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MB701 INTERNATIONAL MANAGEMENT OF FINANCE

CW1: COURSEWORK

Introduction

The United Kingdom (UK) listed organisation, Hardware–UK Plc is a successful and long-standing company that specialises in the production and selling of high-quality building materials. Associating to the consistent track record of profitability, growth, and enhancing shareholder valuation, the corporation has thrived in the domestic market due to limited rivalry from foreign businesses. In terms of seizing new opportunities and addressing identified challenges, Hardware–UK Plc's directors have decided to ensure international expansion. Hence, the assignment proceeds to critically discuss various factors for decreasing sales and profitability, investment appraisal approaches, methods for investment protection, and investing overseas implications concerning Hardware–UK Plc.

Main Body

1. Critically examination the factors that contributed to the decrease in sales and profitability structure of Hardware-UK Plc

The fall in sales and profitability structure of Hardware–UK Plc is attributed to numerous factors comprising Brexit, the Covid-19 pandemic, the increase in fuel prices, and increased competition from foreign enterprises. All these factors have developed a challenging business scenario for Hardware–UK Plc, causing a decline in financial performance.

Firstly, Brexit poses a crucial impact on the UK's economy, comprising the infrastructure and building industry. The uncertainty scenario in the context of the UK's withdrawal from the European Union has resulted in volatility in the financial markets and hereby results in the decline of investor and consumer confidence. As opined by Wilkes (2019), this uncertainty has contributed to reduced investment in the construction sector, causing a decrease in demand for building materials. However, the imposition of new trade barriers, for instance, customs and tariff checks has influenced the complexity and cost of exporting and importing goods. This in return contributes to more difficulty for Hardwar–UK Plc for international trade engagement.

Secondly, the Covid-19 pandemic poses a profound consequence on the global economy, comprising the construction sector (Fabeil *et al*. 2020). Reduced consumer spending, social distancing, and lockdown measures have interrupted construction projects and hereby results in declination in the demand for building materials. Several construction sites were shut down temporarily, reduction in the supplies needed and subsequently leading to project delays. As a consequence, various corporations in this sector, such as Hardware – UK Plc experienced deteriorated sales volumes and revenues as a consequence of these disruptions (Fabeil *et al*. 2020). Furthermore, an increment in fuel prices has also played a major role in the decrease in sales and profitability structure. Higher energy prices pose a direct consequence on the production cost and transportation of goods. As Hardware – UK Plc engages in the manufacturing and selling of building materials, it relies heavily on energy–intensive transportation and processes. The increment in fuel prices has resulted to enhance operating expenses for the corporation, leading to squeeze profit margins (Brotcorne *et al*. 2019). These higher expenses are difficult to pass on to customers, especially in a competitive market scenario, which erodes its further profitability extent.

Irrespective of this, the influx of foreign enterprises into the UK market has contributed to intensified competition level for Hardware – UK Plc. The company historically enjoyed competition from foreign businesses, but the government's foreign investment encouragement in the infrastructure and building industry has changed the landscape (Božič and Dimovski, 2019). Moreover, the emergence of foreign rivalries especially from India, China, and the European Union has introduced cheap and quality building materials into the market, causing pricing pressures for Hardware – UK Plc. These rivalries might pose access to cheaper inputs or lower production expenses, ensuring them to provide products at significantly competitive prices, leading to capturing market share from Hardware – UK Plc. To illustrate the consequence of increased competition, there is a need to consider an example of a new European rivalry that enters the market providing the same building materials at lower prices (Božič and Dimovski, 2019). This rivalry can influence economies of scale, decrease labor expenses and demonstrate supply chains to manufacturers and offer items more cost-effectively. As a consequence, customers, both individuals and corporate might switch towards the competitor's offering, causing a decline in market share and sales structure for Hardware – UK Plc.

2. Critically evaluation of investment appraisal approaches utilised by Hardware – UK Plc

The two investment appraisal approaches that can be utilised by Hardware – UK Plc to evolve the decision for further plant investment to influence their business success includes the net present value (NPV) and the internal rate of return (IRR).

Net present value (NPV)

As referred by Lu and Yin (2021), NPV is a widely utilised investment approach measure that determines the present valuation of cash flows relative to an investment project.

The formula for determining NPV is = ∑ {CFt / (1 + r) t} - Initial Investment

Where, CFt implies the net cash flow at "t" time, "r" signifies the discount rate, and the summation is considered over the overall life of the project. The decision rule for NPV states that the investment is regarded as viable if the NPV is positive and hereby must need to be pursued and vice versa.

Illustrations of NPV relative to the case study

It is assumed that Hardware – UK Plc is undertaking to invest in a new manufacturing plant in India. The initial investment amount is considered £ 10 million and the forecasted cash flows for the upcoming five years include, Year 1: £ 3 million, Year 2: £ 4 million, Year 3: £ 4 million, Year 4: £ 5 million, and Year 5: £ 6 million. Considering the discount rate of 10%, the NPV can be determined as follows.

