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Examining the Effectiveness of different foreign exchange risk management strategies employed by treasury managers in multinational corporations

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Abstract
Foreign exchange risk, the potential for financial loss due to fluctuations in currency exchange rates, is a significant challenge for multinational corporations (MNCs). Treasury managers within these organizations play a crucial role in mitigating this risk and ensuring the financial stability of their businesses. A variety of strategies are employed to manage foreign exchange risk, each with its own advantages and drawbacks. This article will delve into the effectiveness of different foreign exchange risk management strategies and explore the factors that influence their success. One of the most common strategies used by treasury managers is natural hedging. This involves matching foreign currency inflows and outflows to offset exposure to exchange rate fluctuations. For example, an MNC with a subsidiary in a foreign country can use the subsidiary's earnings to fund its foreign currency liabilities. While natural hedging can be a cost-effective approach, it may not be feasible for all MNCs, especially those with uneven cash flows or subsidiaries in countries with unstable currencies. Another popular strategy is forward contracts. These are agreements to buy or sell a specific amount of foreign currency at a predetermined exchange rate on a future date. Forward contracts can provide certainty about future exchange rates, but they also involve the risk of adverse price movements. If the exchange rate moves in an unfavorable direction, the MNC may incur losses on its forward contracts.
Keywords: *Foreign, exchange, risk, management, treasury, managers,multinational, corporations*

I. Introduction

Currency swaps are another tool used by treasury managers to manage foreign exchange risk. A currency swap involves the exchange of principal amounts and interest payments in two different currencies. This strategy can be effective in hedging long-term foreign currency exposures, but it requires careful consideration of interest rate risk and credit risk. (Wilson, 2021)

Options offer flexibility in managing foreign exchange risk. Call options give the holder the right to buy a foreign currency at a specified price, while put options give the holder the right to sell a foreign currency at a specified price. Options can be used to protect against adverse exchange rate movements without incurring the same level of risk as forward contracts. However, options can be expensive, and their effectiveness depends on the volatility of the underlying currency.

The effectiveness of foreign exchange risk management strategies depends on several factors. Market volatility is a key consideration. In volatile markets, options and currency swaps may be more effective than forward contracts. The time horizon of the exposure is also important. For short-term exposures, forward contracts may be sufficient, while longer-term exposures may require more complex strategies. The risk appetite of the MNC is another factor to consider. Some MNCs may be willing to accept a higher level of risk in exchange for potentially higher returns, while others may prefer a more conservative approach.

One of the most common strategies, forward contracts involve agreeing to buy or sell a specific amount of foreign currency at a predetermined exchange rate on a future date. While offering certainty, forward contracts can be costly if exchange rates move favorably. Similar to forward contracts, futures contracts are standardized contracts traded on organized exchanges. They provide liquidity and leverage but may not perfectly match the specific needs of an MNC. These involve exchanging principal amounts in two different currencies on a spot basis, with a simultaneous agreement to reverse the exchange at a future date. Currency swaps can be effective for managing long-term foreign exchange exposures. (Stephen, 2021)

Multinational corporations (MNCs) have become a dominant force in the global economy, exerting significant influence over markets, industries, and even societies. These large-scale enterprises operate across national borders, often with a global reach and a complex network of subsidiaries and affiliates. While MNCs have undoubtedly contributed to economic growth, globalization, and technological advancement, their impact is not without its challenges and controversies.

One of the primary benefits of MNCs is their ability to foster economic growth and job creation. By investing in new markets and industries, MNCs can stimulate economic activity, generate employment opportunities, and transfer technology and expertise. They often play a crucial role in developing infrastructure, improving education, and raising living standards in the countries where they operate. For example, MNCs in the manufacturing and technology sectors have brought significant investments to developing countries, creating jobs and contributing to their industrialization. (Williams, 2020)

Moreover, MNCs can promote globalization by facilitating the flow of goods, services, capital, and information across borders. This can lead to increased competition, lower prices for consumers, and a wider range of products and services. By breaking down trade barriers and fostering cultural exchange, MNCs can contribute to a more interconnected and interdependent world.

