**Globalization**

**Definition** : Globalization is the spread of products, technology, information, and jobs across national borders and cultures.

**Brief History** :

Peterson Institute for International Economics (PIIE), states globalization stalled after World War I and [nations' movements toward protectionism](https://piie.com/microsites/globalization/what-is-globalization.html) as they launched import taxes to more closely guard their industries in the aftermath of the conflict. This trend continued through the Great Depression and World War II until the U.S. took on an instrumental role in reviving international trade.

**From the 1816 to the outbreak of World War I in 1914, the world benefited from a well-integrated financial order, sometimes known as the "first age of globalisation"**

Roots of globalisation are shown by  [Andre Gunder Frank](https://en.wikipedia.org/wiki/Andre_Gunder_Frank%22%20%5Co%20%22Andre%20Gunder%20Frank), an economist associated with [dependency theory](https://en.wikipedia.org/wiki/Dependency_theory). Frank argued that a form of globalization has been in existence since the rise of trade links between [Sumer](https://en.wikipedia.org/wiki/Sumer) and the [Indus Valley Civilization](https://en.wikipedia.org/wiki/Indus_Valley_Civilization) in the [third millennium](https://en.wikipedia.org/wiki/Third_millennium) BC

In India globalization was first felt in the 1990s in India when the then finance minister, Dr Manmohan Singh initiated the economic liberalization plan.

**Critical Steps to Globalization**

* [North American Free Trade Agreement](https://www.investopedia.com/terms/n/nafta.asp) (NAFTA), signed in 1993 – To provide American auto manufacturers the incentive to relocate a portion of their manufacturing to Mexico where they could save on the costs of labor – This continued till 2019 when NAFTA agreement was due to be terminated, and a new trade agreement negotiated by the U.S., Mexico, and Canada was pending approval by the U.S. Congress.

**Why we study this**

* Globalization has sped up to an unprecedented pace since the 1990s, with public policy changes and communications technology innovations cited as the two main driving factors.
* Domino Effect
* Corporations gain a [competitive advantage](https://www.investopedia.com/terms/c/competitive_advantage.asp) on multiple fronts through globalization
* Globalization is a social, cultural, political, and legal phenomenon
* Best part – IT GIVES US CAREER OPPORTUINITIES

**Effect Of Globalisation**

**Advantages**

* Opportunity advantages and Niche creation
* Increase in standard of living
* Attention of trade as well as human rights world wide i.e social justice
* Outsourcing and profit making in a win – win concept

**Disadvantages**

* Domino effect eg - the 2008 financial crisis had a severe impact on Portugal, Ireland, Greece, and Spain. All these countries were members of the European Union, which had to step in to bail out debt-laden nations, which were thereafter known by the acronym PIGS.
* concentration of wealth and power in the hands of a small corporate elite
* disappearance of entire industries to new locations abroad

**Real world examples of Globalization**

* Law of Floatation – floated from Japan to whole world
* China and India are among the foremost examples of nations that have benefited from globalization
* Ghana and Ethiopia had the fastest-growing African economies in the world in 2018, according to a [World Bank](https://www.worldbank.org/en/country/ethiopia/publication/ethiopia-economic-update-reform-imperatives-for-ethiopias-services-sector) report.

### Multinational Firms

Meaning -  A firm or company which has facilities and other assets in at least one country other than its home country. Such companies have offices and/or factories in different countries and usually have a centralized head office where they coordinate global management.

### Roots of Multinational Firms

* Its roots are linked with the history of colonialism
* Many of the first multinationals were commissioned at the behest of European monarchs in order to conduct expeditions.
* One of such first firms arose in 1660: The East India Company, founded by the British headquartered in London
* Other examples include the Swedish Africa Company, founded in 1649, and the Hudson's Bay Company, which was incorporated in the 17th century.

### Categories of Multinationals

* Decentralized - Firms with a strong presence in its home country
* Global or centralized Firm - hat acquires cost advantage where cheap resources are available
* Global  Firms - that builds on the parent corporation’s [R&D](https://www.investopedia.com/terms/r/randd.asp)
* Transnational  Firms - that uses all three categories

**INTERNATIONAL MONETARY SYSTEM**

It  is a set of internationally agreed rules, conventions and supporting institutions that facilitate [international trade](https://en.wikipedia.org/wiki/International_trade), [cross border investment](https://en.wikipedia.org/wiki/Foreign_direct_investment) and generally the [reallocation of capital](https://en.wikipedia.org/wiki/Redistribution_%28economics%29) between [nation states](https://en.wikipedia.org/wiki/Nation_state).

In its earliest form of cross boarder convertible and exchanges were precious metals such as [gold](https://en.wikipedia.org/wiki/Gold) and [silver](https://en.wikipedia.org/wiki/Silver) have been used for trade, sometimes in the form of [bullion](https://en.wikipedia.org/wiki/Bullion).

Features

* It provides for the means of payment acceptable to buyers and sellers of different nationalities, including deferred payment.
* It provides the base to inspire confidence, to provide sufficient liquidity for fluctuating levels of trade, and to provide means by which global imbalances can be corrected.
* system can grow organically as the collective result of numerous individual agreements between international economic factors spread over several decades.

BALANCE OF PAYMENTS

 Meaning - A statement of all transactions made between entities in one country and the rest of the world over a defined period of time, such as a quarter or a year.

It is also known as balance of international payments and is  [net international investment position](https://www.investopedia.com/terms/n/net-international-investment-position-niip.asp) together constitute its international accounts. Balance of payments and international investment position data are critical in formulating national and international economic policy. It is usually calculated every quarter and every calendar year.

In simple words all trades conducted by both the private and public sectors are accounted for in the BOP to determine how much money is going in and out of a country.

Terms - If a country has received money, this is known as a credit, and if a country has paid or given money, the transaction is counted as a [debit](https://www.investopedia.com/terms/d/debit.asp).

Features

The sum of all transactions recorded in the balance of payments must be zero, as long as the capital account is defined broadly. In equation :

Current a/c + broadly define capital a/c +balancing item = 0

reason - every credit appearing in the current account has a corresponding debit in the capital account,

Explaination - If a country exports an item (a current account credit), it effectively imports foreign capital when that item is paid for (a capital account debit).

Balance of payments and international investment position data are critical in formulating national and international economic policy

If a country cannot fund its imports through exports of capital, it must do so by running down its reserves. This situation is often referred to as a balance of payments deficit. Such imbalances can generate tensions between countries: Donald Trump campaigned on a platform of reversing the U.S.'s trade deficits, particularly with Mexico and China.

Note - In India, reporting of the account is done by the Central Bank

BOP divides transactions in two accounts: the [current account](https://www.investopedia.com/terms/c/currentaccount.asp) and the [capital accoun](https://www.investopedia.com/terms/c/capitalaccount.asp)t.

1. capital account  - here all international capital transfers are recorded. This refers to the [acquisition](https://www.investopedia.com/terms/a/acquisition.asp) or disposal of non-financial assets.
2. Foreign Direct Investment: Investment and control in a company based in a country by a foreign company.
3. Portfolio Investment: Investment in stocks, bonds, debts and other financial assets.
4. Government loans to the Government of other countries of the world.
5. In simple words The capital account is broken down into the monetary flows branching from debt forgiveness, the transfer of goods, and financial assets by migrants leaving or entering a country, the transfer of ownership on fixed assets (assets such as equipment used in the production process to generate income), the transfer of funds received to the sale or acquisition of fixed assets, gift and inheritance taxes, death levies and, finally, uninsured damage to fixed assets.
6. It also includes government-owned assets such as foreign reserves, gold, special drawing rights (SDRs) held with the International Monetary Fund (IMF), private assets held abroad, and direct [foreign investment](https://www.investopedia.com/terms/f/foreign-investment.asp).
7. current account - The current account is used to mark the inflow and outflow of goods and services into a country. Earnings on investments, both public and private, are also put into the current account.
8. The Balance of Trade (only visible items i.e. goods): Goods imported and exported to and from the country.
9. Trading of Services: Services received from other countries and rendered to other nations.
10. Net investment income: Income from foreign investment less payments on foreign investments.
11. Net cash transfers: Current transfers in the form of donations, gifts, aids, etc. form part of net cash transfer.
12. These goods and services together make up a country's [balance of trade](https://www.investopedia.com/terms/b/bot.asp) (BOT).
13. The BOT is typically the biggest bulk of a country's balance of payments as it makes up total imports and exports
14. A balance of trade deficit = imports > exports, and
15. A balance of trade surplus = exports > imports.

**DIFFERENCE BETWEEN CURRENT AND CAPITAL ACCOUNT**

| BASIS FOR COMPARISON | CURRENT ACCOUNT | CAPITAL ACCOUNT |
| --- | --- | --- |
| Meaning | An account which records the export and import of merchandise and unilateral transfers done during the year by a nation are known as Current Account. | An account which records the trading of foreign assets and liabilities during the year by a country is known as Capital Account. |
| Reflects | Net Income of the country. | Net change in ownership in national assets. |
| Deals with | Receipt and disbursements of cash and non-capital items. | Sources and application of capital. |
| Components | Trade in goods and services, investment income, unrequited transfers. | Foreign Direct Investment, Portfolio Investment, Government loans etc. |

BOP imbalances

Though there may be many reason of such imbalances; major imbalances that are the cause of concern are as follows:

* A visible trade deficit where import > exports (even if this is balanced by the other components of the current account.)
* An overall current account deficit.
* A basic deficit which is the current account + FDI (but excluding other elements of the capital account like short terms loans and the reserve account.)

Causes of BOP imbalances – Self explainatory

Balancing Mechanisms for BOP imbalances

### Rebalancing by changing the exchange rate

### Rebalancing by adjusting internal prices and demand

### Rules based rebalancing mechanisms

**Present Scenario –**

The fiscal deficit was 68.7 per cent of 2018-19 budget estimate in the year-ago period. The government estimates the fiscal deficit to be at Rs 7.03 lakh crore during 2019-20.

**The Market For Foreign Exchange or FOREX**

Meaning - The foreign exchange market (Forex, FX, or currency market) is a global decentralized or over-the-counter (OTC)market for the trading of currencies. This market determinesforeign exchange rates for every currency. It includes all aspects of buying, selling and exchanging currencies at current or determined prices.

Note :- OTC - A decentralized market, without a central physical location, where market participants trade with one another through various communication modes such as the telephone, email and proprietary electronic trading systems.

**FEATURES**

* Currencies are always traded in pairs, so the "value" of one of the currencies in that pair is relative to the value of the other
* The value of a country's currency depends on whether it is a "free float" or "fixed float".
* Free float currency are the one in which the exchange rate for a country's currency is determined by the supply and demand of that currency on the international currency markets eg dollar, yen , pound etc.
* fixed float are those where government decides the exchange rate.eg -  the Danish krone (DKK) ispegged to the euro at a central rate of 746.038 kroner per 100 euro, with a 'fluctuation band' of +/- 2.25 per cent.
* This market works 24 hours a day and closes on weekends only.
* Most liquid currency pair of this era –
1. GBP/USD
2. USD/JPY
3. EUR/USD

### Forex Leverage -  Leverage is a loan given to an investor by their broker. With this loan, investors are able to increase their trade size, which could translate to greater profitability. Thechnically Leverage in Forex is the ratio of the trader's funds to the size of the broker's credit. It can be calculated as follows :

**Financial Leverage = Total Value of Transaction / Total Trading Capital**

**Benefits of trading in Forex Market**

* Fewer rules, which means investors aren't held to the strict standards or regulations found in other markets.
* No [clearing houses](https://www.investopedia.com/terms/c/clearinghouse.asp) and no central bodies that oversee the forex market.
* Most investors won't have to pay the traditional fees or [commissions](https://www.investopedia.com/terms/c/commission.asp) that is required in another market.
* This market is open 24 hours a day, you can trade at any time of day, which means there's no cut-off time to be able to participate in the market
* One can get in and out whenever you want and you can buy as much currency as you can afford

UNIT II

TERMS

SPOT CONTRACT – is a contract of buying or selling a commodity, security or currency for immediate settlement (payment and delivery) on the spot date( on T+2 Basis)

SPOT RATE – The spot rate is the price quoted for immediate settlement on a commodity, a security or a currency.

MARK TO MARKET – valuation of an asset to reflect its current market levels over a given period of time

1. Initial Margin- The initial amount without which trading can not be done( collected at the end of every day for the open contracts)
2. Maintenance Margin- A **maintenance margin** is the minimum amount of equity that must be maintained in a **margin** account
3. Variations Margin - The volatility margin is imposed to check abnormal intra-day fluctuations in any scrip.

MARGIN TRADING - Margin is the money borrowed from a brokerage firm to purchase an investment. It is the difference between the total value of securities held in an investor's account and the loan amount from the broker I.E. JUST PAY A PERCENTAGE OF MONEY TO BUY A ASSET INSTEAD OF WHOLE PRICE

MARGIN CALLS - a demand by a broker that an investor deposit further cash or securities to cover possible losses.

LONG – Purchase i.e. holder thinks that price of the asset will increase.(+ve bal)

SHORT – Sale i.e. holder thinks that price of the asset will decrease.(-ve bal)

FORWARD PREMIUM - A forward premium is a situation in which the forward or expected future price for a currency is greater than the spot price.(forward >spot)

Note - The basics of calculating a forward rate require both the current spot price of the currency pair and the interest rates in the two countries

FORWRD DISCOUNT - A forward premium is a situation in which the forward or expected future price for a currency is less than the spot price.(forward < spot)

FORWARD EXCHANGE CONTRACTS

Meaning - [Forward contracts](https://www.investopedia.com/terms/f/forwardcontract.asp) are agreements between two parties to exchange two designated currencies at a specific time in the future.

