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SUBJECT: -Global Business Finance

CHAPTER: - 01

CHAPTER NAME: -International Financial Institution and Market

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Submitted By:-

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UNIT – 1

International Financial Institutions and Markets

Meaning of Global Business Finance

Any economic and financial activity taken place in the international level can be called as **Global Business Finance,** purpose of any business activity is to generate revenue on entity across the physical boundary of the country for various resources.

Why companies go Global? Drivers of Globalization.

In today's society, many companies are driven to establish their businesses in foreign markets, through seeking international growth. This is because going global offers enormous different opportunities such as expanding business market share and diversification.

1. Increase Sales and Profitability

Expanding on a global market space is more likely to **increase overall revenue sales and reduce operational costs**, through attracting a larger customer base. In addition, through the help of technologies and the revolution of the internet, international commerce has become even more attractive, for smaller businesses. Through having the opportunity to outsource, they are able to reduce costs and improve their business management & operational efficiency.

2. Greater Economies of Scale

Some companies may want to expand their business products, as they are more likely to be accepted around the world. In many industries, expansion through internationalization may benefit companies, through achieving better economies of scale. This is especially the case for companies operating in smaller more domestic markets. Moreover, internationalization may also serve as **an opportunity to differentiate or exploit a new product extension, service, or brand**.

3. More Customers

Likewise, a small home market usually means customers are short supply. Which in turn affects a company's potential for growth. Simple math here really: Bigger market = more customers.

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4.Diversifying the Business

The international expansion allows a company to diversify its business in a couple of key ways. First, you spread the risk of slowing demand across multiple countries. If one market never gains or loses interest in your offerings, you can pick up the slack with success in other countries. In addition, you can connect with suppliers in international markets and take advantage of raw materials and resources unavailable in domestic markets.

An Overview of Global Business Finance

Global business refers to the trade of goods, services, technology,capital andor knowledge across national borders and at a global or transnational level.

It involves cross-border transactions of goods and services between two or more countries. Transactions of economic resources include capital, skills and people for the purpose of the international production of physical goods and services such as finance, banking, insurance and construction.

Distinguishing features of International Business Finance

1. **Large scale operations**
   In international business all the operations are conducted on a very huge scale. Production and marketing activities are conducted on a large scale.It first sells its goods in the local market.Then the surplus goods are exported.
2. **Integration of economies**
   International Business integrates the economics of many countries. This is because it uses finance from one country, labor from another country, and infrastructure from another country;it designs the product in one country, Produces its parts in many different countries and assembles the product in another country. It sells the product in many countries. That is in the international market.
3. **Dominated by developed countries and MNCs**
   International business is dominated by developed countries and their multinational corporations (MNCs). At present, MNCs from USA, Europe and Japan dominate (fully control) foreign trade. This is because they have large financial and other resources.They also have the best technology and research and development (R and D).They have highly Skilled Employees and managers because they give very high salaries and other benefits.
4. **Benefits to participating countries**
   International business gives benefits to all participating countries; However, The developing (Poor) countries also get benefits .They get foreign capital and technology. They get rapid industrial development. They get more employment opportunities. All this result is economic development of the developing countries.
5. **Keen Competition**
   International business has to face keen competition in the world market. The competition is between unequal partners. That is developed and developing countries. In this keen competition, developed countries and their MNCs are in a favorable position because they produce superior quality goods and services they produce superior quality goods and services at very low prices.

6. **Special role of science and technology**
   International business gives a lot of importance to science and technology. Science and technology help the business to have large-scale production. Developed countries use high technologies. Therefore, they dominate global business. International business helps them to transfer such top high –end technologies to the developing countries.
7. **International restrictions**
   International business facesmany restrictions on the inflow and outflow of capital, technology and goods. Many governments do not allow international business to enter their countries. They have many trade block, tariff barriers,foreign exchange restrictions, etc. All this is harmful to international business.
8. **Sensitive nature**
   The international business is very sensitive in nature. Any change in the economic political environment, etc. has a huge impact on it. Therefore, international business must conduct marketing research to find out and study these changes. They must adjust their business activities and adopt accordingly to survive changes.
9. **Payment in foreign currency**
   In international business, payment is made in foreign currency. Here, different currencies of different countries are involved.
10. **Involving greater risk**
    A greater risk is involved in international business as the commodities have to be carried long distances and even to cross the oceans.
11. **Law of comparative cost**
    A country specializes in the production of those goods for which the country has maximum advantages. It exports such goods together countries. It imports those goods which it cannot produce or for which it has no specific advantage.

