

INTERNATIONAL FINANCIAL MANAGEMENT

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Executive Summary

IMF indicates the practice of maintaining financial resources, financial management practices, and dealing with financial risks globally. Key risk factors associated with IFM include economic risk, competitive risk, translation risk, transactional risk, Contingent risk, and political risk. IMF helps to create a solid plan of financial capital utilisation in the international market. Using Interest Rate Parity theory and Purchasing Power Parity theory such risk factors can be eliminated by MNCs.

Table of Contents

1. Introduction.....	4
2. Critical discussion of methods and techniques related to the financing of international business	4
3. Overview of foreign exchange or forex risks	5
4. Strategies and IFM theories to mitigate foreign exchange risks.....	6
5. Conclusion	8
References.....	9

1. Introduction

International Financial Management (IFM) indicates maintaining financial resources and financial management practices and dealing with financial risks globally. IMF also known as 'international finance' helps to manage overall financial cavities in the international business environment. Therefore, multinational corporations are the organisations that operate in their home country along with other countries throughout the entire globe. Hence, by using IFM strategies a multinational corporation or MNC maintains a supply of adequate funds and makes it safe and secure (Mishra, 2020). IMF helps to create a solid plan of financial capital utilisation in the international market. The present study is going to critically evaluate key techniques and methods connected with international financial management by MNCs or business organisations. After that, it is going to illustrate a clear overview of risk factors related to foreign exchange. Therefore, some strategies and theories of IFM to eliminate foreign exchange risks are going to be critically analysed here.

2. Critical discussion of methods and techniques related to the financing of international business

International business financing for MNCs involves various methods and techniques such as optimisation of capital structure which includes *equity financing and debt financing*. Equity financing helps to get rid of the fixed interest payment burden and the risk factors are shared among the stakeholders (Burlac and Jimenez-Garcès, 2022). In contrast, existing control and ownership can be diluted in Equity financing and may include complex regulations. Therefore, debt financing helps to maintain a favourable borrowing condition for the MNCs and experience lower interest rates. Author Babenko *et al.* (2020), argued that debt financing can cause financial distress and increase forex risk. Another technique of financial management in international business is “*foreign exchange risk management*”. Through using the natural hedges method risk management can be done and forex fluctuations can be reduced by aligning cost and revenue in a single currency. In contrast, it has limited opportunities and lower chances of being feasible. Besides that, using derivatives can be effective in dealing with forex risk in foreign exchange. As argued by Bachiller *et al.* (2020), contracting through derivatives during foreign exchange may become complex and expensive.

After that, *working capital management* is another method where using centralised cost management practices reduces the cost of borrowings and increases liquidity (Mbaye *et al.* 2023). However, it can generate slower responses and operational inefficiencies due to regulatory restrictions. On the other hand, the *cash pooling* method lowers idle cash balances and improves liquidity management. In contrast, higher administrative and legal efforts need to be there for cash pooling. Moreover, *Tax planning* is another method of international business financing (Ftouhi and Ghardallou, 2020). Tax planning helps to adopt strategic planning to optimise tax liabilities which improves the overall profitability of the MNCs. However, organisations can experience reputational damage if they make aggressive tax planning. Therefore, *local financing* is another crucial method to align MNCs with local shareholders and financial institutions that reduce the chances of political risk. However, it can result in higher interest rates and limited capital availability. Finally, *ethical and sustainable financing* is another method to connect with responsible investors, ensure green financing, and improve MNCs' reputations (Ye and Dela, 2023). However, green financing may cost additional operational changes. Moreover, international financial management of MNCs involves various techniques and methods that help to gain a competitive advantage and manage sustainable business practices.

3. Overview of foreign exchange or forex risks

Various types of risks are noted in foreign exchange due to currency exchange rate fluctuation and more. One of the key risk factors is ***economic risk*** or forecast risk which impacts on market value of organisations due to unavoidable exposure to the international market's exchange rate fluctuations. At the same time, economic risk can be experienced due to geopolitical instability, changes in government regulations, and so on. After that, ***Translation risk*** is one of the key risk factors noted as a forex risk (Treasurers, 2024). Such Forex risk occurs when MNCs incorporate foreign assets within their organisational balance sheets and deal with foreign currencies. Moreover, to ensure foreign subsidiaries using native currencies generates translation risk to deal with parent companies' present currency. Another potential risk is ***transaction risk*** which creates risk factors during financial transactions of MNCs in the international market due to the fluctuation of foreign exchange rates (Adams *et al.* 2023).