However, the impact of MNCs is not always positive. One of the major concerns is their potential to exploit workers and the environment. In pursuit of higher profits, MNCs may engage in practices such as outsourcing jobs to countries with lower labor costs and weaker environmental regulations. This can lead to exploitation of workers, child labor, and damage to the environment. Additionally, MNCs may have significant political and economic power, which can enable them to influence government policies and undermine local businesses. (Richard , 2021)

II. Review of Literature

Bennet et al. (2021): MNCs often exploit cheap labor and lax environmental regulations in developing countries, leading to social and environmental injustices. Furthermore, the concentration of economic power in the hands of a few multinational corporations can reduce competition and stifle innovation. This can result in higher prices for consumers and reduced choices. Their large size and economic power can give them significant bargaining leverage, enabling them to secure favorable tax breaks, subsidies, and regulatory exemptions. In some cases, MNCs may even be able to influence government policies to serve their own interests, rather than the interests of the broader public.

Clark et al. (2022): While MNCs offer numerous benefits to the global economy, they also raise important concerns about their impact on local communities, labor standards, and the environment. To maximize the positive effects of MNCs while mitigating their negative consequences, it is essential to develop effective regulatory frameworks and promote responsible corporate behavior. This will require collaboration between governments, businesses, and civil society organizations to ensure that the benefits of globalization are shared equitably and that the negative impacts are minimized.

David et al. (2020): Main challenge is the potential for MNCs to contribute to inequality and social unrest. By concentrating wealth and power in the hands of a few corporations, MNCs can exacerbate existing inequalities and create social tensions. Moreover, the rapid pace of globalization and technological change driven by MNCs can disrupt traditional ways of life and lead to job displacement and economic insecurity.

Nachimas et al. (2021): Multinational corporations are a complex and multifaceted phenomenon. While they can bring significant benefits in terms of economic growth, globalization, and technological advancement, their impact is not without its challenges and controversies. To harness the positive aspects of MNCs while mitigating their negative effects, it is essential to implement effective regulations, promote corporate social responsibility, and foster international cooperation.

III. Research Methodology

A self-made survey was organized with the aid of institutional tutor. This survey helped in gathering the required data for the research work.

Types of sampling

For the current research work, total 400 respondents were chosen by using Straightforward Random Sampling.

Statistical tool

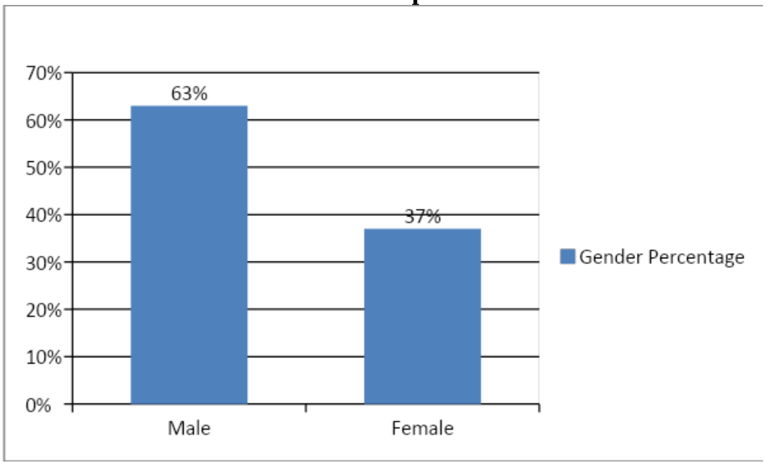
Google Forms were sent to the respondents. The organized survey had four sections including demographic profile and the procedure to get the feedbacks from the respondents. The request was expressed as a declaration evaluated on a 5-point Likert scale ranging from 1 to 5.