In simple words, It is an is an **agreement** between two parties to exchange **two designated currencies** at a specific time in the **future**.

Features

* These contracts always take place on a date after the date that the spot contract settles.
* They are used to protect the buyer from fluctuations in currency prices.
* They cannot be canceled except by the mutual agreement of both parties involved
* The parties involved have two fold interest – 1. they are either interested in  hedging a [foreign exchange](https://www.investopedia.com/terms/f/foreign-exchange.asp) position or 2.  taking a [speculative](https://www.investopedia.com/video/play/speculation/) position.
* It is beneficial for those who can approximate the value of a currency according to the prevailing or anticipatory market conditions.
* Its very nature protect both the parties to protect from the unexpected or adverse movements in the currencies' future spot rates.
* Forward contracts are not traded on exchanges, and standard amounts of currency are not traded in these agreements.
* In it settlement can occur on a cash or delivery basis
* They are not traded on a centralized **exchange** and are therefore regarded as over-the-counter **(OTC)** instruments.
* Generally, forward exchange rates for most currency pairs can be obtained for up to 12 months in the future.
* There are four pairs of currencies known as the **"major pairs.":-**
1. $ and  ‎[€](https://en.wikipedia.org/wiki/Euro_sign)
2. $ and ¥
3. $ and £
4. $ and

Note : For these four pairs, exchange rates for time period of up to 10 years can be obtained. While even short term contracts in terms of few days is also available .

* It is a private agreement.
* Unlike futures it is not settled on everyday.
* They may include Mark to Market on daily basis.along with margin calls .
* Formulae for forward rate -

Forward rate = S x (1 + r(d) x (t / 360)) / (1 + r(f) x (t / 360))

 Where : S = the current spot rate of the currency pair

r(d) = the domestic currency interest rate

r(f) = the foreign currency interest rate

t = time of contract in days

PRACTICAL POINTS TO BE CONSIDERED BY A PROFESSIONAL

1. The **sale date** when the product is sold to the customer and the foreign exchange forward contract is entered into.
2. The **balance sheet date** when the value for the accounts receivable and forward contract liability needs to be restated.
3. The **settlement date** when the customer makes payment in Currency and the foreign exchange forward contract must be settled.

FORWARD EXCHANGE RATES BASED ON CROSS RATES

Meaning :  It reflects possible changes arising from differences in the interest ratebetween the two currencies of the two countries involved.

Cross Rate :- the [currency exchange](https://www.investopedia.com/terms/c/currency-exchange.asp) rate between two currencies when neither are the official [currencies](https://www.investopedia.com/terms/c/currency.asp) of the country in which the exchange rate quote is given.

**FORWARD EXCHANGE RATES BASED ON CROSS RATES**

Meaning of Cross Rates:  [currency exchange](https://www.investopedia.com/terms/c/currency-exchange.asp) rate between two currencies when neither are the official [currencies](https://www.investopedia.com/terms/c/currency.asp) of the country in which the exchange rate quote is given.

Practically  a cross rate is usually a currency pair that doesn't involve the U.S. dollar.

INTER BANK DEALS

purchase and sale of foreign exchange between the banks. In other words it refers to the foreign exchange dealings of a bank in the interbank market.

TERMS

INTER BANK MARKET : the top-level foreign exchange market where banks exchange different currencies. The banks can either deal with one another directly, or through electronic brokering platforms.

Features:

1. It is  [decentralized market](https://www.investopedia.com/terms/d/decentralizedmarket.asp)

2. There is no one "exchange" where every trade is recorded.

3. Trading takes place all over the world on multiple exchanges without the single characterization of an exchange listing.

4. Each market maker records his or her own transactions and keeps it as proprietary information.

5. Primary market makers who make a bid and ask spreads in the currency market are the largest banks in the world.

6. These banks deal with each other constantly either on behalf of themselves or their customers forming a market cloud called Inter bank market

**WHO REGULATES FOREX MARKET**

For individual forex investment, a **[forex broker](https://www.investopedia.com/terms/forex/c/currency-trading-forex-brokers.asp)** must be registered with the [Commodity Futures Trading Commission](https://www.investopedia.com/terms/c/cftc.asp) **(CFTC)** as a [futures commission merchant](https://www.investopedia.com/terms/f/fcm.asp) and be a member of the [National Futures Association](https://www.investopedia.com/terms/n/nfa.asp) **(NFA)**. The CFTC regulates the broker and ensures that he or she meets strict financial standards.

Most FOREX transactions are effected by the top 10 banks  including Deutsche Bank (NYSE:[DB](https://www.investopedia.com/markets/stocks/db/))(German), UBS (NYSE:[UBS](https://www.investopedia.com/markets/stocks/ubs/))(Swiss), Citigroup (NYSE:[C](https://www.investopedia.com/markets/stocks/c/)), (American) and HSBC (NYSE:[HSBC](https://www.investopedia.com/markets/stocks/hsbc/))(British).

Most of these banks have a separate group known as the Foreign Exchange Sales and Trading Department

(Practically : On a foreign exchange spot trading desk, there are generally one or two market makers responsible for each [currency pair](https://www.investopedia.com/terms/c/currencypair.asp). That is, for the [EUR/USD](https://www.investopedia.com/terms/forex/e/eur-usd-euro-us-dollar-currency-pair.asp), there is only one [primary dealer](https://www.investopedia.com/terms/p/primarydealer.asp) that will give quotes on the currency. He or she may have a secondary dealer that gives quotes on a smaller transaction size. This setup is mostly true for the four majors where the dealers see a lot of activity and

The minimum transaction size of each unit trade is approximately 1 million of the [base currency](https://www.investopedia.com/terms/b/basecurrency.asp) and the average one-ticket transaction size tends to be 5 million of the base currency)

**Cover Deals:** 1. Purchase and sale OF

2.  foreign currency TO

3. acquire or dispose foreign exchange

4. required or acquired AS

5. consequence of banks dealings with its customers

6. Purpose ; to insure the bank against any fluctuation in the exchange rates.

**HOW COVER DEALS ARE MADE**

By immediate reverse transactions In simple words :  the bank would like to keep its stock of foreign exchange near zero.

**NOSTRO AND VOSTRO ACCOUNT**

General terms used for the money kept by one bank with that of the other bank

* A nostro – literal meaning “ours” - is our account of our money, held by the other bank i.e. how much of the bank’s money is being held by the other bank
* A vostro – literal meaning “yours” -is our account of other bank money, held by us i.e. how much of the other bank’s money is being held by us
* LORO – our account of their money with you

**DEFINITION**

**NOSTRO –** It is a **current** a/c maintained **by domestic bank** / dealer with **foreign bank** in **foreign currency**

**VSTRO -** It is a **current** a/c maintained **by foreign bank** / dealer with **domestic bank** in **Rupees**

**LORO -** It is a **current** a/c maintained by one domestic bank on behalf of another domestic bank in foreign bank in foreign currency

Eg – If SBI has a current a/c with swiss bank and if PNB refers that a/c of SBI for correspondence then it is called LORO a/c for PNB and NOSTRO a/c for SBI.

**EXECUTION AN CANCELLATION OF FORWARD CONTRACTS**

Theoritically : since every term of forward contract is already known to the parties so theoretically there can be only two conditions i.e. the customer will either deliver or take delivery of the fixed sum of foreign exchange agreed upon.

Practically : delivery under a forward contract may take place before, on or after the due date, or delivery of foreign exchange may not take place at all.

This is done as forword contracts are the tailor made ones and there is no standardization. Theses types of excecution is only permitted by the bank if  customer agrees to bear the loss, if any, that the bank may have to sustain on account of the variation.

Literal meaning of excecution of forward contract is parties being done away with their respective liabilities in the contracts. Ways in which such contracts can be executed are as follows :

 Early delivery. –

Late delivery. –

1. Early Delivery - only if  the customer agrees to bear the loss, if any, that may accrue to the bank
2. Early cancellation. - i.e. cancellation before due date - cancel at forward selling rate prevailing on the date of cancellation with the due date of the original forward contract due date
3. Cancellation on the due date.- cancel at spot rate i.e. the bank purchases at the rate originally agreed and sells the same back to the customer at the ready TT rate and the difference is accounted at profit or loss
4. Late cancellation. – In the absence of any instruction or payment or delivery from the customer, contracts which have matured shall on the 15th day from the date of maturity be automatically cancelled. But  If the 15th day falls on a holiday or Saturday the cancellation will be done on the next succeeding working day in such cases cancellation charges will be recovered from the customer and no gain is passed on to him as its because of his default
5. Delivery on the due date.- in this case transaction rate will be the originally agreed rate irrespective of spot rate.
6. Extension on the due date. - in case if financial or economic conditions of the parties to the contract does not allow to settle on due date then customer may demand extension on the contract (only if party is confident to pay on later date) cancel original contract and rebook the new delivery contract at the prevailing rate of exchanges- rebooking and cancellation charges will be recovered from the customer.
7. Early extension. – before due date
8. Late extension. – rarely granted with customer cushion

Note - Rule 8 of FEDAI says that extension, delivery request or cancellation can only be made before maturity date (bank normally charges Rs 100 for every such request) else a forward contract which remains unutilized after the due date becomes an overdue contract.

**OTHER TERMS**

**Overdue Forward Contracts**: Forward contract which has neither been obeyed nor any instruction is received from the customer in the matter of it .

**Roll over Forward Contracts**: They are done in case of deffered payment contracts which are in excess of the months but they are done only in case of availability of suitable cover In these cases original or base contract is made for 6 months only and and extended forward contract is made for each instalments next to it

**CURRENCY SWAP OR CROSS CURRENCY SWAP**

Meaning -  an agreement in which two parties exchange the principal amount of a loan and the interest in one **currency** for the principal and interest in another **currency**.

At the inception of the swap, the **equivalent principal** amounts are exchanged at the **spot rate**.

**Interest** payments are exchanged at fixed **dates** through the life of the contract.

SPIRIT - It is considered to be a [foreign exchange](https://www.investopedia.com/terms/f/foreign-exchange.asp) transaction and is not required by law to be shown on a [company's balance sheet](https://www.investopedia.com/articles/04/031004.asp).

They are done most commonly to hedge [long-term investments](https://www.investopedia.com/terms/l/longterminvestments.asp) and to change the interest rate exposure of the two parties.

Companies go for it  to get more favorable loan rates in the local currency than they could if they borrowed money from a bank in that country.

**WORKING OF CURRENCY SWAP**

1. parties agree in advance whether or not they will exchange the principal amounts of the two currencies at the beginning of the transaction.

2. Pricing is usually expressed as [London Interbank Offered Rate (LIBOR)](https://www.investopedia.com/terms/l/libor.asp), plus or minus a certain number of points, based on interest rate curves at inception and the [credit risk](https://www.investopedia.com/terms/c/creditrisk.asp) of the two parties.

3. Exchange of interest rates can be done in following ways –

a.  fixed rate to fixed rate

b. floating rate to floating rate or

c. fixed rate to floating rate.

4. During the length of the swap each party pays the interest on the swapped principal loan amount.

5. At the end of the swap the principal amounts are swapped back at either the prevailing spot rate, or at a pre-agreed rate

6. They are over the counter instruments

7. A foreign exchange swap has two legs - a [spot transaction](https://en.wikipedia.org/wiki/Foreign_exchange_spot) and a [forward](https://en.wikipedia.org/wiki/Forward_contract) transaction - that are executed simultaneously for the same quantity, and therefore offset each other.

8.  Are similar to forward foreign exchange transactions in terms of how they are agreed upon; however, they are planned for a specific date in the very near future, usually within the same week.

Example - An American company may be able to borrow in the United States at a rate of 6%,

but requires a loan in rand for an investment in South Africa, where the relevant borrowing rate is 9%.

While

A South African company wishes to finance a project in the United States, where its direct borrowing rate is 11%, compared to a borrowing rate of 8% in South Africa.

In this case each party can get benefit from “fixed for fixed swap” i.e.  American company can borrow U.S. dollars for 6%, and then it can lend the funds to the South African company at 6%. The South African company can borrow South African rand at 8%, then lend the funds to the U.S. company for the same amount.

Lets see Floating rate swap now

Barrow Co, a company based in the USA, wants to borrow €500m over five years to finance an investment in the Eurozone.

Today’s spot exchange rate between the Euro and US $ is €1·1200 = $1.

Barrow Co’s bank can arrange a currency swap with Greening Co. The swap would be for the principal amount of €500m, with a swap of principal immediately and in five years’ time, with both these exchanges being at today’s spot rate.

Barrow Co’s bank would charge an annual fee of 0.4% in € for arranging the swap.

The benefit of the swap will be split equally between the two parties.

The relevant borrowing rates for each party are as follows:

|   | **Barrow Co** | **Greening Co** |
| --- | --- | --- |
| USA | 3.6% | 4.5% |
| Eurozone | EURIBOR + 1.5% | EURIBOR + 0.8% |

We will see what the gain on the swap for each party will be.

|   | **Barrow Co** | **Greening Co** | **Benefit** |
| --- | --- | --- | --- |
| USA | 3.6% | 4.5% | 0.9% |
| Eurozone | EURIBOR + 1.5% | EURIBOR + 0.8% | 0.7% |
| Gain on swap | 0.8% | 0.8% | 1.6% |
| Bank fee | (0.2%) | (0.2%) | (0.4%) |
| Final gain | 0.6% | 0.6% | 1.2% |

**International parity relationships(IRP)**

**Meaning –**

Parity refers to the condition where two (or more) things are equal to each other.

