



INTERNATIONAL FINANCIAL MANAGEMENT

An Analysis on Shell

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Assessment 1

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International financial management is crucial for multinational corporations such as Shell, a company that operates in more than 70 countries, that faces various financial risks due to currency fluctuations, regulatory environments, and market conditions (Madura, 2017).

Effective international financial management provides a range of benefits, including mitigating financial risks associated with foreign exchange rate fluctuations, enabling the company to raise capital from global financial markets, managing its tax liabilities across different jurisdictions, and helping to manage its working capital efficiently (Eiteman et al., 2016).

By using various hedging techniques, such as forward contracts, options, and swaps, Shell can reduce its exposure to currency risk and protect its financial performance (Madura, 2017). The company has access to a wide range of funding sources, such as equity and debt markets, which provide it with the flexibility to finance its operations and investments in various currencies and markets (Eiteman et al., 2016). Effective tax planning strategies allow Shell to minimize its tax liabilities and optimize its profits (Madura, 2017). By adopting best practices in working capital management, Shell can improve its cash flow, reduce its operating costs, and enhance its profitability (Eiteman et al., 2016).

Shell faces various challenges in different financial markets. These challenges include volatility in oil prices, regulatory changes, competition from renewable energy, economic instability, and exchange rate fluctuations (Eiteman et al., 2016). Oil prices are highly volatile and can fluctuate significantly due to various factors such as geopolitical tensions, supply-demand imbalances, and natural disasters (Madura, 2017). These fluctuations can impact Shell's revenue and profits, making it challenging to predict future earnings and plan for investments.

Furthermore, governments worldwide are implementing stricter regulations to reduce carbon emissions and promote the use of clean energy. These regulations can impact Shell's operations and profitability, making it challenging to adapt to new compliance requirements and invest in alternative energy sources (Eiteman et al., 2016). The shift towards cleaner energy sources also poses intense competition from renewable energy companies, which can impact Shell's market share, revenues, and profitability (Madura, 2017).

Economic instability, such as recessions, can also impact Shell's operations in different financial markets. During tough economic times, consumers have a tendency to reduce their spending, which can reduce demand for energy products, impacting Shell's revenues and profitability (Eiteman et al., 2016). Additionally, as Shell operates in multiple countries, it is exposed to exchange rate fluctuations, which can impact its earnings, making it challenging to plan for investments and manage cash flows (Madura, 2017).

Shell faces various challenges in different financial markets. To mitigate these challenges, Shell needs to develop a robust business strategy that considers these factors and adapts to changing market conditions.

International financial management theories engaged by Shell

International financial management theories are essential for companies operating in global markets. Shell utilizes various theories to manage financial risks, optimize capital structure, and evaluate investment opportunities.

The Exchange Rate Risk Management theory suggests that companies need to manage the risk of exchange rate fluctuations to protect their profits and maintain competitiveness in international markets (Krugman et al.,2012). Shell approached exchange rate risk management by implementing a comprehensive risk management program that includes the use of various financial instruments such as currency forwards, options, and swaps. The company employs a team of experts who continuously monitor the foreign exchange market and assess the potential impact of exchange rate fluctuations on their business operations. Shell also diversifies its currency exposures by conducting transactions in multiple currencies and actively manages its foreign exchange risk through hedging strategies. Additionally, the company uses a centralized treasury function to manage its foreign exchange risk across its global operations. This approach has helped Shell to mitigate exchange rate risk and protect its profits in volatile currency markets (Shell,2023).

International Portfolio Diversification theory suggests that investing in a diversified portfolio of international assets can reduce risk and improve returns. By spreading investments across different economies and asset classes, investors can minimize the impact of market volatility and political instability (Krugman et al.,2012). According to Shell's Annual Report, the company manages their risk by diversifying its portfolio and investing in various energy and natural resource projects worldwide, including renewable energy and biofuels, to reduce the impact of market volatility and political instability (Shell,2023).

International Capital Structure: This theory focuses on how companies can optimize their capital structure to minimize the cost of capital and maximize shareholder value. Factors such as the availability of financing, tax rates, and regulatory requirements can all impact a company's decision on how to structure its capital. To optimize capital structure, Shell uses a mix of debt and equity financing while considering factors such as tax rates and regulatory requirements.

International Financial Reporting Standards (IFRS): This theory emphasizes the importance of consistent and transparent financial reporting across international borders. IFRS provides a set of accounting standards that companies can use to ensure that their financial statements are accurate, reliable, and comparable across different countries and regions. The company follows International Financial Reporting Standards (IFRS) to ensure transparent and comparable financial reporting across its global operations.

Shell also uses Purchasing Power Parity (PPP) to evaluate the relative purchasing power of different currencies and to manage currency risk in its global operations.

Furthermore, Shell leverages international trade theory to identify new markets and opportunities for growth, such as expanding into emerging economies or developing new products and services (Shell,2023).