Objectives of global business finance:

1. **Growth of the organization**
   Global expansion of any business with vertical and horizontal approach or either can certainly facilitate for the growth of the organization.
2. **Cost control**
   Quality operations and technological updating to meet the changing needs can reduce the cost to a greater extent.
3. **Customer service**
   Globalization of operation opens the wide opportunity to serve large number of customers
4. **Productivity**
   Operations of an organization at global level improve its productivity

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5. **Competitive advantage**
   To gain competitive advantage companies may go global. Global companies enjoy the benefit of large market base
6. For effective management
7. For best marketing and services
8. For beater financial management

Significance of global business finance

1. Access to capital market across the world enables a country to borrow during tough times and lend during good times.
2. International finance domestic investment and growth through capital import.
3. Worldwide cash flows can exerts a corrective force against bad government policies.
4. International finance prevents excessive domestic regulation through global financial institutions.
5. International finance leads to healthy competition and hence more effective banking system.
6. International finance promotes the integration of economies, facilitating the easy flow of capital. The free transfer of funds would eventually result in more equality among countries that are a part of the global financial system.
7. It provides information on vital areas of investment and leads to effective capital allocation

The challenges of Global Business finance:

The challenges arrives in global business finance is different from domestic business finance. Following are the challenges are global business finance

- Different currency
- Fluctuation in foreign exchange rate
- Different kinds of risk
- Different business environment
- Different roles and regulation
- Different political and economic situation
- To keep up-to-date with significant environmental changes and analyze their implications for the firm.
- To understand and analyze the complex interrelationships between relevant environmental variables and corporate responses.
- To be able to adapt the finance function to significant changes in the firm's own strategic.
- To take in stride post failures and mistakes to minimize their adverse impact.
- To design and implement effective solutions to take advantage of the opportunities offered by the markets and advances in financial theory.

Role of international financial manager in MNC's:

- Currency transactions
- Managing foreign exchange risk exposure
- Global money management
- Financing international business operations

1. **Currency transactions**: It takes place when MNC's wants to make foreign investment making payments to the clients.

   Types of currency transactions:

   1. Spot trade
   2. Forward trade

   Spot trade: An agreement to trade currencies based on the exchange rate today for settlement immediately ("on the spot") technically within two business days

   Forward trade: An agreement to exchange currency at specified future date at a specified price agreed upon today (also called a forward contract)
2. **Foreign exchange risk exposure**

   It's the possibility of a gain or loss to a firm that occurs due to unanticipated changes in exchange rate.

   Types of foreign exchange risk exposure

   1. Translation exposure
   2. Transaction exposure
   3. Economic exposure

   1.**Translation exposure**: Relates to the change in accounting income and balance sheet statement caused due to changes in exchange rates.

   2. **Transaction exposure**: It refers to the extent to which the future value of the firm's domestic cash flow is affected by exchange rate fluctuations

   3. **Economic exposure:** It refers to the degree to which a firm present value of future cash flows can be influenced by exchange rate fluctuations

3. Global money management:

Money management decisions attempt to manage global cash resources efficiently. It includes minimizing cash balances, reducing transaction cost

1. Minimizing cash balances

- Firms need cash balances on hand for notes payable and unexpected demands
- To keep cash accessible cash reserves are usually invested in money market accounts the offer low rates of interest.
- If firms could invest a longer time frame. They could earn higher rates of interest

2. Reducing transaction costs

- Transactions costs are the cost of exchange.
- Every time a firm changes cash from one currency to another they face transaction costs

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- Most banks also charge a transfer fee for moving cash from one location to another.
- Multilateral netting can reduce the number of transactions between subsidiaries and the number of transactions.