In **international** exchange, **parity** refers to the exchange rate between the currencies of two countries making the purchasing power of both currencies substantially equal. Theoretically, exchange rates of currencies can be set at a **parity** or par level and adjusted to maintain **parity** as economic conditions change.

Covered **interest rate parity** exists when forward contract **rates** of currencies can be used to prove that no arbitrage opportunities exist.

International parities are concerned with the relationships between the values of two or more currencies and the respective economic conditions in these countries, and the way in which these relationships respond to the changing economic conditions in these countries.

FEATURES

1. If IRP did not hold, then it would be possible for an astute trader to make unlimited amounts of money exploiting the arbitrage opportunity.

2. Understand the Law of One Price

**CONDITIONS OF INTERNATIONAL PARITY**

**Broadly three conditions can be discussed**

**1.** purchasing power parity (PPP)

**2.** covered interest rate parity (CIRP)

**3.** uncovered interest rate parity (UIRP) or the international Fisher effect (IFE)

**Purchasing Power Parity (PPP)**

**It’s a theory about exchange rate determination** based on a plain idea that the **two** currencies involved in the calculation of the exchange rate have **the same purchasing** power for the **same good** sold in the two countries.

**In simple words** the same goods or basket of goods should sell at the same price in different countries when measured in a common currency, in absence of transactions costs – it is also known as Absolute PPP

covered interest rate parity (CIRP)

It says that

**interest** rate differential between two currencies = differential between the forward and

in the cash money markets spot exchange rates.

Technically - a non-zero cross-currency basis indicates a violation of CIP.

In other words When the no-arbitrage condition is satisfied with the use of a forward contract to hedge against exposure to exchange **rate** risk, **interest rate parity** is said to be **covered**.

**THEN WHAT IS UNCOVERED INTEREST RATE PARITY**

the difference in interest rates between two countries will equal the relative change in currency foreign exchange rates over the same period. And where it is not then the difference may be used for the arbitrage benefits.

This is a very risky contract as no hedge coverage is there

There is no theoretical **difference between covered and uncovered interest rate parity** when the forward and expected spot **rates** are the same

|  |  |
| --- | --- |
| **CIP** | **UCIP** |
| CIPinvolves using **forward or futures** contracts to cover exchange rates, which can thus be **hedged** in the market.  | UCIP involves forecasting rates and not covering exposure to foreign exchange risk – that is, there are no forward rate contracts, and it uses only the expected spot rate. |
| Can hold in short run | It does not hold over the short run |
| Arbitrage boundation is there  | No arbitrage boundation |
| Used for calculating forward exchange rates | Used for calculating sepeculations |

Not much practical evidences are available for UCIP and it is theoretically used to define the rational expectations by the economists.

Theoritically if both CIP and UCIP holds then pure expectation theory holds (i.e. traders bid strictly on the basis of **expectations** about future interest rates, and they are indifferent to maturity because they do not view long-term bonds as being riskier than shorter ones)

UNIT III

INTERNATIONAL FINANCIAL MARKET AND CASH MANAGEMENT

TERMS

QUOTE – Per unit currency pair's exchange rate of a currency.

PAIR – refers to currency pair of which trading is done

BASE CURRENCY – first part of the pair

QUOTE CURRENCY – second part of currency

Eg -  EUR/USD = 1.12

Where EUR is base currency and USD is quote currency

Note – base currency always signifies the unit one and hence the direct quote.

BID AND ASK QUOTE

Trick – These terms are used from the perspective of the [forex broker](https://www.thebalance.com/what-is-a-forex-broker-1344939).

And remember - a bid price is not the price you'll bid when you want to buy a currency pair.

 EUR/USD = 1.3600/05

Here  bid is 1.3600, and the ask is 1.3605.

Or write it as EUR/USD  = 1.3600/1.3605

Where EUR and USD are ISO codes of currency (Usually, codes are comprised of the two first letters defining the name of the country, and the last letter for the name of the currency.)

Simple concept - when you're the potential buyer, the broker will **ask** for a little more than what he might be willing to **bid** if you were selling but since there is boundry of spread you have to pay ask.

Therefore When you're buying, you'll pay what the broker's asking for the currency; when you're selling, you'll need to accept what the broker's bidding.

SPREAD - difference between the bid and the ask

PIP/POINT/TICKS – it is a unit of measure, and it's the smallest unit of value in a forex currency quote in the above mentioned ask is 5 pips from bid. PIP is usually the fourth digit mentioned in the quote.

NICK NAMES

The GBP/USD pair is often referred to as 'cable' or 'the cable', and this is reminiscent of the times when a communications cable under the Atlantic Ocean connected London and New York.

The USD/JPY currency pair is occasionally called 'ninja',

the EUR/GBP currency pair is known as 'chunnel'.

'greenback' is used for the US dollar, 'swissy' for the Swiss franc, 'loonie' for the Canadian dollar, 'aussie' for the Australian dollar and 'kiwi' for the New Zealand dollar

POINT TO REMEMBER

It is important to remember that all buy orders open at the ask price, and subsequently close at the bid price of a traded instrument.

It's worth keeping in mind that although a price chart may be reflecting both bid and ask lines for a currency pair, the chart itself is drawn by the bid price.

Reason being it the demand driven market.

TECHNOLOGICAL TERMS FOR CURRENCY PAIRS

MAJORS

* Majors are widely traded by beginners and professionals alike.
* they have the most liquidity, lowest spreads and the broadest range of movements, majors are generally more stable

CROSSES

* The crosses are any currency pair that doesn’t feature the USD and they do not hold any less profit potential than the majors. Eg – GBP/JPY, EUR/GBP etc

EXOTICS

* The “Exotic” currency pairs are less traded and so much more costly to buy or sell.

DIRECT / INDIRECT QUOTE

* The concept of direct quotes versus [indirect quotes](https://www.investopedia.com/terms/i/indirectquote.asp) depends on the location of the speaker,
* A direct quote is a currency quote for a foreign currency in per unit terms of a domestic currency.
* The first currency shown is the controlling one in terms of placing your order.
* So if you see EUR/USD then you are always choosing to buy or sell the first currency (Euro) against the second currency (U.S. Dollar).
* Simple words - Direct quotation is where the cost of one unit of foreign currency is given in units of local currency
* indirect quotation is where the cost of one unit of local currency is given in units of foreign currency.  In other words, the domestic currency is the base currency in an indirect quote, while the foreign currency is the counter currency
* Indirect quote is also known as quantity quotation
* Difference between direct and indirect quote is called margin which is booked as profit after deducting transaction expenses.

INTERNATIONAL BANKING AND MONEY MARKET

Meaning – An international ban is a financial entity that offers financial services eg payment , lending etc. To foreign clients be it artificial or natural person.

Types of International Banking services

 Correspondent banking – inter banking deposits on international level. Thus this facility allows a banks client to conduct business worldwide through his or her local bank .

Representative offices – It is a facility staffed by the parent bank personnel that is designed to assist MNC client.

Foreign branches – A foreign branch bank operates like a local bank but legally it is a part of the parent bank.

Subsidiaries and affiliate banks

Edge Act Banks – These are federally chartered subsidiaries of US banks that are physically located in the US and are allowed to engage in a full range of international banking activities.

Offshore Banking Centers – a kind of liberty allowed by the host country to external banks to operate in their political boundaries as per their own regulations and this may involve exemption from the banking regulations of the host country

International Banking facilities – they are the separate set of accounts that are segregated on the parents books

Shell Branches – basically they are like post office box , the actual business is done by the parent bank and at the parent bank. The purpose of such branches is to allow parent company to compete internationally without the expense of setting up the operations for real

MONEY MARKET

A market be it virtual or physical where short term instruments are traded. It involves both the institutions and traders

“ FOR THE PURPOSE OF THIS MARKET – MONEY IS CONSIDERED AS A COMMODITY”

Short term means – up to 12 months

Eg of money market instruments –  [treasury bills](https://en.wikipedia.org/wiki/Treasury_security#Treasury_bill), [commercial paper](https://en.wikipedia.org/wiki/Commercial_paper), [bankers' acceptances](https://en.wikipedia.org/wiki/Bankers%27_acceptance), [deposits](https://en.wikipedia.org/wiki/Deposit_%28finance%29), [certificates of deposit](https://en.wikipedia.org/wiki/Certificate_of_deposit), [bills of exchange](https://en.wikipedia.org/wiki/Bill_of_exchange), [repurchase agreements](https://en.wikipedia.org/wiki/Repurchase_agreement), federal funds, and short-lived [mortgage-](https://en.wikipedia.org/wiki/Mortgage-backed_security) and [asset-backed securities](https://en.wikipedia.org/wiki/Asset-backed_security)

* [Certificate of deposit](https://en.wikipedia.org/wiki/Certificate_of_deposit) – Time deposit, commonly offered to consumers by banks, thrift institutions (btains the majority of its funds from the savings of the public. ), and credit unions.
* [Repurchase agreements](https://en.wikipedia.org/wiki/Repurchase_agreement) – Short-term loans—normally for less than one week and frequently for one day—arranged by selling securities to an investor with an agreement to repurchase them at a fixed price on a fixed date.
* [Commercial paper](https://en.wikipedia.org/wiki/Commercial_paper) – Short term instruments promissory notes issued by company at discount to face value and redeemed at face value
* [Eurodollar deposit](https://en.wikipedia.org/wiki/Eurodollars) – Deposits made in U.S. dollars at a bank or bank branch located outside the United States.
* [Treasury bills](https://en.wikipedia.org/wiki/Treasury_security#Treasury_bill) – Short-term debt obligations of a national government that are issued to mature in three to twelve months
* [Money funds](https://en.wikipedia.org/wiki/Money_fund) – Pooled short-maturity, high-quality investments that buy money market securities on behalf of retail or institutional investors
* [Foreign exchange swaps](https://en.wikipedia.org/wiki/Foreign_exchange_swap) – Exchanging a set of currencies in spot date and the reversal of the exchange of currencies at a predetermined time in the future
* Short-lived [mortgage-](https://en.wikipedia.org/wiki/Mortgage-backed_security) and [asset-backed securities](https://en.wikipedia.org/wiki/Asset-backed_security)

INTERNATIONAL BOND MARKET

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 a country native country's currency. They pay interest at specific intervals and pay the principal amount back to the **bond's** buyer at maturity.

Risk Factor in them - Since international bonds are typically denominated and pay interest in the currency of the host or domestic country, the value of the bond in the domestic currency will fluctuate depending on the economic conditions and exchange rates between the domestic country and foreign country.

* Eurobond: this is a bond that is issued and traded in countries other than the country in which the bond’s currency or value is denominated in. These bonds are issued in a currency that is not the domestic currency of the issuer. A French company that issues bonds in Japan denominated in U.S. dollars has issued a Eurobond, more specifically, a [Eurodollar bond](https://www.investopedia.com/terms/e/eurodollarbond.asp). Other types of Eurobonds are the Euroyen and Euroswiss bonds.
* Foreign bond: this bond is issued in a domestic market by a foreign issuer in the currency of the domestic country. For example, a bond that is issued in Canada and valued in Canadian dollars by an American company is a foreign bond. To be more specific, the bond in the example is referred to as a [Maple bond](https://www.investopedia.com/terms/m/maple_bond.asp). Other types of foreign bonds include [Samurai bond](https://www.investopedia.com/terms/s/samuraibond.asp), Matador bond, [Yankee bond](https://www.investopedia.com/terms/y/yankeebond.asp), [Bulldog bond](https://www.investopedia.com/terms/b/bulldogbond.asp), etc.
* Global bond: this is similar to the eurobond but can also be traded and issued in the country whose currency is used to value the bond. Drawing from our Eurobond example above, an example of a [global bond](https://www.investopedia.com/terms/g/globalbonds.asp) will be one in which the French company issues bonds denominated in the U.S. dollar and offers the bonds in both Japan and America
* Brady Bond : A different type of international bond is the [Brady bond](https://www.investopedia.com/terms/b/bradybonds.asp), which is issued in U.S. currency. Brady bonds are issued to help developing countries better manage their international debt. International bonds are also private corporate bonds issued by companies in foreign countries, and many [mutual funds](https://www.investopedia.com/terms/m/mutualfund.asp) in the United States hold these bonds.
* Kangaroo Bond : A kangaroo bond is a type of foreign bond that is issued in the Australian market by non-Australian firms and is denominated in Australian currency.
* Samurai Bond : A samurai bond is a yen-denominated bond issued in Tokyo by a non-Japanese company and subject to Japanese regulations.
* Bull Dog Bond : Bulldog bond is a type of bond purchased by buyers interested in earning a revenue stream from the British pound or sterling. A bulldog bond is traded in the United Kingdom.

ETC.

LIBOR i.e. The London Inter-bank Offered Rate is a benchmark interest rate at which major global banks lend to one another in the international interbank market for short-term loans.

In other words LIBOR is the average interest rate at which major global banks borrow from one another.

It is based on five currencies including the US dollar, the [euro](https://www.investopedia.com/terms/e/euro.asp), the British pound, the Japanese yen, and the Swiss franc, and serves seven different maturities—overnight/spot next, one week, and one, two, three, six, and 12 months.

