International Financial Management

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Abstract

Financial management refers to the efficient and effective management of money (funds) in such a manner as to accomplish the objectives of the organization. It is the specialized function directly associated with the top management. The significance of this function is not seen in the 'Line' but also in the capacity of 'Staff' in overall of a company.

The World of Finance contains chapters on the structure and goals of firm, the role of financial managers, and an examination of the financial environment. Special attention is given to how the Financial Crisis affected nonfinancial companies, financial markets, and financial institutions.

International Finance is an important part of financial economics. It mainly discusses the issues related with monetary interactions of at least two or more countries. International finance is concerned with subjects such as exchange rates of currencies, monetary systems of the world, foreign direct investment (FDI) and other important issues associated with international financial management.

KEYWORDS: IFM, advantages & disadvantages .significances, main challenges.

Introduction of International Financial Management:

As the world economy has become more globally integrated, virtually every firm and individual is affected by developments in the economies of countries other than their own. The debate over the North American Free Trade Agreement (NAFTA) has brought many of these relationships to the fore. Individuals are affected by global economic conditions as multinational firms seek the cheapest place to produce their products—resulting in employment winners and losers. A textile firm may move to Mexico from North Carolina at the same time that Audi considers the construction of a new plant in the southeastern United States. In making plant location decisions, managers consider wage costs, the quality of the workforce, transportation costs, the cost of raw materials, exchange rate levels and risks, and political risk (such as the risk of expropriation or the blocking of funds).

In addition, firms may decide to locate in multiple countries to gain quicker access to new technologies as they develop. Some international plant location decisions are designed, at least in part, to avoid political and regulatory barriers. For example, Japanese and German auto firms, including Toyota, Nissan, Subaru, Mercedes, BMW, and Honda, have built large assembly plants in the United States to reduce the currency risk and labor cost risk associated with a one-country location strategy.

Financial managers willing to venture into the global financial marketplace may find lower-cost financing alternatives than are available in their home country. With trade barriers being lowered around the world, the managers of tomorrow cannot limit their

knowledge to "Island America." Rather, these managers will find that understanding the functioning of the global financial marketplace is a key element of their knowledge and skill base. Here we explore the factors that determine exchange rates, look at ways to forecast future exchange rates, and consider various aspects of foreign exchange risk and ways of managing that risk.

Main Challenges of Global Financial Management:

Global financial management is the financial system of operations that determines the health and performance of the world economy. Even a small business owner needs to be conversant with global finance, especially if you do business internationally. Your marketing and investment strategies hinge on an understanding of the economics of the different regions where you have an interest.

Diverse Economic Environment

Operating in a globalized environment means being answerable to different countries with different political environments and cultural norms, as well as trade procedures and tax conditions to comply with. In addition, the credit conditions may be totally different from what they are domestically. Anticipate day-to-day financial management challenges when operating internationally and devise ways to maintain healthy equilibrium within this economic framework to ensure your business's continued growth and survival.

Risk Management Challenges

Risk management is a major challenge of global financial management. For example, if you're buying supplies or selling products overseas, your business may face the risk of high prices caused by inflation in emerging economies. Although vulnerability to financial crises in many emerging markets has been reduced significantly due to stronger balance sheets, better fiscal policies and more flexible exchange rate regimes, other factors still pose risks. Potential threats to energy supplies, imbalances in the world economy and other fiscal sustainability issues call for prudent financial planning and management of those risks that most affect your particular business.

Dynamic Foreign Exchange Rates

In a globalized economy, the cash that goes in and out of the various countries is subject to fluctuations in exchange rates. This creates uncertainty for financial managers when it comes to the value of the home currency in relation to foreign currencies. Continuous fluctuations in the foreign exchange market could mean slow business for global organizations. If you need part of your financing for projects in emerging economies where you conduct your business, fluctuating exchange rates can subject you to higher interest rates. You have to monitor the foreign exchange market closely for suitable rates that benefit your organization.

Banking Regulations

Unlike financial management in a single country, global financial management must deal with many other banking institutions that have problems of their own. Some multilateral development banks, such as the International Monetary Fund and World Bank, have been set up to regulate international economic affairs in emerging economies and typically give conditions to various countries and their banks. This can be a challenge when doing business in a country where these institutions have influence, since they

advise banks in such countries to avoid testing waters in the riskier markets in its structural adjustment programs.