IV. Data Analysis

Table 1
Gender of Respondents

Gender	Frequency	%
Male	252	63%
Female	148	37%

Figure 1
Gender of Respondents

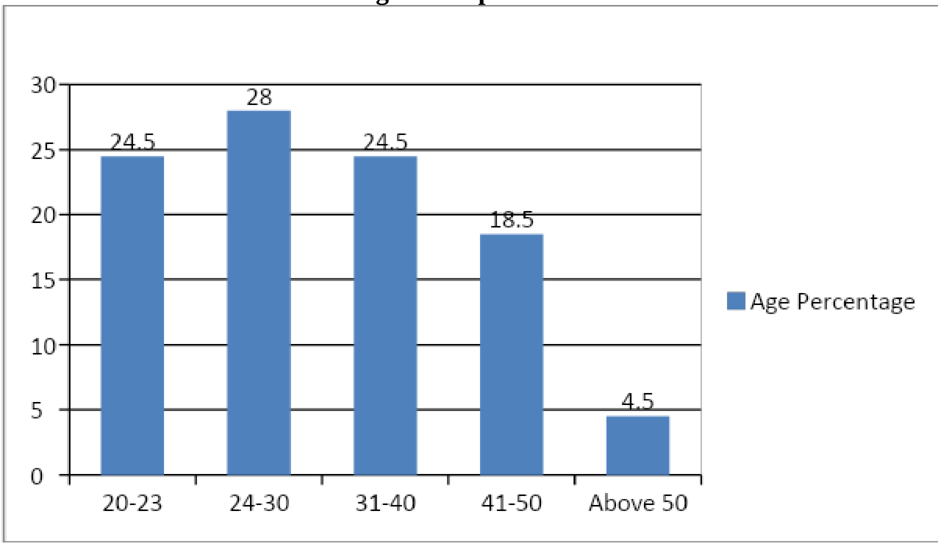


Source: Primary Source
It can be observed from table 1 that out of 400 respondents, there were 63% male and 37% female respondents.

Table 2
Age of Respondents

Age	Frequency	%
20-23	98	24.5
24-30	112	28
31-40	98	24.5
41-50	74	18.5
Above 50	18	4.5

Figure: 2
Age of Respondents



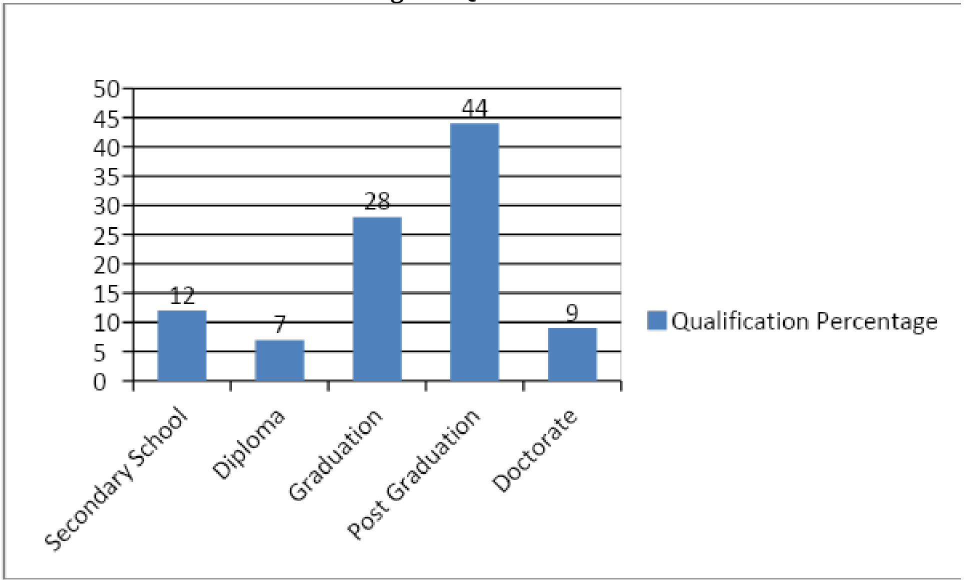
Source: Primary Source

It can be observed from Table 2 that there were 49 respondents of age group 20-23 and 56 respondents were of age group 24-30 while 49 were in the age-group 31-40. 37 respondents belonged to the age-group 41-50 while 9 respondents had the age more than 50 years

Table 3
Highest Qualification

S.No.	Highest Qualification	Frequency	%
01	Secondary School	48	12
02	Diploma	28	7
03	Graduation	112	28
04	Post Graduation	176	44
05	Doctorate	36	9

Figure 3
Highest Qualification



It can be observed from table 3 that majority of the respondents were post-graduated with the highest percentage of 44 while 28% respondents were graduated.

