).

MNCs must decide accurately how much cash to have in each currency and wait till the right time to convert it, and this strategy helps when cash balances from different branches are centralized and managed collectively, making easy the cash management and control the risks (Eckhoff and van Bijsterveldt, 2022).

CONCLUSION

In this report has been highlights that management of foreign exchange risk is a crucial aspect of International Financial Management for MNCs. By integrating a theory of financial management, ownership and control stakeholders' theory and efficient market hypothesis with functional strategies such as project appraisal, capital working and calculate with specific formulas. Real company example to mention is Toyota strategic plan during 2008 financial crisis is a perfect example of successful foreign risk exchange management, employing forward contracts and options, Toyota across the difficult of Yen fluctuations, keeping stable pricing and profit margin in the Global Market. Contacts provides a secure exchange rates during a certain market fluctuation, but if the market conditions change the secure rate might become unfavourable, leading to potential opportunities cost, suitable for MNCs with low risk tolerance. The opposite to forward contract, options offer more flexibility to benefit from good rate fluctuations while protecting. This makes MNCs facing high market changes. The high cost of this flexibility, play in the market with the company who are anticipate currency fluctuations and have available cash flow. Theoretical evaluations of

the Efficient Market Hypothesis suggest that all information is reflected in current exchange rates. This theory supports the use of forward contracts and options as risk tools.

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