Significance of International Finance:

Firms with a presence in different factor and product markets have to grapple with complex issues unique to their operations. Decisions regarding where to set up a new plant (investment decision), in the capital structure and where to raise finances (financing decision), how much cash to hold, which currency to choose for denominating receivables and payables, the sources of short-term funds (working capital management decisions) and whether to pay dividend or not (dividend decision) are routine areas in financial management, for which standard evaluation techniques and management methods exist.

i. Investment Decision:

When an MNC decides to set up or acquire an affiliate overseas, it conducts a financial evaluation. A capital budgeting proposal is evaluated in accordance with accepted measures such as the Net Present Value (NPV) and the Internal Rate of Return (IRR). But an overseas capital budgeting proposal involves exchange rate forecasting, political risk assessment and tax planning.

ii. Financing Decision:

What are the regulatory restrictions in the MNCs home country and in the host country and how will they affect the overall cost of capital? Therefore, managers require a thorough understanding of the nature, structure and functioning of overseas financial markets, the degree of financial integration, and an overview of the regulatory restrictions that are in place.

In 1992, Indian companies were permitted to borrow money at market-determined rates from overseas under annually announced external commercial borrowing (ECB) limits. The quantum of ECBs has risen both in terms of volume and the number of corporates opting for them as a source of finance.

iii. Working Capital Decision:

A related question is that of cash management. A firm's cash holdings are attributed to the transaction motive, precautionary motive and speculative motive respectively. This money may be deployed in the money market and converted to cash as and when required. How much autonomy will the parent give its affiliates with respect to cash management? It involves an assessment of the direction of movement of exchange rates and its impact on funds required by affiliates. Globalization, exchange rate volatility and financial and technological innovations have converted cash management into a part of the treasury management function—exchange rate forecasting is as important as funds procurement and deployment.

iv. Dividend Decision:

An MNC is entitled to receive dividend from its wholly owned overseas subsidiary, and on its equity holding in an overseas firm. What are the dividend tax

regulations in MNC's home and the host countries? Is dividend tax imposed on the company declaring it, as well as in the hands of the recipient? In some countries, such as the USA, dividend is taxed in the hands of the parent company only when it is brought into the US. So, the parent company may choose not to have the dividend remitted.

Advantages & Disadvantages of Financial Management:

Businesses have many areas to manage to keep things working smoothly. Finance is just one of these areas. Because finances impact virtually everything else the company does, it's probably the most important thing a manager must address. However, there are both advantages and disadvantages to financial management in business. Usually the pros outweigh the cons, but managers still must be prepared to face the negative consequences of tracking the money a business has and spends.

Research, Time and Knowledge:

Financial management requires a significant amount of information, which takes time to collect. Once the data is gathered, you must take time to analyze it properly and discuss it with others involved. If you aren't sure how to approach a financial question, you must either learn about it or call in an expert, especially as company objectives change or the market shifts.

Cost:

The expertise, information and time involved with financial management has a very real price tag your company must take into account. You must pay those in your accounting department or the consultants you hire, and even if you handle the finances of the business alone, you cannot work for free.

Revision and Attention:

The financial needs and situation of a business shift constantly, based on market variables and the results of internal controls. For example, you may find that the cost of a part rose 10 cents from the previous budget period -- this drives up your cost of production and forces you to evaluate your budget. Financial management, therefore, is not a do-it-and-leave-it task. You must revisit it and do so often.

Power:

Managers often have to make the final call on where money goes in a business. Employees may take it personally if you don't allot money to them or their projects. This can lead to bad relations within the company.

Money Availability

When you manage your finances well, you know exactly what you're spending and what you're earning. You also know when funds will be available. With this knowledge, it's much less likely that you'll run into debt or be unable to pay back what you already owe. You know that money will be available when you need it.

Planning:

When you manage your business funds, reviewing the financial data allows you to identify specific trends and make some forecasts for the future. Because your finances

connect directly to what you can do in the business, this lets you develop new strategies for your operations and plan what you're going to do from both the short- and long-term perspectives. You also can assess your areas of risk and take steps to fix problems.

Accountability:

Financial management forces you and everyone else in the business to make a case for everything on which they're spending. With proper financial controls, you also can prevent instances of fraud. Financial management thus is a major tool for keeping everyone in your business accountable.

Confidence:

Proper financial management usually means that a company can grow in one or more areas, or at the very least, remain stable. It also provides you with an opportunity to follow through on your policies and plans. When these things happen, your employees and investors may have more confidence in you as a business leader. This often translates into continued loyalty.

Conclusion:

This unit looked at the question of whether the financial markets are efficient in the sense that prices demanded are fair and reflect all known and relevant information about investments. The Efficient Markets Hypothesis defines such efficiency at three levels, depending on how much information is in fact incorporated into prices. The weak form states merely that the current price already reflects all information incorporated into previous prices, so that each successive price move is a reaction to fresh news and therefore cannot be predicted from old prices.

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