4. **Financing international business operations**:
   - Exim bank (Export-Import bank)
   - Loans from the parent company
   - Eurodollar loans
   - International / equity market
   - The international finance corporation (IFC)

Difference between Domestic and International finance management:

Domestic financial management	International finance management
• Limited cultures and subcultures.	• Multicultural, different values, ethics and costs of conduct.
• Country specific accounting standards and GAAP principles.	• Different accounting standards and GAAP principles in different countries.
• Risks are related to domestic country.	• Multiple risks such as interest rate risks, currency risk, political risk etc.
• Domestic financial management currency is single currency.	• International financial management .this is multiple currencies.
• Financial instruments use is limited.	• Large number of future, interest rates swaps etc.
• Unique economic and legal systems.	• Different economic and legal systems.
• The availability of portfolio for investment is limited.	• The availability of portfolios for investment is wide and large across in the world.
• It has no scope for access to global markets.	• The MNC's ventures into the area of global markets and there by benefit from an expanded business.
• It is limited to scope.	• It has wider scope.
• It is not exposed to foreign exchange risk and risks.	• International finance is related to cross border transactions and exposed for foreign exchange and political risks.
• It is subject to market imperfections of one country.	• It is very much subject to market imperfections because MNC's should operate in different economies

International Financial Institution:-

An international financial institution is a financial institution that has been established by more than one country, and hence are subjects of international law. Its owners or shareholders are generally national government, although other international institutions and other organizations occasionallyfigures shareholders. The most prominent International Financial Institutions are creation of multiple nations, although some bilateral financial institution (Created by two countries) exit and are technically IFIs.The best know IFIs were established after World War II to assist in the reconstruction of Europe and provide mechanisms for international Co-operation in managing the global financial system.

Objectives of International Financial Institution:-

Some of the objectives of International financial system are as

1. To reduce global poverty and improve people's living conditions and standards.
2. To support sustainable economic, Social and institutional development.
3. To promote regional Co-operation and integration.

International Financial Market:-

The International Financial market is the place where financial wealth is traded between individuals (and between countries).It can be seen as a wide set of rules and institution where arrest are traded between agents in surplus and agents in deficit and where institutions by down the rules.

Objectives of International financial market:-

The objective of regulation and supervision is to facilitate the efficient and fair performance of economic function, but a practical regulatory structure must deal with (and will influence) the products and institutions through which those functions are performed.

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Bank for International Settlements:-

It was setup in 1930 consisting of the European central banks as members. [illegible] New members could be admitted only on invitation from BIS.

Objectives of BIS:-

The objective of BIS is

1. To promote Co-operation among the Central Banks in their international financial operations.
2. To act as a trustee or agent in regard to international settlement entrusted to it by the member countries.

Functions of BIS:-

1. Gold operations in international markets.
2. Foreign exchange purchase or sale operations.
3. To act as trustee and agent of the member country.
4. Purchase and sale to central bank or the short term marketable government securities of member countries.
5. To act as [illegible] agents for the European payments union and European coal and steel community.

International Monetary Fund:-

It is outcome of Bretton Wood's agreement in 1944, it started its function in 1947 and it is having head quarter in Washington it consisting of 182 member countries.

Objectives of IMF:-

1. **International Monetary Co-operation:-**
   The most important objective of the fund is to establish international monetary co-operation amongst the various member countries through a permanent institution that provides the machinery for consultation and collaboration in various international monetary problem and issues.
2. **Ensure exchange stability**
   Another important objective of the fund is to ensure stability in the foreign exchange rates by maintaining orderly exchange arrangements among members and also to rule out unnecessary competitive exchange depreciations.
3. **Balanced Growth of Trade**
   IMF has also another important objective to promote international trade so as to achieve the required expansion and balanced growth.
4. **Multilateral trade and payments**
   To establish a multilateral trade and payments system in respect to current transactions between members in place of the old system of bilateral trade agreements was another important objective of IMF.
5. **Balanced Growth**
   Another objective of IMF is to help the member countries especially the backward countries, to attain balanced economic growth by exchange the level of employment.

Functionsof IMF:

1. **Exchange Stability**
   The first important function of IMF is to maintain exchange stability and thereby to discourage any fluctuations in the rate of exchange.
2. **Determination of par value**
   IMF enforces the system of determination of par values of the currencies of the member countries.
3. **Stabilize economics**
   The IMF has an important function to advise the member countries on various economics and monetary matters and thereby to help stabilize their economics.
4. **Credit facilities**
   IMF is maintaining various borrowing and credits facilities so as to help the member countries in correcting disequilibrium in their balance of payments.
5. **Maintaining Balance between demand and supply of currencies**

   IMF is also entrusted with important function to maintain balance between demand and supply of various currencies.
6. **Reducing Tariffs**

   The fund also aims at reducing tariffs and other restrictions imposed on international trade by the member countries so as to cease restrictions of remittance of funds or to avoid discriminating practices.