The company engages in foreign direct investment (FDI) to establish new businesses or acquire existing ones in foreign countries, carefully evaluating the factors that drive FDI, such as market size and government policies.

Shell closely monitors the international monetary system and conducts comprehensive country risk analysis to evaluate the potential risks and rewards of doing business in new markets, developing

strategies to manage those risks, such as forming partnerships with local companies or investing in sustainable development initiatives (Eiteman et al., 2016).

The Efficient Market Hypothesis (EMH) is another financial theory that suggests that financial markets, including the stock market, are informationally efficient. This means that stock prices reflect all available information, and it is impossible to earn excess returns by trading on this information as the market has already priced in all of the available information (Malkiel, 2003). If we examine the validity of the EMH theory in the context of Shell's stock market performance we can see empirical evidence from several studies that have examined the EMH theory in relation to the stock market performance of energy companies, including Shell.

Borovkove & Petrov's (2018) study found that the stock prices of energy companies, including Shell, were influenced by oil prices and market trends, but there was no evidence of any predictable patterns in the stock prices.

Similarly, Yang et al. (2017) examined the impact of oil price shocks on energy companies, including Shell, and found that while oil price shocks had a significant impact on the stock prices of energy companies, there was no evidence of any predictability in the stock prices.

These studies suggest that the EMH theory holds in the case of Shell, as the stock price reflects all available information and there are no predictable patterns that can be exploited for excess returns. In conclusion, the EMH theory is valid in the case of Shell and suggests that the current stock price reflects all available information about the company and its industry.

Shell's dividend policy

Shell's dividend policy has been a subject of discussion and analysis in the financial industry for many years. While the company has a long history of paying high dividends to its shareholders, its policy of increasing dividends each year has been criticized for its inflexibility and potential unsustainability. Shell's dividend policy is commendable for its consistency, paying a dividend every quarter for over 70 years, and its ability to maintain dividend payments even during periods of economic uncertainty. However, the company's focus on high dividends may not be sustainable in the long term as it may not be investing enough in research and development or exploring new business opportunities. Additionally, the company's inflexible approach to increasing dividends each year has led to situations where it has had to borrow money or sell assets to maintain its dividend payments. This could negatively impact its long-term financial health. Therefore, Shell needs to balance its dividend payments with investments in its future growth and innovation to remain competitive in the changing energy landscape. This may require rethinking its dividend policy and being more flexible in adjusting dividend payments based on market conditions and the company's financial health. Ultimately, the success of Shell's dividend policy will depend on its ability to balance the interests of its shareholders and the long-term sustainability of the company (Investopedia, 2021).

Shell's Method of appraising Projects

Shell employs the Project and Technology Selection (PTS) process to evaluate investment opportunities systematically based on their potential benefits, costs, risks, and strategic fit with the company's goals and values. This process consists of several stages, including screening, scoping, economic evaluation, risk management, and decision-making. (Baker, 2007) The process is known for its comprehensiveness and structured approach that considers all relevant factors and stakeholders when evaluating investment opportunities (Shell, 2020.). Moreover, the PTS process is supported by a range of analytical tools and techniques, such as discounted cash flow analysis and scenario planning, which help assess the financial and non-financial impacts of different options (Shell, 2020). However, the PTS process is also criticized for its resource-intensiveness, reliance on quantitative data, and potential biases due to the assumptions and inputs used in the analysis (Lozano, 2019).

In addition to the PTS process, Shell employs the Discounted Cash Flow (DCF) method to appraise projects. This method assesses the net present value of a project's cash flows over a specified time period, considering factors such as future cash flows, the cost of capital, and the risk associated with the investment (Santos, Figueira, & Marques, 2020). One of the strengths of the DCF method is its flexibility, allowing adaptation to different types of projects and industries. It also incorporates qualitative factors, such as environmental and social impacts, into the decision-making process (Santos et al., 2020). However, the DCF method is criticized for its failure to account for broader social and environmental impacts and externalities (Lozano, 2019).

We can determine that while Shell's PTS process and DCF method have their strengths and weaknesses, they remain widely recognized and used methods for project appraisal. It is essential to supplement these methods with other approaches that consider broader social and environmental impacts, involve stakeholders and local communities in the decision-making process, and address potential biases and limitations.

In conclusion, international financial management is crucial for Shell, a multinational corporation that operates in over 70 countries and faces various financial risks. Effective international financial management provides a range of benefits, including mitigating financial risks associated with foreign exchange rate fluctuations, enabling the company to raise capital from global financial markets, managing its tax liabilities across different jurisdictions, and helping to manage its working capital efficiently. Shell utilizes various theories, strategies, and tools to manage financial risks, optimize capital structure, and evaluate investment opportunities.

However, the company also faces various challenges in different financial markets, such as volatility in oil prices, regulatory changes, competition from renewable energy, economic instability, and exchange rate fluctuations. To mitigate these challenges, Shell needs to develop a robust business strategy that considers these factors and adapts to changing market conditions.

Ultimately, effective international financial management is essential for Shell's long-term sustainability and success.

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