The combination of five currencies and seven maturities leads to a total of 35 different LIBOR rates calculated and reported each business day. The most commonly quoted rate is the three-month U.S. dollar rate, usually referred to as the current LIBOR rate.

Each day, ICE (Immigration and Customs Enforcement) asks major global banks how much they would charge other banks for short-term loans. The association takes out the highest and lowest figures, then calculates the average from the remaining numbers. This is known as the trimmed average. This rate is posted each morning as the daily rate, so it's not a static figure. Once the rates for each maturity and currency are calculated and finalized, they are announced/published once a day at around 11:55 am London time by IBA.

The rate is calculated using the Waterfall Methodology, a standardized, transaction-based, data-driven, layered method

INTERNATIONAL EQUITY MARKETS

Equity market investments over cross boarders .

It involves two type of markets a. Primary market and b. Secondary market

Types of Orders in Equity market

Note : types of orders is a concern of secondary market

* **Market order** − A market order is traded at the best price available in the market, which is the market price.
* **Limit order** − A limit order is held in a limit order book until the desired price is obtained.

Types of secondary market

* In a **dealer market,** the broker takes the trade through the dealer. Public traders do not directly trade with one another in a dealer market. The over-the-counter (OTC) market is a dealer market.
* In an **agency market,** the broker gets client’s orders via an agent.

Note : Difference between a broker and a dealer

1. A broker is a person who executes the trade on behalf of others, whereas a dealer is a person who trades business on their own behalf.

2. A dealer is a person who will buy and sell securities on their account. On the other hand, a broker is one who will buy and sell securities for their clients.

3. While dealers have all the rights and freedom regarding the buying and selling of securities, brokers seldom seldom have this freedom and these rights.

4. A broker has only a little experience in the field compared to dealers. It has also been seen that brokers become dealers once they get experience.

5. A broker is normally paid a commission for transacting the business. A dealer is not paid a commission, and he or she is a primary principal.

## American Depository Receipts (ADR)

An ADR is a receipt that has a number of foreign shares remaining on deposit with the U.S. depository’s custodian in the issuer’s home market. The bank is a transfer agent for the ADRs that are traded in the United States exchanges or in the OTC market.

ADRs offer various investment advantages. These advantages include −

* ADRs are denominated in dollars, trade on a US stock exchange, and can be purchased through the investor’s regular broker. This is easier than purchasing and trading in US stocks by entering the US exchanges.
* Dividends received on the shares are issued in dollars by the custodian and paid to the ADR investor, and a currency conversion is not required.
* ADR trades clear in three business days as do U.S. equities, whereas settlement of underlying stocks vary in other countries.
* ADR price quotes are in U.S. dollars.
* ADRs are registered securities and they offer protection of ownership rights. Most other underlying stocks are bearer securities.
* An ADR can be sold by trading the ADR to another investor in the US stock market, and shares can also be sold in the local stock market.
* ADRs frequently represent a set of underlying shares. This allows the ADR to trade in a price range meant for US investors.
* ADR owners can provide instructions to the depository bank to vote the rights.

There are two types of ADRs: **sponsored** and **unsponsored**.

* **Sponsored ADRs** are created by a bank after a request of the foreign company. The sponsoring bank offers lots of services, including investment information and the annual report translation. Sponsored ADRs are listed on the US stock markets. New ADR issues must be sponsored.
* **Unsponsored ADRs** are generally created on request of US investment banking firms without any direct participation of the foreign issuing firm.

**GDR**

**Meaning -** A global depositary receipt (GDR) is a bank certificate issued in more than one country for [shares](https://www.investopedia.com/terms/s/shares.asp) in a foreign company.

Each GDR represents a particular number of shares in a specific company. A single GDR can represent anywhere from a fraction of a share to multiple shares, depending on its design.

GDRs provide a lower-cost mechanism in which these investors can participate

 These shares trade as though they are domestic shares, but investors can purchase the shares in an international marketplace.

**EURO**

**Mening -** The **euro** ([sign](https://en.wikipedia.org/wiki/Currency_sign): [**€**](https://en.wikipedia.org/wiki/Euro_sign); [code](https://en.wikipedia.org/wiki/ISO_4217): **EUR**) is the official currency of 19 of the 28 [member states](https://en.wikipedia.org/wiki/Member_state_of_the_European_Union) of the [European Union](https://en.wikipedia.org/wiki/European_Union). This group of states is known as the [eurozone](https://en.wikipedia.org/wiki/Eurozone%22%20%5Co%20%22Eurozone) or euro area,

 The currency is also used officially by the [institutions of the European Union](https://en.wikipedia.org/wiki/Institutions_of_the_European_Union), by [four European microstates](https://en.wikipedia.org/wiki/International_status_and_usage_of_the_euro) that are not EU members

The euro is the second-largest [reserve currency](https://en.wikipedia.org/wiki/Reserve_currency) as well as the second-most traded currency in the world after the United States dollar

The euro is managed and administered by the [Frankfurt](https://en.wikipedia.org/wiki/Frankfurt)-based [European Central Bank](https://en.wikipedia.org/wiki/European_Central_Bank) (ECB) and the [Eurosystem](https://en.wikipedia.org/wiki/Eurosystem%22%20%5Co%20%22Eurosystem) (composed of the [central banks](https://en.wikipedia.org/wiki/Central_bank) of the eurozone countries).

The euro is divided into 100 [cents](https://en.wikipedia.org/wiki/Cent_%28currency%29) (also referred to as euro cents, especially when distinguishing them from other currencies, and referred to as such on the common side of all cent coins)

|  |  |  |
| --- | --- | --- |
| BASIS | ADR | GDR |
| Acronym  | American Depository Receipt | Global Depository Receipt |
| Meaning | ADR is a negotiable instrument issued by a US bank, representing non-US company stock, trading in the US stock exchange | GDR is a negotiable instrument issued by the international depository bank, representing foreign company's stock trading globally. |
| Relevance | Foreign companies can trade in US stock market. | Foreign companies can trade in any country's stock market other than the US stock market |
| Issued in | United States domestic capital market. | European capital market. |
| Listed in | American Stock Exchange such as NYSE or NASDAQ | Non-US Stock Exchange such as London Stock Exchange or Luxemberg Stock Exchange. |
| Negotiation | In America only. | All over the world. |
| Disclosure Requirement | Onerous | Less Onerous |
| Market | Retail investor market | Institutional market |

#### Terms

#### DEPOSITORY BANK

Located in the country of ADR issuance. The depository bank is the ultimate issuer of the DR’s on a local exchange.

#### CUSTODIAN BANK

Located in the country from where the shares have originated. The depository bank, sitting in the USA chooses the custodian bank.

#### BROKER

A broker undertakes to oversee the entire process from inception to issuance. He is usually located in the country of ADR issuance.

#### FOREIGN STOCK EXCHANGE

The exchange ultimately listing the ADR’s. (Here, NYSE)

Step 1

The US broker purchases the shares of foreign company through his international branch situated in there. He then has these shares delivered to the custodian bank

Step 2

The depository bank (USA) confirms the delivery and receipt of the underlying shares with the custodian bank. Its a signal from Custodian Bank to the depository bank that the shares are deposited with it and ADRs in lieu of them can now be issued.

Step 3:

ADRs are issued upon confirmation. A predetermined number of underlying shares are consolidated to constitute an ADR. The ADR ratio is decided upon after considering several economic factors including the existing exchange rate of foreign currency to USD as on that date.

Step 4 :

The broker receives the so formulated ADR’s. The broker is an intermediary between the foreign country and the American Exchange. He then proceeds to conclude the process of listing of the ADR’s on the NYSE.

MULTINATIONAL CASH MANAGEMENT

Trick – It is same as that of domestic cash management

Aim - minimizing the overall cash requirements of the firm as a whole without adversely affecting the smooth functioning of the entity.

How it is done – by the maximization of the firm’s financial resources is achieved by effectively receiving payments as fast as possible while taking advantage of all liability provisions, payable periods, which are low in cost.

Mechanism

**The international cash management techniques employed for the payments depend on whether the payment is to be associated with a related or unrelated third party**.

The primary conduit for cash management in each country is the utilization of local banking and cash management services

**The typical multinational firm possesses cash flows between the parent and its subsidiaries, the subsidiaries and their suppliers, the subsidiaries and their customers, and between subsidiaries themselves, all of which are generally processed through banking institutions. As part of the “**[Multinational Treasury and Cash Management](http://accounting-financial-tax.com/2009/06/multinational-treasury-and-cash-management/)**” post series, this post describes a detail overview of  Multinational Cash management**. Enjoy!

International Cash Management Goals

The theory of international cash management is the same as that of domestic cash management: the maximization of the firm’s financial resources is achieved by effectively receiving payments as fast as possible while taking advantage of all liability provisions, payable periods, which are low in cost.

There are two primary reasons why cash is transferred across national boundaries:

• First, for the payment for resources used such as materials, technology (fees), property rights (royalties), financing and debt service (principal and interest), or invested capital (dividends).

• The second reason is for the effective deployment or repositioning of funds in order to obtain higher rates of return, assure accessibility to funds, minimize currency risk, minimize total capital invested in working capital forms, and to minimize the global tax bill of the firm.

Mechanics of International Cash Management

The international cash management techniques employed for the payments depend on whether the payment is to be associated with a related or unrelated third party.

 The primary distinction arises from the ability of the parent to dictate or coordinate cash flow payment methods and timing between internal units, often without true market incentives (such as discounts), as opposed to third-party payments which are obviously less controllable.

The primary conduit for cash management in each country is the utilization of local banking and cash management services.

International treasury, either through a regional treasurer or through a representative of the parent company, would typically consider and evaluate any of the following potential techniques for the management of payments with unrelated parties:

• Timing of billing

• Use of lockboxes or intercept points

• Negotiated value dates

• DI and EFT avenues

• Same-day value basis transfers

**international cash management/banking activity might take one of two forms:**

* **CASH POOLING**

**It is a commingling of cash flows or balances between affiliate operations**.

Cash pooling can take a variety of forms, including notional pooling and zero balancing, each of which requires the establishment of a master account in each country over the individual affiliate accounts

How it is done - Notional pooling (also commonly referred to as interest compensation) is when interest charges are calculated on a notional pool of cash—the master account, although the individual balances are not intermixed. Individual balances are mathematically pooled for the calculation of master account interest expense/charges. Zero balancing refers to a structure in which funds are transferred from the subsidiary accounts each day to the master account in order to maintain an end-of-day zero-balance on the affiliate level. Although many treasurers prefer a structure in which no physical transfer is made, the notional pooling approach, both techniques are financially equivalent.

* **CASH CONCENTRATION**

**It is the establishment of a cross-border master account to which all individual foreign affiliates have access**

**Essentially the creation of an internal bank, the cash concentration account can be constructed to allow access to funds, and accept payment of funds, in a variety of currencies.**

**The reporting and monitoring system for global cash management should be designed to ensure that the firm, on a global basis, can hold overall cash balances to a minimum, avoid political and foreign exchange risk, minimize net interest expense, and minimize costs associated with transactions, bank float, and the general movement of funds**.

BARRIERS OF EFFECTIVE INTERNATIONAL CASH MANAGEMENT

* **Differences and discrepancies in national bank rules, regulations, and practices**
* **National restrictions on netting, leads and lags, and hedging practices**
* **Limited local banking services**
* **Few standards for pricing of banking services**
* **Chronic informational failures such as confirmation delays**
* **National differences in corporate payment practices and customs**

UNIT IV

INTERNATIONAL PORTFOLIO INVESTMENTS

Meaning - An international portfolio is a grouping of investment assets that focuses on securities from foreign markets rather than domestic ones

CERTAIN MERITS AND DEMERITS OF SUCH INVESTMENTS

Merits

* Risk diversifications
* Diversification through currency exposures – as  When investors buy stocks for their international portfolios, they are also effectively buying the currencies in which the stocks are quoted.
* Market cycle timing

Demerits

* Political and economic risks
* Increased transaction cost

FDI

 The International Monetary Fund's Balance of Payments Manual defines FDI as –

 "An investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor, the investor's purpose being to have an effective voice in the management of the enterprise".

**Prerequisites of FDI**

Basic prerequisites of FDI includes basically

1. Investing country – also known as Home Country in FDI terminology
2. Investee Country – Also known as Host Country in FDI terminology.
3. Favourable trade conditions and liberalisation in this respect from the sides of both the countries concerned.
4. Consensus –ad-idem of the countries concerned as regard to reaping the subjective benefit of the FDI project

**FDI Entry Structure in India**

India has outstretched the arms towards FDI and has cleared many structural level foundations for FDI in India , these are as follows –

#### (a.) EXTENSION OF FOREIGN ENTITY:

This is probably the most preferable mode for investor’s. Under this entry mode Liaison office, Branch office (BO) or Project Office (PO) etc are established by FDI investor in India. These offices can undertake only the activities specified by the RBI. Approvals are granted under the Government and RBI route. Automatic route is available to BO/PO upon meeting certain conditions.

####

#### (b) INCORPORATING A COMPANY IN INDIA:

It can be a private or public limited company as per Companies Act 2013. Both wholly owned & joint ventures are allowed.

####  (c) LIMITED LIABILITY PARTNERSHIPS:

Allowed under the Government route in sectors which falls under no cap restriction i.e. 100% FDI allowed under the automatic route and without any conditions.