NPV = (3 / (1 + 0.10) ^ 1) + (4 / (1 + 0.10) ^ 2) + (4 / (1 + 0.10) ^ 3) + (5 / (1 + 0.10) ^ 4) + (6 / (1 + 0.10) ^ 5) – 10 = £ 2.66 million.

Hence, by substituting the valuations, the NPV of the considered project of Hardware – UK Plc is explored as approximately £ 2.66 million. As the NPV highlights positively, the investment in the context of the new manufacturing plant in India is financially favorable.

Benefits of NPV

- It takes into account the time value of money by discounting future cash flows and thereby ensuring a more relevant representation of the investment's profitability structure.
- It helps in prioritising investment projects by comparing their relative profitability (Ouyang1a and Wan, 2023).
- It accounts for the overall cash flows of the project undertaking both outflows and inflows implications.

Shortcomings of NPV

- It does not undertake the investment's payback period or the project's scale, which might be the subjects' significant factors for decision-making.
- It depends on relevant estimates of the discount rate and the cash flows, which implies as subject to and challenging to uncertainties (Ouyang1a and Wan, 2023).

Internal rate of return (IRR)

IRR considers another investment appraisal technique that is utilised to determine the discount rate at which the present cash inflows valuation equals the present cash outflows valuation. Furthermore, the decision implication for IRR implies that if the determined IRR exceeds the required hurdle rate or rate of return, the investment is regarded as viable (Meta and Bajramović, 2021).

Illustrations of IRR relative to the case study

A similar investment project in India is considered with an initial investment structure of £ 10 million and forecasted cash flows as earlier mentioned. Hence, the rate of return can be explored considering the IRR formula that makes the NPV zero as illustrated below.

$$0 = (3 / (1 + IRR)^1) + (4 / (1 + IRR)^2) + (4 / (1 + IRR)^3) + (5 / (1 + IRR)^4) + (6 / (1 + IRR)^5) - 10$$

Thus, by solving the above equation, the IRR of the project is generated as approximately 16.6%.

Benefits of IRR

- It undertakes the time valuation of money and offers a single rate of return for easier comparison purposes with the required return rate (Pflaumer, 2022).
- It accounts for the overall cash flows of the project and undertakes the scale of the project.
- It helps in evaluating the profitability of the project and whether it fulfills the financial objectives of the corporation.

Shortcomings of IRR

- It assumes that the generated cash flows from the investment will be reinvested at the IRR, which might not always be realistic (Meta and Bajramović, 2021).
- It can contribute to several IRRs or no actual solution in some circumstances, ensuring difficulty in the interpretation of the results.

3. Methods for abroad investments protection against foreign exchange risks

In terms of protecting abroad investments against foreign exchange risks, Hardware – UK Plc can undertake utilising two methods including currency diversification and hedging. Hence, a detailed discussion of the methods is presented below.

Currency diversification

The currency diversification strategy intends to minimise the consequence of adverse exchange rate movements on the entire investment portfolio of the corporation (Anastasovska, 2022).

Identification

Hardware- UK Plc can recognise the currencies that are most adequate to their international business operations and choose a diversified currencies portfolio accordingly.

Definitions

Currency diversification comprises funding in several currencies irrespective of concentrating every investment in a single currency. This can be performed through several financial instruments, such as direct investments in foreign currencies or currency exchange-traded funds (ETFs) (Khan, 2019).

Explanation

Hardware – UK Plc by diversifying their investments across several currencies intends to reduce the issue of facing crucial losses from a single currency's depreciation. Moreover, if one currency weakens, investments held in other currencies might offset the losses.

Illustration

Hardware – UK Plc can allocate a portion of its investment to asset denominations in other currencies, such as the US dollar or the euro. This can be performed irrespective of investing solely in Indian assets with Indian rupee exposure. This diversification ensures addressing the adverse exchange rate movements' consequences particular to one currency.

Benefits

Currency diversification ensures Hardware – UK Plc spreads risks across several currencies and thereby decreasing the depreciation vulnerability of a single currency. This in return also offers a protection level against foreign exchange market uncertainties and decreases the potential consequence of unfavourable exchange rate fluctuations (Anastasovska, 2022).

Problems

Currency diversifications need a thorough understanding of the diverse economics, markets, and risks concerning several currencies. It might also result in enhancing complexity in the context of managing the investment portfolio of the corporation and adding transaction and administrative expenses (Khan, 2019).

Hedging

Hedging comprises utilisation of financial instruments to offset potential losses due to foreign exchange rate fluctuations. There exists numerous hedging techniques comprising forward contracts, futures, and options (Ruf and Wang, 2019).

Identification

Hardware – UK Plc can recognise the particular foreign exchange issues they experience while trading aboard, for instance, exposure to the Indian rupee or other currencies.