Table: 4
Current employment Status

S.No.	Current Employment Status	Frequency	%
01	Employed	312	79
02	Self Employed	88	21

Table: 5
Regression Analysis

	Private Sector	Public Sector
R^2	0.393	0.396
F	33.405*	37.839*
Constant	0.289	0.301
Currency swaps	0.198*	0.008
natural hedging	0.006	0.296*
forward contracts	0.290*	0.196***

Market volatility	0.296*	0.198***

Table 5 shows that the Currency swaps, natural hedging, forward contracts and Market volatility variable explain 44.2% (Private Sector) and 43.1% (Public Sector) variance of literary adaptation.

V. Discussion

Options contracts give the holder the right, but not the obligation, to buy or sell a foreign currency at a predetermined exchange rate. They offer flexibility but can be expensive. This involves matching foreign currency inflows and outflows to offset exposures. While cost-effective, natural hedging can be challenging to implement, especially for complex operations. This strategy involves creating a basket of currencies to hedge against multiple exposures. It can be effective in reducing overall risk but may require careful management.

The volatility of foreign exchange markets can significantly impact the effectiveness of hedging strategies. In highly volatile markets, options contracts may be more attractive due to their flexibility. The specific objectives of an MNC can influence its risk management approach. For example, a company with a focus on short-term profits may prefer more aggressive hedging strategies, while a company with a long-term perspective may opt for more conservative approaches.

The nature of an MNC's business can also affect its foreign exchange risk exposure. For instance, a company with a significant export business may face different risks compared to a company that primarily imports goods.

The choice of foreign exchange risk management strategies for MNCs depends on a variety of factors, including market conditions, corporate objectives, and business characteristics. While traditional hedging strategies like forward contracts and futures contracts remain popular, alternative approaches such as options contracts and natural hedging can also be effective in mitigating foreign exchange risk. Treasury managers must carefully evaluate the potential benefits and drawbacks of different strategies to select the most appropriate approach for their organization.

A manufacturing company with a significant portion of its revenue generated in foreign currencies. By using forward contracts to hedge its expected foreign currency inflows, Company A was able to lock in favorable exchange rates and protect its profit margins. A technology company with a diversified customer base and operations in multiple countries. Company B found that natural hedging, through its global sourcing and sales operations, was sufficient to manage its foreign exchange risk.

Foreign exchange risk management is a critical aspect of managing multinational corporations. Treasury managers must carefully evaluate the various strategies available and select the most appropriate ones based on their company's specific needs and circumstances. By effectively managing foreign exchange risk, MNCs can protect their financial stability and enhance their competitiveness in the global marketplace.

MNCs may exploit low-wage labor and lax environmental regulations in developing countries to maximize profits. This can lead to exploitation of workers, environmental degradation, and a transfer of wealth from developing countries to developed nations. Additionally, MNCs may have significant market power, which can enable them to dictate terms to suppliers and consumers, reducing competition and limiting the choices available to consumers.

MNCs can introduce new products, technologies, and ideas to local markets, contributing to cultural exchange and innovation. For example, the global spread of Western brands like Coca-Cola and McDonald's has led to the adoption of Western consumer culture in many parts of the world. On the other hand, MNCs can also contribute to cultural homogenization, as they often promote a standardized corporate culture that can erode local traditions and customs. This can lead to concerns about cultural imperialism and the loss of cultural diversity.

Multinational corporations are powerful economic actors that can have both positive and negative effects on local economies, cultures, and the environment. While they can contribute to economic growth and development, their activities can also raise concerns about exploitation, environmental degradation, and cultural homogenization. To maximize the benefits of MNCs while mitigating their negative impacts, it is essential for governments to develop effective policies and regulations that balance the interests of corporations, workers, and the broader public.

VI. Conclusion

Foreign exchange risk management is a critical function for MNCs. A variety of strategies are available to mitigate this risk, each with its own advantages and drawbacks. The effectiveness of these strategies depends on factors such as market volatility, time horizon, and risk appetite. Treasury managers must carefully evaluate the options available and select the strategies that best meet the needs of their organization. By effectively managing foreign exchange risk, MNCs can protect their financial stability and enhance their competitiveness in the global marketplace.

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