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MODULE 4 ASSIGNMENTS

1. How do MNCs come into existence?

The word MNCs stands for Multinational Coperations.

These are companies which engage in making and selling their products in more than one country.

They operate in other countries through subsidary companies or branhes.

Multinational Coperations come into existence through the following:

A typical MNCs raise capital in serveral countries simultaneously or sequentially.

Technologies may be developed in one country but use in different countries.

People move easily move from one country another to acquire new skills to use them in a third countries.

The ability of MNCs to use these globally available factors of production makes them competititive rather than the resource endowments of the parent country.

The existence of MNCs is based on the international mobility of factors of production.

An Indian parent company raise finances in US capital market to use it to acquire a company in Malaysia and sell the products of this acquired company in Latin American countries.

What steps may an MNC follow in becoming

global?

The steps that an MNC may follow in becoming global are:

A firm tries to exploit factor advantages internationally and to attempt to reduce the competitive threats by others.

Companies gradually increase their commitment to international business.

The sequence normally involves exporting, setting up international coperations departments, establishing a marketing subsidary, entering into licensing agreements and eventually creating facilities for manufacturing abroad.

It is not necessary that all companies follow this evolutionary process, this process represents a sequence of moving from a relatively low-risk, low-return, exporting- based strategy to a higher-risk, higher-return production-based strategy.

Starting the internationalization process from exports has certain advantages.

The advantages of creating manufacturing base abroad is that the MNC will be able to realize a full sales potential of its product when an MNC sets up production facility abroad , one of the important decisions, it is confronted with wether to create its own affiliate or to acquire a going concern.

1. Compare licensing agreement with establishment of a subsidiary.

The licensing is an arrangement in which a company licensor sells the right to use intellctual property or produce of a company,s product to the licensee for royalty while the subsidary company or daughter company is a company that is owned or controlled by another company which is called the holding company.

The slide difference between the licensing agreement and establishment of subsidary is that subsidary is more restrictive than licensing agreement.

Usually franchisors also provide more support and training than a licensor more regularly.

Licensee fee may a on time or annual thing, franchisees pay fees

1. What risks does an international finance manager face?

The risks that an international finance manager faces are:

To understand the interrelationship between the enviromental changes and corporate response. For example will the credit conditions be impacted by stock market crash, how will the defaults by some debtor countries affect funding ability in the capital market.

To understand the development and use of new instruments such as options, forwards futures, and swaps for effective management.

To develop ways to minimize risks through internal and external techiques.

To take a balanced view of success and failures, treating them as experiences to learn from.

Decisions such as taking loan in a currency that has started appreciating fast, taking a fixed rate financing when rates have started going down will have an adverse impact and impel finance manager to continue the demage to the extent possible.

Other risks are; timely financial reporting, fundraising, financial analysis etc.

1. Describe the different kinds of international financial flows.

The term international financial flow refers to the flowing of funds into or out of a country on account of various types of inernational transaction.

The different kinds international financial flows are:

Merchandise trade flows; enviroment trade may be related to goods or services.

The merchandise trade flows has two sides; the exporting and importing.

For example, if India exports various goods, it will get convertible currencies and that will be an inflow of funds, on the contary, it has to make payments in convertible currencies for imports it makes .

Thus, export and import of goods lead to international financial flows.

Invisible international financial flows; invisible include broadly, trade in services, investment income unilateral transfers.

If an Indian shipping company carries goods of a foerign exporter or importer and gets the fright changes, it will be treaded as inflows of funds on the account of trade services.

Foerign investment flow; Foerign investment here may be of two kinds; direct and portfolio.

Foreign direct investment FDI occurs when a firm moves abroad for the production of goods and provision of servivces and participates in the management of that company located abroad.

On the contary, foreign portfolio investment FPI is not at all concerned with the production of gooods and rendering of services.

Its purpose is to earn a return through investment in foreign securities without any intention of grabbing the voting power in the company whose securities it purchases.

Extenal assistance and external commercial Borrowings flows; external assistance and external commercial Borrowing are different in the sense that whie former flows normally from an official institution, being bilateral or multilateral, the later flows from internal banks or other private lenders.