It can be stated that ***Contingent risk*** is also noted in foreign exchange during direct foreign investment management, bidding for international projects, and foreign negotiations. As illustrated

by Akinci and Queralto (2023), Contingent risk is noted during foreign exchange when an uncertain transaction of events occurs and it impacts the rate of currency exchange. Despite that, **political and regulatory risks** are crucial during foreign exchange by MNCs. Such risk factors occur due to political instability, changes in government actions, tariffs, cost control, and so on which impact international foreign exchange value. At the same time, **Competitive risk** is also noted in international forex which arises due to exchange rate fluctuation based on organisations' position in the international market. Therefore, uncertainties in international exchange generate such risk factors (International Trade Administration, 2023). Besides that, competitive risk impacts foreign exchange which directly impacts the import and export of an MNC.

4. Strategies and IFM theories to mitigate foreign exchange risks

Strategies like **Financial hedging management with derivatives** can be effective in making future contact to exchange currencies of MNCs at a fixed rate through which uncertainties can be eliminated. It will help to bring flexibility, manage liquidity, and reduce exchange risk factors. However, complexity and risk management may be noted using such a strategy. As stated by Eltrudis and Monfardini (2020), adopting a **centralised treasury management strategy** will be effective in eliminating forex risk. It provides better control of cost management, reduces overall transactional costs, and improves the performance efficiency of MNCs. In contrast, such a strategy may create complexities and remain less responsive to the native market situation. Besides that, maintaining **strategic tax planning** will also help to eliminate forex risk factors by eliminating tax liabilities (Estiasih and Saraswati, 2021). However, it can create complexity and proper regulatory scrutiny needs to be ensured. Despite that, some IFM theories can be adopted to deal with the risk factors such as:

The Theory of Interest Rate Parity (IRP): The theory indicates that differences in forex interest between two countries are equal to the differences between the spot exchange rate and forward exchange rate. The implementation of the theory indicates the elimination of arbitrage opportunities during the forward contracts. As illustrated by Altuntas (2021), IRP maintains a relationship between the forward exchange rate and the spot exchange rate between two currencies by focusing on their interest rates. Hence, MNCs can impact such theory to eliminate their forex risk factors by maintaining a clear relationship between the foreign exchange rate and interest rate (Odionye *et al.* 2023). In contrast, due to market imperfections, it may not hold proper capital

mobility. Moreover, such a theory is effective in forex risk mitigation by ensuring a positive interest rate parity and generating riskless profit.