####  (d) SOLE PROPRIETORSHIP/PARTNERSHIP FIRM:

Sole proprietorship and partnership are also allowed by raising capital through FDI. This route of entry is allowed under RBI approval i.e. RBI decides the application in consultation with Government of India.

#### (e)OTHER STRUCTURES:

Foreign investment or contributions in other structures like not for profit companies etc. are also allowed in India subject to provisions of Foreign Contribution Regulation Act (FCRA).

RECENT INITIATIVES FOR FDI PROMOTION BY INDIAN GOVERNMENT

* ”Investment Facilitation” policy of BRICS summit held in Johansburg held 24-27 July 2018
* Vibrant Gujarat Summit
* Make In India
* Japan-India Make-in-India Special Finance Facility
* Individual states local initiatives like "Make in Odisha", [Vibrant Gujarat](https://en.wikipedia.org/wiki/Vibrant_Gujarat), "Happening Haryana" and "Magnetic Maharashtra".
* E- Boz Project – This Project is monitored by DIPP and envisages at setting up G2Bportal to serve as a one-stop shop for delivery of convenient and efficient services and addresses the need of investors and businesses right from cradle to crown.

**Route of FDI in India**

Meaning - Route of investment refers to the way through which FDI can be directed towards designated country .

FDI in India can be done by two ways:-

**(a) Automatic Route –** Under thisroute of investment  Permission by Government or Reserve Bank of India is not required.

**(b) Government Route-** Under thisroute of investment Permission of Government is necessary.

**Laws governing FDI in India**

Specific Laws foverning FDI in India are as follows

1.The Foreign Exchange Management Act (1999)

2. FDI Policy

3.FDI Policy clarifications and circulars

**Restricted Sector of FDI in India**

These are the areas in which  FDI is not permitted at all. Such areas are as follows -

(i) Gambling and Betting activities.(e.g-casinos).
(ii) A business of chit fund, Nidhi company.
(iii) Prohibition on the making of cigars, cigarettes or any Tobacco substitute.
(iv) Agriculture activities( except Floriculture, Horticulture, Fisheries, Livestock (animal husbandry), Development of seeds, cultivation of vegetables & mushrooms, and allied activities.
(v) Activities reserved for the Public sector -Atomic energy, Railways, National security services.
(vi) Real estate business(except development of the town, housing, built of infrastructure and construction department projects) or construction of farmhouses.
(vi) Trading in transferable development projects.

CROSS BOARDER ACQUISITIONS

Meaning - **Cross border Mergers and Acquisitions or M&A are alignment deals between foreign companies and domestic firms in the target country**.

Such cross boarder M&A can be either friendly or hostile

Definition - The merger is the juridical (legal) act of two or more legal persons, whereby one acquires the property, rights and interests and the liabilities of the other by universal succession of title or whereby a new legal person, formed or incorporated by them jointly by such juridical (legal) act, acquires their property, rights and interests and the liabilities by general (universal) title.

Note – else self explainatory

MANAGEMENT OF ECONOMIC EXPOSURE

Economic exposure is a type of foreign exchange exposure caused by the effect of **unexpected currency fluctuations** on a company’s future cash flows, foreign investments, and earnings.

 It is also known as operating exposure. There are 2 strategies to manage such types of risks

OPERATIONAL STRATEGIES

* Diversifying product facilities and market for the products
* Sourcing flexibility - such as using substitutes in case of exchange rate fluctuations

CURRENCY RISK MITIGATION STRATEGIES

* Matching currency flows – eg if a European company has significant inflows in US dollars and is looking to raise debt, it should consider borrowing in US dollars.
* Currency risk sharing agreements – may include call put options trading or hedging
* Back to back loans – i.e. credit swap

MANAGEMENT OF TRANSACTION EXPOSURE

Firms face foreign exchange (FX) transaction exposure if they have accounts payable and/or receivable in foreign currencies.

Important

The danger of transaction exposure is typically one-sided.

Only the business that completes a transaction in a foreign currency may feel the vulnerability.

The entity that is receiving or paying a bill using its home currency is not subjected to the same risk.

|  |  |  |
| --- | --- | --- |
| **Point of Difference** | **Transaction Exposure** | **Economic Exposure** |
| CASH FLOW | Transaction exposure is driven by transactions which have already been contracted for and hence they are of short term nature. For example: if Company A, based in the US has already supplied goods worth $100 Mio to another Company B in the UK and has agreed to receive the payment in GBP, it has already undertaken transaction risk on cash flows | Economic exposure =(transaction + operating)exposure and is related to future cash flows These cash flows are not realised or contracted for and the exposure is more anticipatory in nature. Economic exposure can arise due to change in future sales, volume, pricing or cost profile. |
| NATURE OF RISK | limited to the contract or transaction under discussion | Risk associated impacts the core value of a business rather than one particular transaction or contract+risk to present value of future operating cash flows |
| IDENTIFICATION | Easy |  anticipatory nature + very hard |
| CAUSE AND SCOPE | Narrow as it arises only when you enter into a contract involving future receivables/payables in foreign currency.  | Wide as arise without having any transaction exposure |
| CHARACTERSTICS | technical + tactical  |  is linked to a firm’s strategy and hence is fundamental in nature |
| HEDGING APPLICATION | Quite frequent | Most firms seldom apply any [hedging](https://efinancemanagement.com/derivatives/hedging) strategy for managing economic exposure and believe in natural hedging |

MANAGEMENT OF TRANSLATION EXPOSURE

Meaning - risk of the value of a company’s assets, equities, income or liabilities changing due to fluctuations in exchange rates.

Translation exposure (also known as [translation risk](https://www.investopedia.com/terms/t/translationrisk.asp)) is the risk that a company's equities, assets, liabilities or income will change in value as a result of [exchange rate](https://www.investopedia.com/terms/e/exchangerate.asp) changes

Methods of measuring

**Current/Non Current Method**

CA and CL with 1 year maturity –convert @ current exchange rate

NON (CA and CL)- convert @ past exchange rate o.e. the record date of those assets or liabilities

Income – rate on booking date

Depreciation – rate prevailing on the date of charging them

Concept – CA > CL + appreciation in local currency = Translation Gain

**Monetary /Non Monetary method**

All monetary B/S items – @ current exchange rate

Non monetary B/S items - @rate on date of recording them

Concept – This method categorizes  accounts on the basis of similarities of attributes rather than maturities.

**Temporal Method**

All monetary accounts @ current exchange rates

Other accounts if carried at current value then current rate else @ historical rates

COGS and Depreciation @ historical exchange rate if their associated accounts were carried out at historical costs

**Current Rate Method**

Conversion = (All Balance Sheet items - stockholders equity ) @current exchange rate

P& L items @exchange rate on their respective recognition dates

## TRANSLATION EXPOSURE MANAGEMENT

The following are the ways to manage or hedge translation exposure:

### CURRENCY SWAPS

Currency swaps are a settlement between two entities to exchange cash flows denominated for a particular currency for a fixed time frame. Currency amounts are swapped for a predetermined period and interest is paid during that time span.

### CURRENCY OPTIONS

The Currency option gives the right to the party to exchange the amount of a particular currency at an agreed exchange rate. However, the party is not obligated to do so. Nevertheless, the transactions must be conducted on or before a set date in the future.

### FORWARD CONTRACTS

Under the forward contracts, two entities fix a specific exchange rate for the interchange of two currencies for a future date. The settlement for the agreed amount of currencies is conducted on the particular future date which is pre-decided.

**Economic vs.Transaction vs. Translation Exposure**

|  |  |  |  |
| --- | --- | --- | --- |
| **Basis** | **Economic Exposure** | **Transaction Exposure** | **Translation Exposure** |
| Duration | Life time of Project  | Duration of Contract only | At a particular point of time |
| Gain/Losses | Quite difficult to compute actual value | Relatively less difficult | Easy if concepts are clear |
| Contract | General in nature | Specific in nature | Specific in nature |
| Measurement | Value depends on variation in actual spot rates | Value depends on variation in actual spot rates | Value depends on the accounting guidelines |
| Hedging | Difficult | Relatively easy | Easy |
| Value calculated by  | MV of Assets | Contract value of assets and liabilities | BV of Assets and liabilities |
| Extent of Exposure | Guided by the factor and factor markets | Determined by the nature | Dependent on accounting rules |
| Management of exposure by | All departments | Treasury department | Treasury department |

FOREIGN TRADE CONTRACTS AND PROCEDURES

Basic Understanding

1. Make it in writing to prevent any misunderstanding.

### 2. What should be included in an international trade contract?

The contract should set out where the goods are being delivered. It should cover who is responsible for every stage of the journey, including customs clearance, and what insurance is required. It should also make it clear who pays for each different cost.

### 3. Include Incoterms

To avoid confusion, internationally agreed Incoterms should be used to spell out exactly what delivery terms are being agreed, such as:

* **where** the goods will be delivered
* who arranges **transport**
* who is responsible for insuring the goods, and who pays for **insurance**
* who handles **customs** procedures, and who pays any **duties and taxes**

### 4. Include payment details

As well as including delivery details, the contract should cover **payment**. This should include what currency payment will be made in, how much will be paid, when payment is due and what payment method will be used.

### IMPORTANT - Trade in services

With no physical delivery of the product, contracts in services cannot use Incoterms. Instead, the key issue tends to be defining exactly what services are being provided and to what standards

TYPES OF FOREIGN TRADE CONTRACTS

(i) Commodity contracts,

(ii) Service contracts,

(iii) Commodity cum technology contracts,

(iv) Technology contracts,

(v) Technical assistance contracts,

(vi) Agency contracts,

(vii) Machinery contracts,

(viii) Project contracts,

(ix) Long term contracts,

(x) Short term contracts,

(xi) Spot contracts,

(xii) Revolving contracts,

(xiii) Futures contracts,

(xiv) Licensing and sub licensing contracts,

Etc

Things to be considered in Foreign Trade Contracts

1. Parties to the contract

2. Nature of contract
3. **Prices and modes of payment**

**4. Modalities of transport**

**5. Modalities of delivery**

**6.** **Force majeure**

**7. Guarantees**

**8. Juridiction in case of legal dispute**

**9. Language**

**etc**

UNIT V

INCOTERMS i.e. International Commercial Contracts Terms-

These  are a set of rules which define the responsibilities of sellers and buyers for the delivery of goods under sales contracts.

This is a set of standardized three-letter codes for common international trade terminology (e.g. “DAT” stands for “Delivered at Terminal.”)

They were developed by the International Chamber of Commerce to help prevent misunderstandings in foreign trade.

Some eg of INCOTERMS

### Group 1. Incoterms that apply to any mode of transport are:

* EXW Ex Works
* FCA Free Carrier
* CPT Carriage Paid To
* CIP Carriage and Insurance Paid To
* DAT Delivered at Terminal
* DAP Delivered at Place
* DDP Delivered Duty Paid

##

### Group 2. Incoterms that apply to sea and inland waterway transport only:

* FAS Free Alongside Ship
* FOB Free on Board
* CFR Cost and Freight
* CIF Cost, Insurance, and Freight

## eCommerce Incoterms

Most [B2B ecommerce](https://www.export.gov/article?id=eCommerce-Definitions) agreements will use EXW, CPT, or CIF; most business-to-consumer (B2C) transactions will use CPT or CIF (and sometimes DDP). Except for DDP, the Incoterms mentioned above require the buyer to pay all tariffs and taxes upon arrival. To make sense of all these terms, you should take the tiame to understand their usage.

PURPOSE

The main purpose of Incoterms is to provide a **uniform, constant and authentic interpretation of the commercial terms of delivery of goods**, most frequently used in International transactions, and, by means of their application, removing any uncertainty due to divergent interpretations.

OTHER FEATURES of INCOTERMS – They :

* are **optional rules,**not laws;
* do not affect the transport contract, as they relate with the **sales contract;**
* do not concern the property transfer or any other sales right;
* do not govern all of the obligations undertaken by the parties of a sales contract, as they are confined to the **delivery of the goods**;
* do not concern the breach of the contract, with the relevant consequences for the party in breach.

ICC, i.e. the International Chamber of Commerce, grouped the obligations of the Seller and the Buyer in 10 points, marked by the “A”, for the Seller, and by the letter “B”, for the Buyer, so that each point (title) related with the Seller, under the letter “A”, matches with the position of the Buyer, under the letter “B”.

## Obligations of the parties under Incoterms 2010

|  |  |
| --- | --- |
| **Seller’s obligations** | **Buyer’s obligations** |
| **A 1.** Supply of the goods in conformity with the contract | **B 1.** Payment of the price. |
| **A 2.** License, authorization and formalities | **B 2.** License, authorization and formalities |
| **A 3.** Transport contract and insurance | **B 3.** Transport contract and insurance |
| **A 4.**Delivery | **B 4.**Take-over |
| **A 5.**Risk transfer | **B 5.**Risk transfer |
| **A 6.**Breakdown of fees | **B 6.**Breakdown of fees |
| **A 7.**Notice to the buyer | **B 7.**Notice to the buyer |
| **A 8.**Proof of delivery, transport document or any equivalent electronic message | **B 8.**Proof of delivery, transport document or any equivalent electronic message |
| **A 9.**Checking, packing, marking | **B 9.**Inspection of the go**ods** |
| **A 10.**Other obligations | **B 10.**Other obligations |

**COMPARE HEDGING OF TRANSACTION EXPOSURE USING FORWARD CONTRACT V/S MONEY MARKET INSTRUMENTS. WHEN DO ALTERNATIVE HEDGING APPROACHES PRODUCE SAME RESULT**

**LETTER OF CREDIT**

Also known as a **documentary credit** or **bankers commercial credit**, or **letter of undertaking** (**LoU**)

MEANING - A letter of credit is a letter from a bank guaranteeing that a buyer's payment to a seller will be received on time and for the correct amount. In the event that the buyer is unable to make a payment on the purchase, the bank will be required to cover the full or remaining amount of the purchase.