Definitions

Forward contracts, for instance, ensure corporations lock in an exchange rate for future transactions. Futures contracts provide standardised agreements to sell or buy currencies at a specified future date and price (Liao and Zhang, 2020). Options provide the right, but not the obligation to sell or buy currency at a predetermined rate.

Explanation

Hardware – UK Plc can address the consequence of adverse exchange rate movements by utilising hedging instruments. For instance, if the corporation expects the Indian rupee to weaken, they are likely to enter into a forward contract for rupees selling at a favorable rate and thereby protecting themselves from potential losses.

Illustration

Hardware – UK Plc assumes plans to invest in a manufacturing plant in India. They can consider a forward contract to lock in the exchange rate between the rupee and the pond for a particular date in the future. This in return enables the valuation of their investment to exist stable irrespective of currency fluctuations.

Benefits

Hedging ensures the corporation limits and manages potential losses concerning currency volatility, offering stability to their international investments (Liao and Zhang, 2020). It offers budgeting certainty as the corporation might forecast future cash flows with more confidence.

Problems

Hedging instruments arise with expenses, such as premiums or transaction fees. Besides, appropriate prediction of exchange rate movements subjects challenging and inaccurate hedging decisions that might cause unnecessary expenses or missed opportunities (Ruf and Wang, 2019).

4. Critically discussion of ethical, financial, regulatory, and strategic implications for overseas investment

Investing overseas, specifically in the context of setting up a manufacturing plant in India, reflects numerous strategic, ethical, regulatory, and financial implications for Hardware – UK Plc. Moreover, each of these aspects is discussed below in detail.

Strategic implications

Market expansion: Investing in an overseas manufacturing plant ensures Hardware UK to evolves with new markets and hereby diversifies its customer base. It offers an opportunity for customers targeted in India and other nations where the corporation can demonstrate a robust existence (Liang and Renneboog, 2020).

Competitive advantage: Hardware- UK by manufacturing locally in India can benefit from decreased production expenses such as cheaper raw materials and labor, which might influence its pricing strategy and competitiveness.

Ethical implications

Environmental impact: Hardware –UK requires to undertake the environmental implications relative to its operations in India. It must comply with local regulations concerning emissions, sustainable manufacturing practices, and waste management (Phillips and Johnson, 2021).

Labor standards: Hardware – UK should adhere to local labor laws while setting up a manufacturing plant in India and hereby enable fair engagement with workers. It must prioritise offering safe working scenarios, reasonable working hours, and fair wages (Schiff *et al*. 2020).

Regulatory implications

Intellectual property protection: Hardware – UK must safeguard its intellectual property rights and proprietary technology while expanding to India. It should enable that its trademarks, copyrights, and patents are protected adequately under Indian Law (Liang and Renneboog, 2020).

Legal framework: Investing overseas needs compliance with the regulations and laws of the host nation. Hardware-UK should navigate the legal landscape in India comprising intellectual property rights, corporate governance needs, trade policies, and tax regulations.

Financial implications

Revenue generation: Investing in an overseas market can potentially enhance Hardware-UK's revenue streams by selling products both for export and locally (Jackson *et al*. 2020). Moreover, corporations require to access pricing dynamics, potential sales volume, and market demand to enable profitability.

Foreign exchange risks: Operating in several nations exposes Hardware-UK to foreign exchange rate fluctuations. The corporation might require to consider financial instruments such as currency options or forward contracts to protect its investments and also to manage these risks.

Specific examples associated with India relocating

Strategic: Hardware-UK might consider the benefit of enhancing infrastructure development in India, influenced by initiatives like enhanced foreign direct investment and 'Make in India". This offers an opportunity for the corporation to supply high-quality building resources for several construction projects across the nation.

Ethical: Hardware-UK must enable compliance with labor laws in India, like workplace safety hazards, working hour regulations, and minimum wage requirements. By supporting local communities and offering fair employment opportunities, the corporation can demonstrate a positive ethical reputation (Schiff *et al*. 2020).

Regulatory: Hardware- UK requires to navigate the regulatory landscape of India comprising custom duties, foreign investment policies, and tax regulations. The corporation must seek legal suggestions to enable compliance and address any potential regulatory challenges (Liang and Renneboog, 2020).

Financial: The labor cost in India is comparatively less compared to the UK, ensuring Hardware-UK enhances profitability and decreases production expenses (Jackson *et al*. 2020). The corporation can also benefit from the nation's large consumer market as the demand for building materials is assumed to enhance with the increasing infrastructure development and urbanisation.

Conclusion

Thus, it can be concluded that investing in an overseas manufacturing plant in India poses numerous implications for Hardware-UK Ltd concerning financial, strategic, ethical, and regulatory perspectives. The company requires to carefully evaluate and mitigate these implications to ensure informed decisions and effectively navigate the overseas investment complexities. Furthermore, relevant planning, risk management, and due diligence can contribute to Hardware-UK's success in expanding internationally its operations and hereby sustain its competitiveness in a changing market landscape.

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