

BA BUSINESS MANAGEMENT

Module: INTERNATIONAL FINANCIAL MANAGEMENT

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Word count: 1509

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Introduction

Financial management has huge relevance within all businesses. However, when it comes to transnational or multinational businesses, the importance of financial management is greater. This is because these businesses or companies need to focus on international financial management. Technological advancements taking place worldwide and increase in globalisation are the two major factors that are contributing towards international financial management. Diageo Plc, commonly known as Diageo, is a multinational organisation producing a variety of premium drinks that is present all over the world in 180 countries with 132 production sites (Diageo, 2023a). The organisation has a portfolio of 200 brands with a workforce of 27000 employees (Diageo, 2023b). This study is going to discuss largely on international financial management as well as the significance of international financial management within this company. Discussions will also be conducted on the challenges that this company faces regarding international financial management in addition to evaluating its dividend policy, efficient market hypothesis and investment decisions.

Discussion

The achievement of effectiveness in operations and overall success, international financial management is of huge significance within multinational organisations. **International financial management** is defined in simple words as the process of making efficient financial decisions in companies while managing their financial performance for the attainment of an enhanced financial position (Madura, 2020). The company Diageo focuses largely on the attainment of efficient international financial management. However, according to Aziz *et al.* (2021), a range of reasons is existent for this importance of international financial management within companies. For example, it is important in Diageo for the management of the company's financial performance and position while ensuring the effective allocation of its funds. It also has a significant role in making investment decisions, managing financial risks and maximising the wealth of shareholders. All these aspects are in turn advantageous for managing stakeholder expectations.

However, in international financial management, a primary challenge is managing **foreign currency risks**. According to Du and Schreger (2022), any sort of risk arising within a company because of the consistent fluctuations occurring in currency value is known as a foreign currency risk. These risks can make even the profitable transactions of a company loss making. In Diageo, these risks are managed by adopting the **working capital management theory**. The working capital management theory revolves around managing and optimising the cash flows of a company. In Diageo, the management is of the belief that they have adequate levels of funding available so that its working capital needs can be addressed (Diageo, 2023c). Based on this theory, the company and its management are observed to match all the trading transactions of the company by a central system. All the inter-firm payment terms of the company are developed strategically while the forward contracts are developed for managing the borrowing needs or the excess cash needs of its subsidiaries. These aspects of international financial management in Diageo help it in managing its foreign currency risks and all other financial risks.

The **agency problem** is also another key problem or challenge encountered in multinational companies. As stated by Zhang (2022), an agency problem is a problem, which arises within companies due to the clashes or contrasts between the interests of their managers and shareholders. The shareholders of Diageo are scattered throughout the world and all of them belong to different sorts of cultures and backgrounds, which leads to differences in manager

and shareholder interests. This often leads to an increase of the agency costs of the company. However, to deal with this challenge posed to the company's international financial management, Diageo adopts the **agency theory**. As stated by Vitolla *et al.* (2020), the agency theory is one of the theories of international financial management that explains and solves the problems that occur between the principals and agents of a company. Depending on this theory, the directors of Diageo have a range of fiduciary responsibilities and duties. However, a certain control of ownership of the company is given to its shareholders. Such a balance in responsibilities and duties and control of ownership balances the goals and interests of the company's shareholders and managers, thereby solving its agency problems largely.

In addition to the challenges determined and evaluated above, another major challenge that is faced in Diageo is maximising shareholder wealth. Shareholders are a major stakeholder of a company and keeping them satisfied is of great importance. Dividend payout is the main way in which shareholder wealth can be maximised. However, to ensure that optimal dividends are provided to shareholders, the adoption of an efficient **dividend distribution policy** is necessary. In Diageo, dividends provided on each share during 2021 were 72.55 pence (Diageo, 2023c). However, dividends provided on each share during 2022 were 76.18 pence. This shows an increase of 5% in the dividends of the company. In this company, there has been an increase of 220% in the absolute dividends paid on each share. Moreover, it has been able to return about £7.9 billion to its shareholders via share buybacks.

Depending on the dividend payouts of Diageo, it can be mentioned that the company adopts the progressive dividend distribution policy. The **progressive dividend policy** refers to a policy that is adopted within businesses in which dividends are expected to increase based upon the increases occurring in their earnings per share (Ukpong and Ukpe, 2023). This type of a dividend policy helps Diageo in the growth and maintenance of dividends in each accounting year. It is also beneficial for making reinvestments in the company and accounting for the earnings expectations. All these aspects in turn help the company to manage and improve the returns provided to shareholder and ensuring shareholder wealth maximisation.

In the context of international financial management, **efficient market hypothesis (EMH)** is one of the most common theories. According to Kumar *et al.* (2020), the EMH theory states that the financial instruments of a company turn out being an indicator of all the information available about the market. This theory mentions a range of strategies that include active

management and passive management. However, at Diageo, based on the EMH theory, the active management strategy is adopted. The reasons behind the adoption of this strategy are that it helps in exploiting the opportunities available in niche marketing as well as market inefficiencies. It also helps in enhancing allocation of resources and ensuring higher returns. Hence, international financial management in the company improves considerably.

However, according to Shapiro and Hanouna (2019), the efficiency of *managing investments* in a company largely affects its international financial management. It is because the capital investments that are made by a company are generally cost intensive while the returns that are generated from investments are usually affected by diverse foreign currency risks. However, to ensure better and stronger international financial management, measuring the viability of investments is essential. The measurement of the viability of investment is done by the adoption of a range of investment appraisal approaches. In Diageo, there is an adoption of a range of investment appraisal approaches for the measurement of investment viability. The two main approaches adopted are the payback period, net present value and scenario planning. The *payback period* is an approach that helps in the evaluation of the timeframe that is required by projects and investments for recovering their initial costs (Yankovy *et al.*, 2020).

Conversely, the *net present value* is an approach that helps in the evaluation of the probable profits that can be generated from investments by considering cash flows at present value (Hering *et al.*, 2021). The adoption of the payback period in Diageo helps the managers of the company in the evaluation of the liquidity of its investments. On the other hand, the net present value helps the company in terms of understanding the profitability of its investments by the deduction of cash outflows from cash inflows at present value. As a result, investment decisions of the company are improved. However, *scenario planning* is yet another important approach for investment appraisal adopted in the context of Diageo. Scenario planning is an approach that helps in the measurement of the sensitivity of the returns that can be generated from investments and the changes occurring in the initial investment assumptions (Lukyanova *et al.*, 2020). This approach helps Diageo in conducting an examination of the opportunities associated with the potential investments of the company while analysing their risks and uncertainties, thereby improving its investment decisions.

Conclusion

Therefore, the discussions in the study help in concluding that within all multinational companies, the significance of international financial management is substantial. The discussions made related to Diageo helped to understand the actual reasons for which the significance of international financial management is substantial in multinational companies. A range of theories related to international financial management, for example, agency theory, working capital management theory and others could be derived. Besides this, it could be determined that the company has a strong and effective dividend distribution policy. The efficient market hypothesis of the company could be derived while it could be identified to apply a range of project appraisal methods for making decisions on investment.

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