It is a [payment mechanism](https://en.wikipedia.org/wiki/Payment) used in [international trade](https://en.wikipedia.org/wiki/International_trade) to provide an

economic [guarantee](https://en.wikipedia.org/wiki/Guarantee) from a creditworthy [bank](https://en.wikipedia.org/wiki/Bank) to an exporter of goods / services.

MECHANISM - It is typically a negotiable instrument

Given by - the issuing bank

To - the beneficiary or any bank nominated by the beneficiary or in case if  a letter of credit is transferable, the beneficiary may assign another entity, such as a corporate parent or a third party, the right to draw.

Banks Charges/ Fees –a percentage of the size of letter of credit.

TERMINOLOGY OF LETTER OF CREDIT

* Applicant -  is the person or company who has requested the letter of credit to be issued; this will normally be the buyer.
* Beneficiary  - is the person or company who will be paid under the letter of credit; this will normally be the seller
* Issuing Bank  - is the bank that issues the credit, usually following a request from an Applicant.
* Nominated Bank  - is a bank mentioned within the letter of credit at which the credit is available.
* Advising Bank - is the bank that will inform the Beneficiary or their Nominated Bank of the credit, send the original credit to the Beneficiary or their Nominated Bank, and provide the Beneficiary or their Nominated Bank with any amendments to the letter of credit.
* Confirmation  - is an undertaking from a bank other than the issuing bank to pay the Beneficiary for a Complying Presentation, allowing the Beneficiary to further reduce payment risk, although Confirmation is usually at an extra cost.
* Confirming Bank -  is a bank other than the issuing bank that adds its confirmation to credit upon the issuing bank's authorization or request thus providing more security to beneficiary.
* Complying Presentation  - is a set of documents that meet with the requirements of the letter of credit and all of the rules relating to letters of credit.

### Documents That May Be Requested For Presentation

* **Financial documents** — [bill of exchange](https://en.wikipedia.org/wiki/Negotiable_instrument), co-accepted draft
* **Commercial documents** — [invoice](https://en.wikipedia.org/wiki/Invoice), [packing list](https://en.wikipedia.org/wiki/Shipping_list)
* **Shipping documents** — [bill of lading](https://en.wikipedia.org/wiki/Bill_of_lading) (ocean or multi-modal or charter party), airway bill, lorry/truck receipt, railway receipt, CMC other than mate receipt, forwarder cargo receipt
* **Official documents** — license, embassy legalization, origin certificate, inspection certificate, [phytosanitary certificate](https://en.wikipedia.org/wiki/Agreement_on_the_Application_of_Sanitary_and_Phytosanitary_Measures%22%20%5Co%20%22Agreement%20on%20the%20Application%20of%20Sanitary%20and%20Phytosanitary%20Measures)
* **Insurance documents** — insurance policy or certificate, but not a cover note

TYPES OF LETTER OF CREDIT

#### Commercial Letter of Credit

This is a direct payment method in which the issuing bank makes the payments to the beneficiary. In contrast, a [standby letter of credit](https://www.investopedia.com/terms/s/standbyletterofcredit.asp) is a secondary payment method in which the bank pays the beneficiary only when the holder cannot.

**Import/export:** — The same credit can be termed an import or export letter of credit depending on whose perspective is considered. For the importer it is termed an Import LC and for the exporter of goods, an Export LC

#### Revolving Letter of Credit

This kind of letter allows a customer to make any number of draws within a certain limit during a specific time period.

**Revocable/ Irrevocable:** — Whether a LC is revocable or irrevocable determines whether the buyer and the issuing bank are able to manipulate the LC or make corrections without informing or getting permissions from the seller. According to UCP 600, all LCs are irrevocable, hence in practice this type of LC increasingly obsolete. Any changes (amendment) or cancellation of the LC (except it is expired) is done by the applicant through the issuing bank. It must be authenticated and approved by the beneficiary.

#### Traveler's Letter of Credit

For those going abroad, this letter will guarantee that issuing banks will honor drafts made at certain foreign banks.

#### Confirmed Letter of Credit

A [confirmed letter of credit](https://www.investopedia.com/terms/c/confirmed-letter-credit.asp) involves a bank other than the issuing bank guaranteeing the letter of credit. The second bank is the confirming bank, typically the seller’s bank. The confirming bank ensures payment under the letter of credit if the holder and the issuing bank default. The issuing bank in international transactions typically requests this arrangement

**Restricted/ Unrestricted:** — Either the one advising bank can purchase a bill of exchange from the seller in the case of a restricted LC or; the confirmation bank is not specified, which means that the exporter can show the bill of exchange to any bank and receive a payment on an unrestricted LC.

**Deferred / Usance:** — A credit that is not paid/assigned immediately after presentation, but after an indicated period that is accepted by both buyer and seller. Typically, seller allows buyer to pay the required money after taking the related goods and selling them.

Additionally, a letter of credit may also have specific terms relating to the payment conditions which relate to the underlying reference documents. Some of these include

* **At Sight:** — A credit that the announcer bank immediately pays after inspecting the carriage documents from the seller.
* **Red Clause:** — Before sending the products, seller can take the pre-paid part of the money from the bank. The first part of the credit is to attract the attention of the accepting bank. The first time the credit is established by the assigner bank, is to gain the attention of the offered bank. The terms and conditions were typically written in red ink, thus the name.[[13]](https://en.wikipedia.org/wiki/Letter_of_credit#cite_note-13)
* **Back to Back**: — A pair of LCs in which one is to the benefit of a seller who is not able to provide the corresponding goods for unspecified reasons. In that event, a second credit is opened for another seller to provide the desired goods. Back-to-back is issued to facilitate intermediary trade. Intermediate companies such as trading houses are sometimes required to open LCs for a supplier and receive Export LCs from buyer.
* **Standby Letter of Credit:** — Operates like a Commercial Letter of Credit, except that typically it is retained as a "standby" instead of being the intended payment mechanism. In other words, this is a LC which is intended to provide a source of payment in the event of non-performance of contract. This is a security against an obligation which is not performed. If you present the bank with demands of non-payment it is not a guarantee - trigger isn't non-payment - it is presented by documentation.[[14]](https://en.wikipedia.org/wiki/Letter_of_credit#cite_note-14) UCP600 article 1 provides that the UCP applies to Standbys; [ISP98](https://en.wikipedia.org/wiki/Institute_of_International_Banking_Law_%26_Practice) applies specifically to Standby letters of Credit; and the United Nations Convention on Independent Guarantees and Standby Letters of Credit[[15]](https://en.wikipedia.org/wiki/Letter_of_credit#cite_note-15) applies to a small number of countries that have ratified the Convention.

OPERATION OF LETTER OF CREDIT/ PROCESS OF OBTAINING LETTER OF CREDIT

1. after a [sales contract](https://en.wikipedia.org/wiki/Sales_contract) parties to the contract come to an agreement to cover the payment under letter of credit.

2. Applicant will contact a bank to ask for a letter of credit to be issued

3. issuing bank assesses the buyer's credit risk – i.e. that the Applicant will be able to pay for the goods – it will issue the letter of credit

4. Once the Beneficiary (the seller) receives the letter of credit, it will check the terms to ensure that it matches with the contract and will either arrange for shipment of the goods or ask for an amendment to the letter of credit so that it meets with the terms of the contract.

Note - The letter of credit is limited in terms of time, the validity of credit, the last date of shipment, and in terms of how much late after shipment the documents may be presented to the Nominated Bank.

5. Once the goods have been shipped, the Beneficiary will present the requested documents to the Nominated Bank.

6. Nominated Bank will check the documents, and if they comply with the terms of the Letter of Credit, the issuing Bank is bound to honor the terms of the letter of credit by paying the Beneficiary.

7. If the documents do not comply with the terms of the letter of credit they are considered **Discrepant**.

At this point,

the Nominated Bank will inform the Beneficiary of the discrepancy and offer a number of options depending on the circumstances after consent of applicant.

However, such a discrepancy must be more than trivial. Refusal cannot depend on anything other than reasonable examination of the documents themselves. The bank then must rely on the fact that there was, in fact, a material mistake.

Note - A wrong date such as an early delivery date was held by English courts to not be a material mistakes. If the discrepancies are minor, it may be possible to present corrected documents to the bank to make the presentation compliant. Failure of the bank to pay is grounds for a chose in action. Documents presented after the time limits mentioned in the credit, however, are considered discrepant.

If the corrected documents cannot be supplied in time, the documents may be forwarded directly to the issuing bank "in trust"; effectively in the hope that the Applicant will accept the documents. Documents forwarded in trust remove the payment security of a letter of credit so this route must only be used as a last resort.

Some banks will offer to "Telex for Approval" or similar services. This is where the Nominated Bank holds the documents, but sends a message to the Issuing Bank asking if discrepancies are acceptable. This is more secure than sending documents in trust.

EXPORT – IMPORT BANK OF INDIA – EXIM

Nature -  a finance institution in India.  It is the principal financial institution in India for foreign and international trade. It was previously a branch of the IDBI, but as the foreign trade sector grew, it was made into an independent body.

Established – 1982  under Export-Import Bank of India Act 1981.

Organization of EXIM Bank

Exim Bank is managed by a Board of Directors, which has representatives from the Government, [Reserve Bank of India](https://en.wikipedia.org/wiki/Reserve_Bank_of_India), [Export Credit Guarantee Corporation of India](https://en.wikipedia.org/wiki/Export_Credit_Guarantee_Corporation_of_India), a [financial institution](https://en.wikipedia.org/wiki/Financial_institution), [public sector](https://en.wikipedia.org/wiki/Public_sector) banks, and the business community.

**The Bank's functions are segmented into several operating groups including:**

* Corporate Banking Group which handles a variety of financing programmes for [Export Oriented Units](https://en.wikipedia.org/wiki/Export-oriented) (EOUs), [Importers](https://en.wikipedia.org/wiki/Importer), and overseas investment by Indian companies.
* Project Finance / Trade Finance Group handles the entire range of export credit services such as supplier's credit, pre-shipment Agriculture Business Group, to spearhead the initiative to promote and support Agricultural exports. The Group handles projects and export transactions in the [agricultural sector](https://en.wikipedia.org/wiki/Agricultural_sector) for financing.
* Small and Medium Enterprise: EXIM Bank India handles credit proposals from SMEs under various lending programmes of the Bank.
* Export Services Group offers variety of advisory and value-added information services aimed at investment promotion.
* Export Marketing Services Bank offers assistance to Indian companies, to enable them establish their [products](https://en.wikipedia.org/wiki/Product_%28business%29) in overseas markets. The idea behind this service is to promote Indian export. Export Marketing Services covers wide range of export oriented companies and organizations. EMS group also covers Project exports and Export of Services.
* Besides these, the Support Services groups, which include: Research & Planning, Treasury and Accounts, Loan Administration, Internal Audit, Management Information Services, Information Technology, Legal, Human Resources Management and Corporate Communications.

OTHER FUNCTONS AND FACILITIES OF EIM BANKS

(i) It provides direct financial assistance to exporters of plant, machinery and related service in the form of medium-term credit.

(ii) Underwriting the issue of shares, stocks, bonds, debentures of any company engaged in exports.

(iii) It provides rediscount of export bills for a period not exceeding 90 days against short-term usance export bills discounted by commercial banks.

(iv) The bank gives overseas buyers credit to foreign importers for import of Indian capital goods and related services.

(v) Developing and financing export oriented industries.

(vi)Collecting and compiling the market and credit information about foreign trade.

EXPORT CREDIT INSURANCE

**Export credit insurance** is a policy offered by both government **export credit** agencies and private entities to businesses that want to protect assets from the **credit** risks of importers. These risks include non-payment, currency issues and political unrest.

Risks covered are - non-payment, currency issues and political unrest

In other words it is the strategy to mitigate the risk of non payments associated with the foreign trade.

Coverage

Short-term ECI, which provides 90 to 95 % coverage against commercial and political risks that result in buyer payment defaults, typically covers

(a) consumer goods, materials, and services up to 180 days, and

 (b) small capital goods, consumer durables, and bulk commodities up to 360 days.

Medium-term ECI, which provides 85 % coverage of the net contract value, usually covers large capital equipment up to 5 years. ECI, the cost of which is often incorporated into the selling price by exporters, should be a proactive purchase, in that exporters should obtain coverage before a customer becomes a problem.

