



International Financial Management

Assessment 1

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Introduction

Financing is a monumental part of every organisation because if the organisation fails to manage its financial departments, it will face a liquidity crisis. So, organisations try to figure out different sources of financing from their own countries and other countries too. When the door of financing from the own country closes, organisations try to collect funds from international platforms which is known as international financing (Bandy, 2018). International financing has become very popular and attractive because of the revolution of globalisation which is why organisations can easily manage international financing as per requirements. However, international financing is associated with different risks that bring threats to organisations. So, the purpose of the report is to bring in different strategies adopted by multinational corporations to reduce foreign exchange risk. At first, the report applies different factors considered in different models of international financial management to understand how international financing is managed. Then, the report applies different methods of international financing for multinational corporations. Furthermore, the report introduces foreign exchange risks and types of foreign exchange risks. The report ends with providing different strategies for multinational corporations to manage foreign exchange risks.

Main Body

Factors considered by different models in managing international financing

International financing is very risky as it is connected with different factors related to the international economy. If the international economy is in crisis, organisations face jeopardy in operating business activities smoothly (Bekaert & Hodrick, 2018). So, while collecting funds from international sources, organisations need to consider some factors that are stated below:

Exchange rate: The exchange rate is the measure of currency value to figure out how much money will be taken by exchanging a currency with another currency. Exchange is very important while collecting funds (Bragg, 2011). If the exchange rate is very poor, organisations will have to ask for a higher amount of money than they need. So, the exchange rate needs to be passable for international financing.

Optimum currency areas: According to DIMA (2022), optimum currency areas are another important factor for international financing because if the currency is not optimum in the financial institutions, there is no way it can provide money as a loan to multinational organisations. So, organisations need to select those areas where enough currency is stored to provide to organisations.

Financial globalisation: Financial globalisation has ensured opportunities for international financing as organisations can connect with international banks and financial institutions to seek help if national banks and financial institutions face a financial crisis (Jones et al., 2022). So, financial globalisation is important for international financing. If financial globalisation is not maintained by banks or other institutions, they won't provide financial aid to multinational organisations.

Interest rate: While collecting funds from national sources, organisations have to pay interest and international financing is not out of it. Lee (2012) stated that since international financing is risky for both parties, they want to be benefited from the transaction. However, a heavy interest rate increases the costs which reduces the value of money. So, a moderate interest rate can be given by organisations for international financing in order to ensure the best utilisation of funds.

Methods of International Financing for Multinational Corporations.

A multinational company can collect funds from different international sources to raise its funds in order to meet the liquidity requirements every day. Among all the international funding sources, the organisation chooses the most convenient and attractive source which brings a small benefit to the organisation (Moshirian, 2002). Among all the methods of international financing, some are discussed below:

International banks and financial institutions: There are a lot of international banks and financial institutions that accept financing requests from multinational organisations. They provide money to organisations and charge a fixed amount of interest. So, organisations can easily collect funds from international banks by agreeing to give the interest and principal within a fixed time.

Trade credit: Trade credit is another method of financing where organisations can collect goods and products from suppliers in the agreement of paying the money in future but within a fixed time (Szafarczyk, 2020). As a result, organisations can take goods on loan and can sell the goods to meet the financing requirements of the company.

Forfaiting and factoring: Forfaiting and factoring is a method of collecting funds by selling the accounts receivables to a third party at a reasonable price. As a result, organisations don't have to wait for the time given to receivables to pay the money rather they can collect funds whenever they want by selling the payment of receivables to another party (Verner, 2012).

Foreign Exchange Risks and Types of Foreign Exchange Risks.

Foreign exchange risk refers to the reduction of the value of the currency that brings a negative impact on the company's performance because due to foreign exchange risk, the value of currency reduces and the organisations don't get enough money as required. Bandy (2018) stated that the main reason for foreign exchange risks is the fluctuation of money. When the exchange rate is reduced, foreign exchange risk occurs because at the time of a lower exchange rate organisations have to exchange currency by providing a higher amount of money in exchange for a lower amount. Mainly there are three kinds of foreign exchange risks called transactional, translation and economic. According to a transactional point of view, foreign exchange risks occur when organisations sell products in the present day for payment in future (Bekaert &

Hodrick, 2018). If the value of money is reduced than the selling day of products, organisations face foreign exchange risks in transactions. Translation foreign exchange risks is a risk when a parent company presents financial data in one currency and a subsidiary translates the data into another currency. If the value of currency reduces due to translation, foreign exchange risks occur (Bragg, 2011). Furthermore, economic exchange rate risks are associated with international economic factors that have a negative impact on the exchange rate and reduce the value of a currency.

Strategies for Multinational Corporations to Manage Foreign Exchange Risks.

International financing brings a lot of risks in which exchange rate risk being the most important one. Because the exchange rate risk reduces the value of the currency which is why organisations get lower cash flow and capital from international financing (DIMA, 2022). So, organisations need to manage foreign exchange risks to ensure smooth cash flow of the organisations. The following part of the report will elaborate on different strategies adopted by multinational organisations to manage exchange rate risks:

Transaction in own currency: Transaction in own currency is the basic and easy strategy taken by multinational organisations to manage foreign exchange risks. When an organisation transact in its own currency, there is no need to exchange money as the payment of the transaction is made with its own currency (Jones et al., 2022). So, a transaction in its own currency reduces the first type of foreign exchange risk called transactional risks. Since transactions in own currency don't have any relation with the exchange rate at the time of payment, it helps multinational organisations to avoid foreign exchange risks.

Transaction with the foreign country with protections: Transaction with a foreign country can be protected through insurance and guarantees of governmental agencies. According to Lee (2012), when multinational organisations take insurance or guarantees from governmental agencies, they will get the full money even if the exchange rate is reduced. Insurance is made for any kind of protection. If multinational organisations create insurance of getting a premium for reducing the exchange rate, they will get the premium at the time of payment for the reduction of the exchange rate. As a result, they won't have to face the risks of taking lower money due to lower exchange rates.

Currency swap: A currency swap refers to the exchange of interest and principal between two currencies at the same rate. When the currency rate or value is the same, there is no chance of losses due to the change in the exchange rate (Moshirian, 2002). By entering into a currency swap, organisations can take control of the exchange rate as there is no chance of facing a lower exchange rate in a currency swap. So, by entering into the currency swap, multinational organisations can reduce the chance of facing losses due to lower exchange rates.

Conclusion

International financing is an important option for collecting funds for multinational corporations. International financing has more risks than national financing which needs to be managed by multinational corporations to ensure smooth application of funds in different sectors. The purpose of the report was to bring in different strategies adopted by multinational corporations to reduce foreign exchange risk. At first, the report applied different models of international financial management to understand how international financing is managed. Then, the report applied different methods of international financing for multinational corporations. Furthermore, the report introduced foreign exchange risks and types of foreign exchange risks. The report ended by providing different strategies for multinational corporations to manage foreign exchange risks.

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