The role of internal in the former is usually low along with a longer maturity period.

The later carries market rate of interest and shorter maturity.

Short flow of funds flow; normally, loans and foerign direct investment are meant for a exceeding one year.

There are financial flows that occur for this than a year movement of funds relating to banking, channels, euro notes, speculative and arbitrage activities etc are examples of short term funds that move across countries

1. Comment on the structure of balance of payments.

Funds flowing into or out of a country on account of various types international transactions are recorded by the monetary authorities of that country in a prescribed statement known as the balance of paytment.

A company prepares a cashflow statement that shows incoming and outgoing of cash.

Therefore, balance of payment is a statement that records all different from of funds inflow and outflow and arrives at conclusion wether there is a net inflow in the country or outflow out of country influencing in turn, the foreign exchange reserves possessed by the country.

What are the basic principles

governing recording of the flows?

The basic principles governing recording of the flows are:

While recording the international financial flows in the balance of payments, a couple of norms need to be followed as below;

One is that the structure of balance of payment is based on the principles of the double entry of book keeping.

It means that all the inflows of funds are put on credit side and all the outflows of funds are debited and the two sides are balanced.

Secondly, the other norm is that since the different forms of financial flows vary in nature, they are to be entered accordingly in two compartments of the balance of payment, current account and capital account.

Those transactions that represent earning or spending are recorded in the current account while the one that does not represent earnin g are recorded in capital account. Eg Foerign direct investment or foerign portfolio investment is entered in capital account.

6. How can the trade deficit be reduced or eliminated? Give your arguments based on the

elasticity approach,

The trade deficit can be reduced or eliminated based on the elasticity approach as below:

The adjustment in the balance of payments disequilibrium is thought of in terms of changes in the fixed exchange rate that is through devaluation or upward revaluation.

But its success is dependent upon the elasticity of demand for export and import.

Marshall 1924 and Lerred 1944 explained this phenomenon through the elasticity approach.

The elasticity is based on partial equilibrium annalysis where everything is heed constant except for the effects of exchange rate exchanges on export or import.

If the elasticity of demand is greater than unity, the import bill will contract and export earnings will increase as sequel to devaluation. Trade deficit will be removed.

However, the problem is that trade partner may also devalue its own curreny as a retaliating measure.

British exports and imports item has come to a conclusion that the balance of trade should

improve if ; elasticity of demand for exports and imports is high and is equal to one coupled with elasticity of supply both for exports and imports which is either high or low.

Elasticity of demand for imports and exports is low but elasticity of supply for imports and exports is lower.

7. Why are MNCs driving investments in South Asian Countries like Thailand, Malaysia

and Indonesia?

The reasons are as below:

The South Asian countries formed the association called Association of Southeast Asian Nations which led them being driving investment because they have maximum capital operation and advancee skills.

Another reason is that foreigh direct investment policy laid down by thses countries made most of investors to make investment in Southeast Asian countries compared to the West.

8. Why are China and India emerging as attractive centers of FDI in recent years?

The reasons why China and India emerging as attractive centers of FDI in recent years are:

There has been remarkable growth in recent years in portfolio investment by both individual and institutional investors in foerign securities.

This is also justified by globalization and liberation of finacial markets following the strategic initiatives by the governments of major countries including India anf China by giving freedom to their citizens to invest freely in foreign securities.

The information and communication technogy have also contributed to spurt in internatinal investments by facilitating crossborder transaction and rapid dissemination of information across national borders.

The introduction of investment vechicles, such as international mutual funds, country funds and intertionally listed stocks which alow investors to achieve international deversification without incuring excessive costs.

9. What forces stimulate FDI in a country?

Intense competitive pressures in domestioc economy forces stimulate FDI in a country.

Rationalizing of production activities so as to reap economies of scale and lower overall production costs.

Higher commodity prices have also stimulated FDI flows to countries rich in natural resources such as oil and minerals.

Increased mergers and amalgamation an activity at global level has also acted as a stimulant for FDI flows.