International Bank of Reconstruction and Development (IBRD):-

The International Bank of Reconstruction and Development is a development bank administered by the World Bank that offers financial products and policy advice countries aiming to reduce poverty and promote sustainable development. The (IBRD) is a cooperative owned by 189 member countries.

The (IBRD) is one of the two major institutions that makeup the world Bank, with the other being the International Development Association, a financial institution dedicated to making development loans to the world's poorest countries. The IBRD was founded in 1944 with the goal of helping war-torn European countries rebuild their infrastructure and their economies. Following the recovery from world war two, the IBRD shifted its mandate to increasing global economic growth and eliminating poverty. Today, the IBRD focuses its resources on middle income countries, or countries where the per capita [illegible] to

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$12475 per years. These countries, like Indonesia, India and Thailand are often home to fast-growing economies that attract a lot of a foreign investment and large infrastructure building projects, the IBRD shifts its focus to promoting economic development in other parts of the world.

Function of International Bank of Reconstruction and Development

1. World Bank provides various technical services to the member countries. For this purpose, the Bank has established "The Economic Development Institute" and a Staff College in Washington.

2. Bank can grant loans to a member country up to 20% of its share in the paid-up capital.

3. The quantities of loans, interest rate and terms and conditions are determined by the Bank itself.

4. Generally, Bank grants loans for a particular project duly submitted to the Bank by the member country.

5. The debtor nation has to repay either in reserve currencies or in the currency in which the loan was sanctioned.

6. Bank also provides loan to private investors belonging to member countries on its own guarantee, but for this loan private investors have to seek prior permission from those counties where this amount will be collected.

International Development Association (IDA):-

The International DevelopmentAssociation (IDA) is an international financial institution which offers confessional loans and grants to the world's poorest developing countries. The IDA is a member of the World Bank group and is headquarters in Washington Dc, United States. It was established in 1960 to complement the existing international bank for Reconstruction development by leading to developing countries which suffering from the lowest gross national income from troubled worthiness, or from the lowest per capital income. Together, the international development association and IBRD are collectively generally knows as the World Bank, the IDA'S started aim to assist the poorest nations in growing more quality, and sustainably to reduce power type. The IDA is the single largest provider of funds to economic and human development projects in the world's poorest nations. The IDA has issued a total $238 billion

USD in loans and grants since its launch in 1960. Thirty-six ofthe association's borrowing countries have graduated from their eligibility for its concessional lending. However, eight of these countries have relapsed and have not re-graduated.

Function of International Development Association (IDA)

a) The credit is interest free. Only a small service charge of 3/4% per annum. is payable on the amount withdrawn and outstanding to cover administration expenses.

(b) Repayment period is long-extending over 50 years. There is an initial moratorium for 10 years and the amount borrowed is repayable in the next 40 years.

(c) IDA finances not only the foreign exchange component but also a part of the domestic cost.

(d) The credit can also be repaid in the local currencies of borrowing countries. Thus, the repayment of loan does not burden the balance of payments of the country.

International Finance Corporations (IFC):-

The International Finance Corporations (IFC) is an organization dedicated to helping the private sector within developing countries. It provides investment and asset management services to encourage the development of private investment and asset management. Services to encourage the development of private enterprises in nations that might be lacking that the necessary infrastructure or liquidity for businesses to secure financing. The IFC is governed by its 184 member countries and it's headquartered in Washington Dc.

Function of International Financial Corporations (IFC)

(i) invests in private enterprises in member countries in association with private investors and without government guarantee, in case where sufficient private capital is not available on reasonable terms;

(ii) Seeks to bring together investment opportunities, private capital of both foreign and domestic origin, and experienced management, and

(iii) Stimulates conditions conducive to the flow of private capital, domestic and foreign into productive investments in member-countries

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Multilateral Investment Guarantee Agency (MIGA)

The MIGA was established in 1988 to encourage equity investment and other direct investment flows to developing countries by offering investors a variety of different services.