MERITS

1. **Expand Into New Markets**Expand into [new markets](https://grow.exim.gov/blog/export-and-enter-new-markets-using-medium-term-credit-insurance) confidently knowing that — should a foreign customer default — your business will be compensated up to 95 percent of your foreign invoice.
2. **Boost Sales with Existing Customers**Many exporters have existing customers that would buy more with an extension of credit terms, or an increase in the credit line offered. A safety net for business’ foreign receivables allows it to seize opportunities and increase sales.
3. **Unlock More Attractive Financing**Banks are hesitant to lend money against export-related assets. With credit insurance, your bank will likely be more willing to lend against foreign accounts receivable, knowing that they are backed by the full faith and credit of the U.S. government.
4. **Transfer the Burden of Credit Management**As an exporter, you’ve got enough on your plate. The one thing you don’t have is time. Export credit insurance can help by easing the burden of credit risk management and allowing you to focus on what you do best. A relationship with the Export-Import Bank (EXIM) and its credit management expertise can improve receivables management from buyer assessment to protection to collection. EXIM’s Express policy even includes complimentary foreign buyer credit reports.
5. **Realize Tax Benefits**When doing business, your financial department needs to account for a loss reserve. Purchasing export credit insurance, your business can reduce its loss reserve knowing it will be compensated for foreign customer nonpayment and, in turn, lower your business’ overall tax burden since the premiums paid for export credit insurance are tax deductible..

**EXIM ELIGIBILITY ANND REGULATIONS**

Buyer's Credit is EXIM banks unique credit facility programme that motivates Indian exporters to explore new geographies. Through this programme, the overseas buyer can open a "letter of credit" in favour of the Indian exporter and can import goods and services from India on deferred payment terms.

Salient features

* Facilitates exports for SMEs by providing credit to overseas buyer to import goods from India
* Offered for financing capital goods or services on deferred payment terms
* Provides non-recourse finance to Indian exporters by converting deferred credit contract into cash contract
* Extended as advance payments to Indian exporters on behalf of the overseas buyer
* Can be a transaction specific financing or a revolving/renewable limit
* Can be extended to more than one overseas subsidiaries of any Indian company
* Since it is a non-LC transactions, it saves LC charges

Benefits to foreign customers

* Medium and long-term financing facilities for smooth execution of projects
* Competitive and attractive rates of interest available against host country's high borrowing cost

Eligibility

* Buyer's credit is extended to a foreign project company that intends to award the project execution to an Indian project exporter.
* The financing will be available to all kinds of projects and service exports from India.
* The facility is available for development, upgrading or expansion of infrastructure facilities; financing of public or private projects such as plants and buildings; professional services such as surveyors, architecture, consultations, etc.

**SOME TERMS**

**Strike price**. In finance, the **strike price** (or exercise **price**) of an **option** is the fixed **price** at which the owner of the **option** can buy (in the case of a call), or sell (in the case of a put), the underlying security or commodity.

Call OPTION

In the money = Strike Price <Current Price

AT the money = Strike Price = Current Price

Out of the money =Strike Price >Current Price

Reverse for PUT Option

The **straddle option** is a neutral strategy in which you simultaneously buy a call **option** and a put **option** on the same underlying stock with the same expiration date and strike price.

A trader will profit from a long straddle when the price of the security rises or falls from the strike price by an amount more than the total cost of the [premium](https://www.investopedia.com/terms/p/premium.asp) paid.

Strangle -  investor holds a position in both a [call](https://www.investopedia.com/terms/c/call.asp) and a [put](https://www.investopedia.com/terms/p/put.asp) option with different [strike prices](https://www.investopedia.com/terms/s/strikeprice.asp), but with the same expiration date and underlying asset. A strangle is a good strategy if you think the underlying security will experience a large price movement in the near future but are unsure of the direction.

A **strip** is an **option strategy** that involves the purchase of two put **options** and one call **option** all with the same expiration date and strike price. It can also be described as adding a put **option** to a straddle. Like straddles, **strips** attempt to capitalize on large price movements of an underlying stock. IT IS A BEARISH MARKET STRATEGY

1. Buy 1 No. \* ATM Call
2. Buy 2 Nos. \* ATM Put

STRAP – its like straddle – IT  IS A “BULLISH” MARKET NEUTRAL STRATEGY

1. Buy 2 ATM (at-the-money) call options
2. Buy 1 ATM (at-the-money) put option

All three options should be bought on the same underlying security, at the same [strike price](https://www.investopedia.com/terms/s/strikeprice.asp) and expiration date.

Secondary Market  also called the **aftermarket** and **follow on public offering**

**Meaning – It is** the [financial market](https://en.wikipedia.org/wiki/Financial_markets) in which previously issued [financial instruments](https://en.wikipedia.org/wiki/Financial_instruments) such as [stock](https://en.wikipedia.org/wiki/Stock), [bonds](https://en.wikipedia.org/wiki/Bond_%28finance%29), [options](https://en.wikipedia.org/wiki/Option_%28finance%29), and [futures](https://en.wikipedia.org/wiki/Futures_contract) are bought and sold

The national exchanges, such as the [New York Stock Exchange](https://www.investopedia.com/terms/n/nyse.asp) (NYSE) and the [NASDAQ](https://www.investopedia.com/terms/n/nasdaq.asp) are the felicitator of secondary market

DISTINGUISH BETWEEN CURRENCY FORWARD AND CURRENCY FUTURE

|  |  |  |
| --- | --- | --- |
| BASIS | FORWARD CONTRACT | FUTURES CONTRACT |
| Meaning | Forward Contract is an agreement between parties to buy and sell the underlying asset at a specified date and agreed rate in future. | A contract in which the parties agree to exchange the asset for cash at a fixed price and at a future specified date, is known as future contract. |
| What is it? | It is a tailor made contract. | It is a standardized contract. |
| Traded on | Over the counter, i.e. there is no secondary market. | Organized stock exchange. |
| Settlement | On maturity date. |  On a daily basis. |
| Risk | High | Low |
| Default | As they are private agreement, the chances of default are relatively high. | No such probability. |
| Size of contract | Depends on the contract terms. | Fixed |
| Collateral | Not required | Initial margin required. |
| Maturity | As per the terms of contract. | Predetermined date |
| Regulation | Self regulated | By stock exchange |
| Liquidity | Low | High |

TECHNICAL FORCASTING OF FOREIGN EXCHANGE RATES

Fundamental Approach of forex forecasting

* The fundamental approach is based on a wide range of data regarded as fundamental economic variables that determine exchange rates.
* These fundamental economic variables are taken from economic models.
* Usually included variables are GNP, consumption, trade balance, inflation rates, interest rates, unemployment, productivity indexes, etc.
* In general, the fundamental forecast is based on structural (equilibrium) models.
* These structural models are then modified to take into account statistical characteristics of the data and the experience of the forecasters. It is a mixture of art and science.

TECHNICAL APPROACH FOR FOREX FORECASTING

 There are three basic ways for technical interpretation of foreign exchange rates :

### 1. Purchasing Power Parity-

* Most popular
* This approach is based on – no arbitrage concept
* forecasts that the exchange rate will change to offset [price changes](https://www.investopedia.com/terms/p/price-change.asp) due to [inflation](https://www.investopedia.com/terms/i/inflation.asp) based on this underlying principle.
* Practical example –
* suppose that prices of pencils in the U.S. are expected to increase by 4% over the next year while prices in Canada are expected to rise by only 2%. The inflation differential between the two countries is:
* \begin{aligned} &4\% - 2\% = 2\% \\ \end{aligned}​4%−2%=2%​﻿

This means that prices of pencils in the U.S. are expected to rise faster relative to prices in Canada.

In this situation, the purchasing power parity approach would forecast that the U.S. dollar would have to depreciate by approximately 2% to keep pencil prices between both countries relatively equal.

So if US$=CA 0.90 this forecast will give price as follows:

(1+0.02)×(US $0.90 per CA $1)=US $0.92 per CA $1

### 2. Relative Economic Strength

* Theme of this approach – This is based on the idea that a strong economic environment and potentially high growth is more likely to attract investments from foreign investors

And

 in order to purchase investments in the desired country, an investor would have to purchase the country's currency – creating increased demand that should cause the currency to appreciate.

* Note - The relative economic strength method doesn't forecast what the exchange rate should be, unlike the PPP approach
* Then -  this approach gives the investor a general sense of whether a currency is going to appreciate or depreciate and an overall feel for the strength of the movement.

### 3. Econometric Models of Forecasting Exchange Rates

* Involves gathering factors that you believe affect currency movements and creating a model that relates these factors to the exchange rate.
* This method is flexible to be used

OTHER TECHNICAL MODELS ARE AS FOLLOWS

Filter Models

* Working - It is based on the finding that asset prices show significant small autocorrelations.
* If price increases tend to be followed by increases and price decreases tend to be followed by decreases, trading signals can be used to profit from this autocorrelation.

Momentum Models

* Momentum models determine the strength of an asset by examining the change in velocity of the movements of asset prices.
* If an asset price climbs at significant increasing speed, a buy signal is issued

Newer Models

* These models monitor the derivative (slope) of a time series graph. Signals are generated when the slope varies significantly.
* There is a great deal of discretionary judgement in these models.

FOREIGN EXCHAGE MARKET AND ITS PARTICIPANTS

**Participants in Foreign Exchange Market:**

#### **1. Commercial Banks:** These banks serve their retail clients, the bank customers, in conducting foreign commerce or making international investment in financial assets that require foreign exchange.

These banks operate in the foreign exchange market at two levels.

a. At the retail level, they deal with their customers-corporations, exporters and so forth.

b. At the wholesale level, banks maintain an inert bank market in foreign exchange either directly or through specialized foreign exchange brokers.

#### **2. Foreign Exchange Brokers:**

They act as agents who facilitate trading between dealers.

Note : Unlike the banks, brokers serve merely as matchmakers and do not put their own money at risk.

#### **3. Central banks:**

Central banks frequently intervene in the market to maintain the exchange rates of their currencies within a desired range and to smooth fluctuations within that range.

#### **4. MNCs:**

MNCs are the major non-bank participants in the forward market as they exchange cash flows associated with their multinational operations. The major contracts played by them in this market covers forward, future and currency swaps

#### **5. Individuals and Small Businesses:**

**Segments of Foreign Exchange Market:**

#### 1. Spot Market

#### 2. **Forward Market**

TOOLS USED IN INTERNATIONAL BOND MARKET

Meaning - 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.

TYPES OF INTERNATIONAL BONDS

* [Corporate](https://en.wikipedia.org/wiki/Corporate_bond)
* Government and agency
* [Municipal](https://en.wikipedia.org/wiki/Municipal_bond)
* [Mortgage-backed](https://en.wikipedia.org/wiki/Mortgage-backed_security), asset-backed, and [collateralized debt obligations](https://en.wikipedia.org/wiki/Collateralized_debt_obligation)
* Funding

Participants include:

* [Institutional investors](https://en.wikipedia.org/wiki/Institutional_investor)
* Governments
* [Traders](https://en.wikipedia.org/wiki/Trader_%28finance%29)
* Individual

INSTRUMENTS IN INTERNATIONAL BOND MARKET

1. Straight fixed rate bonds or vanilla bonds-they come with specified coupon rate, maturity and no options attached

They pay regular fixed interest rates over fixed period of time and return principal at the maturity and are usually annual in nature.

2.Floating Rate Noted – in them interest rate is tied to some referece rate eg – LIBOR or EURIBOR etc.

Their rate gets revised every 3 or 5 months and premium or discount is usually small

3. Zero Coupon Bonds – They don’t carry any coupon and are sold at significant discount with eventual redemption value.

4. Equity Related Bond – They are again of 2 types

a. Convertible Bonds – It allows the investor to exchange the bond for a predetermined no. Of ES which is usually at premium

b. Bonds with Equity Warrants – They allow the holder to keep his bond but still buy a specified no. Of shares in the firm of the issuer at a specified price or in simple words they have fixed interest rate with the call option .

5. Dual Currency Bonds – Bonds where principal payments are in one currency while coupon payments are in another currency.

6. Composite currency bonds or cocktail bonds– It is a basket or portfolio of some currencies

HIGHLIGHT THE IMPACT OF VARIOUS INVESTMENT CONSTRAINTS ON BENEFIT AND ASSET ALLOCATION OF INTERNATIONAL OPTIMAL PORTFOLIO FOR DOMESTIC INVESTORS IN VARIOUS COUNTRIES

Here you just need to write the benefit of cross country diversification of portfolio .

GOALS OF MNC

* Market Dominance
* Expansion
* DiversificationMarket Dominance
* Expansion
* Diversification
* Innovation
* Cost Advantage
* Wealth maxmization of share holders

SIGNIFICANCE OF INTERNATIONAL CASH MANAGEMENT FOR GLOBAL MARKET

* To improve profitability
* Reduce all types of risks associated with it
* Eliminate dead currency
* Better utilization of funds
* Currency Exposure and hedging thereto

INTEREST RATE PARITY THEORY

Meaning - Interest rate parity (IRP) is a theory in which the [interest rate differential](https://www.investopedia.com/terms/i/interest-rate-differential.asp) between two countries is equal to the differential between the forward exchange rate and the [spot exchange rate](https://www.investopedia.com/terms/s/spotexchangerate.asp).

Or say

(Interest rate of Country A - Interest rate of Country B )= (Forward exchange rate – Spot Exchange Rate)

Formulae

F0​ = S0​×(​1+ic​​)

 (1+ib)

Where

F0 = Forward Rate

So = Spot Rate

ic=Interest Rate Of Country C ​​

ib = Interest Rate Of Country B

Note **:** The difference between the forward rate and spot rate is known as swap points.If this difference (forward rate minus spot rate) is positive, it is known as a forward premium; a negative difference is termed a forward discount.

PURCHASING POWER PARITY (BOTH ABSOLUTE AND RELATIVE VERSION)

 PPP is an economic theory that compares different countries' currencies through a "basket of goods" approach.