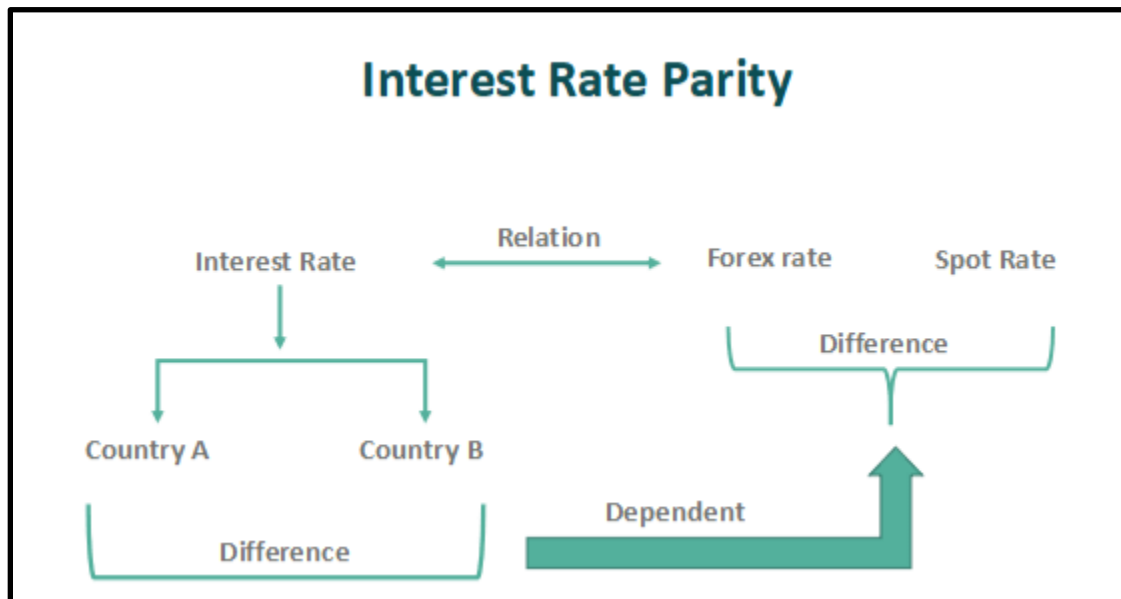


Figure 1: Interest Rate Parity (IRP)

(Source: Altuntas, 2021)

Purchasing Power Parity or PPP Theory:

The theory indicates that when the purchasing power of currencies is the same in two countries then their exchange rates become in equilibrium. The theory emphasises exchange rate determination and indicates that price levels between the countries need to be equal during the exchange process (She *et al.* 2022). Hence, through the implementation of such theory, MNCs can eliminate forex risk factors by forecasting exchange rates in the long term which will help to make strategic market entry, financial sourcing, and proper price management. In contrast, real-time exchange rate prediction may become difficult using such a theory. At the same time, MNCs will be able to eliminate forex risk using such theory as it helps to ensure equilibrium rates as per differences of inflation. As per the opinion of Plošinjak and Festić (2021), the PPP theory is effective in forex risk mitigation as it encompasses structural changes in the forex during its transition period by bringing a positive movement in the exchange rate.

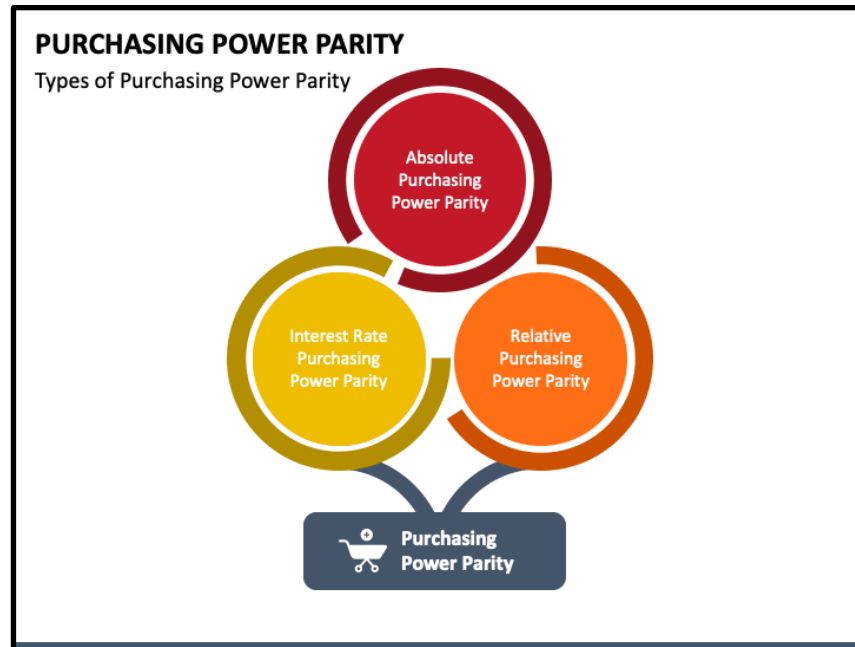


Figure 2: Types of PPP

(Source: Plošinjak and Festić, 2021)

5. Conclusion

It can be summarised through the analysis of the entire research that International Financial Management or IFM involves the key factors in managing financial resources by MNCs in the international market. After that, the study indicates there are various key techniques and methods used to manage foreign exchange or forex. Some of those strategies include foreign exchange risk management strategy, tax management strategy, and capital structure management through debt financing and equity financing. Some other forex strategies also include working capital management, cash pooling, ethical sourcing, legal or regulation management, and so on. There are various risk factors associated with IFM by MNCs such as economic risk, transactional risk, translation risk, competitive risk, Contingent risk, and political risk. Therefore, through the implementation of Purchasing Power Parity theory and Interest Rate Parity theory such detected risk factors can be eliminated by MNCs. Moreover, centralised treasury management and Financial hedging management also can be effective in eliminating risk factors.

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