Objectives of MIGA

1. To promote flow of direct foreign investment into the less developed member nations.
2. To give insurance cover to investor against political hazards.
3. To offer assurance against noncommercial hazards such as risks involved in currency transfer, war and civil conflicts and violation.
4. To offer promotional and advisory services.
5. To set up reliability.

International conference for settlement of investment disputes (ICSID)

The international center for settlement of investment disputes is an international arbitration institution which facilitates arbitration & conciliation of legal disputes between international investors.

The ICSID is a member of the World Bank Group.

Functions of ICSID

1. Forum for investor- State dispute settlement in international investment Treaties, investment laws and contracts.
2. Promotion of International investment environment as envisaged in the ICSID Convention formulated by the World Bank.
3. Facilitator of dispute resolution in state dispute under the ambit of investment treaties as well as free trade agreements.
4. Acts as an administrative regulatory to take control of and to regulate investment relations.
5. Settlement of disputes via conciliations, arbitrations or fact finding.

Development Banks

A development bank is a [illegible] development finance institution devoted to improve the social & monetary development of its associate nations.

Its main emphasis is the welfare of the people.

A development banks policies or programs

a) Economic Growth
b) Human Development
c) Good Governance
d) Environmental Protection
e) Regional Cooperation

The main functions of a development bank

1. Increase loans & equity investment in its developing associate countries for their monetary & social development.
2. Promote & facilitate mobilization of public and private capital for growth & development.

Euro Currency Markets

The euro currency market is the money market in which currency held in banks outside of the country where it is legal tender is borrowed & lent by banks.

The euro currency market is utilized by banks, multinational corporations, mutual funds and hedge funds that wish to circumvent regulatory requirements, tax laws & interest rate caps often present in domestic banking, particularly in the United States.

The term euro currency has nothing to do with the euro currency of Europe and the market function in many financial centers around the world.

Euro Currency Market

The euro prefix can be applied to any combination of deposits and financial institutions. For example, a deposit denominated in [illegible] held in a Brazilian bank is a [illegible]. Euro currency is used as a source of short to medium term finance especially in international trades because of easy convertibility.

Euro Banking

A Euro bank is a financial institution that accepts foreign currency denominated deposits and makes foreign currency loans as a Euro bank does not necessarily have to be located on the continent of Europe; can be anywhere in the world. For example a bank [illegible] [illegible] states that extends loans or holds deposits in Japanese yen is a Euro [illegible].

Market for International securities

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An International securities market (ISM) is defined as a market for the listing and trading of securities of issuers incorporated in a specific territory that would otherwise be listed and traded on other exchanges around the world.

What is an International Bond?

An International Bond is a debt investment that is issued in a country by a non-domestic entity. An International Bond is a debt investment that is issued in a country by a non-domestic entity. International Bonds are issued in countries outside of the United States, in their native country's currency; they pay interest at specific intervals and pay the principal amount back to the bond's buyer at maturity.

Euro Note

Although the euro as a currency was introduced on 1 January 1999, it was an electronic currency only for the first three years of its existence. Physical euro notes and coins began circulating in the euro area or Eurozone.

Euro notes are legal tender in the form of a banknote that can be used in exchange for goods and services in the Eurozone. The supply of euro notes is controlled by the European Central Bank (ECB).

Euro-Commercial Paper

Euro Commercial Paper is an unsecured general obligation in the form of a promissory bearer note, issued on a discount or interest -bearing basis by large commercial and industrial organizations. Maturities of ECP range from a few days up to one year, with most being 182 days.

What is the meaning of Euro Medium Term Note-(EMTN)?

A euro medium -term note is a medium term flexible debt instrument that is traded and issued outside of the United States and Canada. These instruments require fixed payments and are directly issued to the market with maturities that are less than five years.EMTNs allow an issuer to enter foreign markets more easily to obtain capital.

Question of 1st Unit

- I. **Different between Global Financial Management and Domestic Financial Management? (May 2017, 5 marks)**
- II. **Explain factors responsible for increase the role of global business finances?**
- III. **Explain the feature of global business finance?**
- IV. **Explain the function of global finance manager?**
- V. **Write a note on IMF [International Monetary Fund].**
- VI. **Write a note on Word Bank Group.**
- VII. **What is BIS? Explain its role?**
- VIII. **What is EURO currency market? Explain.**
- IX. **Explain the market for international securities**
- X. **Role of Global Financial Manager in MNCs (May/June 2018,15 marks)**

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