10.. What is internationalization theory of FDI? Discuss strengths and weaknesses of the

theory?

The internationalization theory of foreign direct investment is tested by comparing gains from foreign direct investment FDI and non foreign direct investment modes of expansion.

The proponents’ international theory arugue that FDI modes of expansion are better since the risk of dissemination of information monopoly is less when firms expand using these modes.

However, critics, argue that non FDI modes of expansion are preferable because high agency cost of decentralisation associated with FDI modes.

This slightly sledes some light on the debate by comparing the gains from FDI and non FDI modes of expansion.

The results show that obnorrmal returns to the share are significantly higher when firms expand using non FDI modes of expansion. Eg sales, contract, relative to FDI modes of expansion. Eg subsidary, acquistions and joint ventures.

Firms assets are easily copied producing within the firm rather than licensing to out side firm may be easier for a firm to protect its assets.

Firms with strong FSAs in a particular location can create clustering advantages and thereby can legally trigger large benefits accruing the competitive strength of the product will thus be affected by country biases.

They undertake FDI to expliot comparative advantages from many countries.

11. Gold standard provided domestic price stability and automatic adjustment in balance of

payments and in exchange rate. Discuss.

Even if pound had been minted of gold as far back as the 17th century,gold standard originated in England in 1816 when gold became the official tender.

By 1870s,gold standard stood widely accepted among countries and reigned with full fervor till the outbreak of the Great war 1914.

Gold standard provided domestic price and automatic adjustment in balance of payment and in exchange rate due to the curreny being on gold exchange standard was convertible into gold. Eg ruble could be exchanged for gold via British pound.

12. Mention the features of the fixed parity system of exchange rate.

The exchange rate regim was known as the fixed parity system with adjustable pegs.

In fact, it was designed at Bretton woods exchange rate system with 31 systems in the fixed parity each member country was to set a fixed value called the par value of its currency in terms of gold or US dollars.

It brought flexibility in the fixed exchange rate system for the purpose of attaining equilibrium in the balance of payments.

Changes up to five percent did not require prior approval of IMF but beyond it an IMF approval was necessary.

The provision also contained cautions so that there might not be competitive devaluation.

What were the causes

behind its collapse?

The causes of its collapse are:

The system performed well during 1940s and till late 1950s.

But when the US balance of payments began to experiencing growing deficits on account of widening trade deficit and out flow of dollar, the real value of dollar turned lower compared to it norminal value .

It shook confidence in dollar and central banks began converting the US dollar denominated securities into gold .

It led to the outflow of gold from USA that in turn slashed further the real value of dollar.

A vicious circle emerged between falling real value of dollar, loss of confidence in dollar, conversion of US dollar denonated securities into gold and the outflow of gold from the USA.

The outflow of gold was so huge in august 1971 that the then president Nixon suspended the convertibility of USA dollar into gold.

This decision threatened the fundamentals of the fixed parity system.

In order to bring back the confidence in US dolar, the Smithsonian committee resolutions of December 1971 devalued dollar and revalued upwardly some major currencies.

At the same time the normall fluctuation band was widened to +/- 2.25 percent.

But the Smithsonian measures failed to generate confidence.

A few currencies came to floct and finally the fixed parity system collapsed in February 1973.

13. Do you agree that fixed exchange rate is better than floating rates? Explain.

Yes, in fixed exchange rate system, the government of a country can peg its currency to the currency of of another country.

The currency of South Sudan is for pegged to Ugandan shillings.

A currency can be pegged to a basket of of currencies.

Indian rupee was for example pegged to basket of five currencies prior to 1993.

The reason is that, the appreciation and depreciation of currencies in the basket of the weighted a

verage comparative stable compared to floating exchange rate which is determined by the market forces of supply and demand.

14. What do you mean by SDRs?

The term SDRs stnads for Specialty Drawing Rghts, which refers to the creation of international

reserves assets created out of the contributions of member countries based on their quota

How do they help improve international liquidity?

Created in the response to concern about the limitation of gold and dollar as the sole means of

settling international accounts, SDRs augment internal liquidity by suplimenting the standard reserve currencies.