According to this concept, two currencies are in equilibrium—known as the currencies being [at par](https://www.investopedia.com/terms/a/at-par.asp)—when a basket of goods is priced the same in both countries, taking into account the exchange rates. In other words  when a country’s inflation rate rises relative to that of the other country, the former’s currency is expected to depreciate

Formulae

S=P2

 ​P1​​
Where

S = Exchange rate of currency 1 to currency 2

P1​= Cost of good X in currency 1

P2​= Cost of good X in currency 2​
Types of PPP

THE ABSOLUTE PPP

* is similar to the Law of One Price
* means that the prices of the same products in different countries should be equal when they’re measured in a common currency.
* Formulae:
* 

THE RELATIVE PPP

* states there is a correlation between price-level changes between two countries and currency exchange rates
* Relative PPPP maintains that though the price for the same item varies in different countries, the **percentage of the difference** is relatively the same over a longer period

|  |  |  |  |
| --- | --- | --- | --- |
| BASIS | APPP | RPPP | IPP |
| Applicability | Only in situations in which consumer purchases the exact same basket of goods in both the foreign and domestic markets | Only in situations in which consumer purchases the exact same basket of goods in both the foreign and domestic markets | No such requirement |
| Concept | Price of same items in one country will remain relatively same in the equivalent currency of other country  | Price of same items in two countries may vary but percentage change remains same | % change in forward and spot rates = % change in interest rate of these countries |
| Based on  | Spot Prices | Spot Prices | Both forward and Spot Prices |

Note : If the exchange rate changes satisfy PPP competitive positions of the countries remain unaffected following exchange rate changes.

PPP is useful in predicting exchange rates on long term basis since it is a time consuming process

CAUSES OF DEVIATIONS FROM PURCHASING POWER PARITY

* Barriers in international integration
* Trade barriers and Non Traded goods
* Taxation effect
* Political imbalances
* Range and quality of goods
* Differences in price level measurement
* Global Poverty line

EXTERNAL EXPOSURE MANAGEMENT TECHNIQUES USED BY IMPORTER AND EXPORTER

* Future
* Forward
* Hedge
* Adjusting , roll over and early delivery of forward contracts
* Options

FACTORING V/S REVERSE FACTORING

|  |  |  |  |
| --- | --- | --- | --- |
| **BASIS** | **trade discount** | **factoring** | **reverse factoring** |
| **Eligibility** | all invoices | all invoices | validated invoices |
| **Financement** | at the ordering party initiative | at the supplier’s initiative | at the ordering party initiative |
| **Sum financed** | 100% of the invoice (-discount) | part of the invoice | part of the invoice |
| **Interest rate** | depends on the supplier’s situation | depends on the supplier’s situation | depends on the ordering party’s situation |
| **Payment** | immediate | due date | due date |
| **Impact on the Need Working Cash** | negative | none | none |
| **Financial interests** | value of the discount (but involves cash outflow) | none | percentage of the discount |
| **Deployment to other suppliers** | slow (adaptation to each supplier) | none | fast |

| **BASIS FOR COMPARISON** | **FACTORING** | **FORFAITING** |
| --- | --- | --- |
| Meaning | Factoring is an arrangement that converts your receivables into ready cash and you don't need to wait for the payment of receivables at a future date. | Forfaiting implies a transaction in which the forfaiter purchases claims from the exporter in return for cash payment. |
| Maturity of receivables | Involves account receivables of short maturities. | Involves account receivables of medium to long term maturities. |
| Goods | Trade receivables on ordinary goods. | Trade receivables on capital goods. |
| Finance up to | 80-90% | 100% |
| Type | Recourse or Non-recourse | Non-recourse |
| Cost | Cost of factoring borne by the seller (client). | Cost of forfaiting borne by the overseas buyer. |
| Negotiable Instrument | Does not deals in negotiable instrument. | Involves dealing in negotiable instrument. |
| Secondary market | No | Yes |

EQUILIBRIUM EXCHANGE RATE

Definition - The [exchange rate](http://www.investorwords.com/1806/exchange_rate.html) at which the [supply](http://www.investorwords.com/4822/supply.html) for a currency [meets](http://www.investorwords.com/10302/meet.html) the [demand](http://www.investorwords.com/1396/demand.html) of the [same](http://www.investorwords.com/10993/same.html) currency. As [foreign exchange rates](http://www.investorwords.com/2044/foreign_exchange_rate.html) are affected by a [number](http://www.investorwords.com/10438/number.html) of [factors](http://www.investorwords.com/1872/factor.html), the [equilibrium](http://www.investorwords.com/1722/equilibrium.html) exchange rate in [turn](http://www.investorwords.com/11363/turn.html), are also influenced by its [supply and demand](http://www.investorwords.com/12668/supply_and_demand.html). Hence equilibrium is achieved when a [currency's](http://www.investorwords.com/1240/currency.html) demand is equal to its supply.

FACTORS TO BE CONSIDERED IN CROSS BOARDER MERGERS AND ACQUISITIONS

* Proper Management
* Cultural Integration
* Business Policies
* Taxation
* General Business conditions in the destination

OBJECTIVE OF INTERNATIONAL PORTFOLIO MANAGEMET

* Stable Return
* Marketability
* Tax Planning
* Appreciation in the value of capital
* Liquidity
* Safety

EPCG

* **EPCG** means, Export Promotion Capital Goods. **EPCG is** one **of** the schemes provided by government **of** India to importers and exporters to promote exports.
* **EPCG is** a scheme related to machinery, machinery parts and similar goods.
* basic purpose - to allow exporters to import machinery and equipment at affordable prices(at nil/concessional rate of Customs duty) so that they can produce quality products for the export market
* Applicant - Manufacturer exporters with or without supporting manufacturer(s), merchant exporters tied to supporting manufacturer(s) and service providers are eligible under the EPCG scheme. EPCG scheme also covers Common Service Provider (CSP).
* Export obligation of this scheme- This scheme gives benefit on import subject to condition –

a.  export obligation equivalent to six times of duty saved, to be fulfilled in 6 years reckoned from date of issue of EPCG authorisation

b. I n case, EPCG authorisation holder fails to fulfil prescribed export obligation, the importer is required to pay customs duties plus interest as prescribed by Customs authority.

Note - Export obligation can be fullfilled by the EPCG authorisation holder through export of goods which are manufactured by him or his supporting manufacturer/services rendered by him, for which EPCG authorisation has been granted.

EOU

* Meaning - Export oriented units are units undertaking to export their entire production of goods.
* Eligibility - For being accorded the status of EOU –

a. the project must have a minimum investment of Rs.1 crore in plant and machinery. This condition does not apply for software technology parts, electronics hardware technology parks and bio-technology parks.

b. EOU involved in handicrafts, agriculture, animal husbandry, information technology, services, brass hardware and handmade jewellery do not have any minimum investment criteria.

* Benefits of EOU
* EOUs are allowed to procure raw material or capital good duty free, either through import or through domestic sources;
* EOUs are eligible for reimbursement of [**GST**](https://www.indiafilings.com/gst-portal/);
* EOUs are eligible for reimbursement of duty paid on fuels procured from domestic oil companies;
* EOUs are eligible for claiming [**input tax credit**](https://www.indiafilings.com/learn/gst-input-tax-credit/) on the goods and services and refund thereof;
* Fast track clearance facilities;
* Exemption from industrial licensing for manufacture of items reserved for SSI sector

Foreign BILL OF EXCHANGE

Meaning - a written order to a person requiring them to make a specified payment to the signatory or to a named payee; a promissory note

A foreign [bill of exchange](https://thelawdictionary.org/bill-of-exchange/) drawn in one state or country, upon a foreign state or country.

MAJOR REASONS BEHIND BOP IMBALANCE

**(i) Economic Factors:**

(a) Imbalance between exports and imports. (It is the main cause of disequilibrium in BOR),

(b) Large scale development expenditure which causes large imports,

 (c) High domestic prices which lead to imports,

(d) Cyclical fluctuations (like recession or depression) in general business activity,

(e) New sources of supply and new substitutes.

**(ii) Political Factors:**

Experience shows that political instability and disturbances cause large capital outflows and hinder Inflows of foreign capital.

**(iii) Social Factors:**

(a) Changes in fashions, tastes and preferences of the people bring disequilibrium in BOP by influencing imports and exports;

(b) High population growth in poor countries adversely affects their BOP because it increases the needs of the countries for imports and decreases their capacity to export.

#### 2. Measures to correct disequilibrium in BOP:

#### i) Export promotion:

**(ii) Import**

**(iii) Reducing inflation: EG -** Government may control foreign exchange by ordering all exporters to surrender their foreign exchange to the central bank and then ration out among licensed importers

**(iv) Exchange control**

**(v) Devaluation of domestic currency : if currency is having fixed exchange rate system**

**(vi) Depreciation: if currency is free float**

DO MULTINATIONAL EXPORT JOBS? HOW DOES IT EFFECT WAGES

RANDOM WALK MODEL FOR EXCHANGE RATE FORECASTING

Random walk model suggests that changes in forex rates have the same distribution and are independent of each other. Therefore, it assumes the past movement or [trend](https://www.investopedia.com/terms/t/trend.asp) of a stock price or market cannot be used to predict its future movement. In short, random walk theory proclaims that currency take a random and unpredictable path that makes all methods of predicting forex rates futile in the long run.

This theory believes it's impossible to outperform the market without assuming additional risk.

What effects the rate here  is the occurrence of an event determined by a series of random movements. Since the magnitude of dynamics in forex market is far deep this is the apt model for forex rates forecasting.

CONDITIONS UNDER WHICH FOREIGN EXCHANGE RATE WILL BE AN UNBIASED PREDICTOR OF FUTURE SPOT EXCHANGE RATE

The forward exchange rate will be an unbiased predictor of the future spot rate if

(I) the risk premium is insignificant and

(ii) foreign exchange markets are informationally efficient.

HEDGING MARKET RISK IN INTERNATIONAL MARKET

CROSS BORDER EQUITY FLOWS

It refers to taking the ownership stake cross boarders.

HOW DO MNC RESPOND TO BARRIER OF TRADE AND TAX AND INVESTMENT INCENTIVE

Self explainatory – tell me if explaination required

TYPES OF INSTRUMENTS IN EURO BOND MARKET

IMPACT OF FED RATE HIGH ON INDIAN ECONOMY

Sharp increases in interest rates may hurt businesses they lead to higher borrowing costs, but gradual increases may point to positive trends in the overall economy.

However, some sectors do benefit from interest rate hikes. One sector that tends to benefit most is the financial industry. Banks, brokerages, mortgage companies, and insurance companies' earnings often increase as interest rates move higher because they charge more for lending.

Changes in interest rates can create opportunities for investors. To be able to take advantage or to hedge against these swings in interest rates you would need an investment account through a broker.

When the Fed raises the federal funds rate, newly offered [government securities](https://www.investopedia.com/terms/g/governmentsecurity.asp), such as Treasury bills and bonds, are often viewed as the safest investments and will usually experience a corresponding increase in interest rates.

VARIOUS ACCOUNTS OF BOP AND IDENTITY OF BOP

Notes – identity refers to the favourable or adverse nature of BOP

CENTRALIZED MNC MANAGEMENT V/S DECENTRALIZED MNC MANAGEMENT

Self explanatory – tell me if required

WHY HOST COUNTRY TENDS O RESIST CROSS BORDER ACQUISITIONS RATHER THAN GREENFIELD INVESTMENTS

Note - a **greenfield investment** (GI) refers to a type of foreign direct **investment** (FDI) where a company establishes operations in a foreign country. In a **greenfield investment**, the company constructs new facilities (sales office, manufacturing facility, etc.) cross-border from the ground up

Also

 **Brownfield investment** is an investor **investing in an** existing plant. **Brownfield investment** is mainly made through merger and acquisitions

The host country tends to view green field investments as creating new production facilities and new job opportunities. In contrast, cross-border acquisitions can be viewed as foreign takeover of existing domestic firms, without creating new job opportunities.

FDI V/S LICENSING AGREEMENT WITH FOREIGN PARTNER

|  |  |  |
| --- | --- | --- |
| BASIS | FDI | LICENSING AGREEMENT |
| Term | Is not limited to intangible property only and is of long term nature | sells the right to intangible property to another firm (licensee) for a limited period for which the licensor is paid a fee for this agreement |
| GW | They build and own their own GW | They encash the GW of someone else |
| Set up cost | Huge set up cost | No set up cost |
| Limitation | No limits | Limited to the terms of use stated in the agreement |
| Choices in  | Less risky host | Risky hosts |
| R&D specific firms | Opt FDI | Avoid licensing |
| Competition sake | Preferred | Criticized as parent company might be creating own competitor |

STRUCTURE OF FOREIGN EXCHANGE MARKET



ROLE OF PARTICIPANTS OF FOREIGN EXCHANGE MARKET

EXPOSURE MANAGEMENT INFORMATION SYSTEM

* Also known as risk management **information system** (RMIS) or National Exposure Information Systems (NEXIS)
* Meaning – It is an **information system** that assists in consolidating property values, claims, policy, and **exposure information** and providing the tracking and management reporting capabilities to enable the user to monitor and control the overall cost of risk management.
* Risk management information systems/services (RMIS) are used to support expert advice and cost-effective information management solutions around key processes such as:

a. Risk identification and assessment

b. Risk control

c. Risk financing

IMPORTANT POINTS TO REMEMBER

* In forex market exchange markets are informationally efficient. Thus, unless one has private information that is not yet reflected in the current market rates, it would be difficult to beat the market hence future and forward rates are difficult to forecast than that of spot rates