# 1. INTRODUCTORY CHAPTER ON INTERNATIONAL FINANCE:

## 1.1.INTRODUCTION:

Most countries of the world which raced to the path of economic and industrial development had to depend on foreign capital to some extent. Under developed countries like India have to depend on foreign capital for financing their development programmes as they suffer from low level of income and low level of capital accumulation. The degree of dependence, however, varies from country to country depending upon its level of mobilization of domestic capital, technology development, attitude of the government, etc. But the fact cannot be denied that foreign capital contributes in many ways to the process of rapid economic growth and industrialization. Like international trade and business, international finance exists due to the fact that economic activities of businesses, governments, and organizations get affected by the existence of nations. It is a known fact that countries often borrow and lend from each other. In such trades, many countries use their own currencies. Therefore, we must understand how the currencies compare with goods are paid for and what is the determining factor of the prices that the currencies trade at.

## 1.2 OBJECTIVES

After studying this lesson, you will be able to:

- explain the meaning of international finance;
- determine scope of international finance;
- discuss the need for foreign capital;
- understand the nature of international finance.

## 1.3 OVERVIEW OF INTERNATIONAL FINANCE

We live in a globalized world. Every country is dependent on another country in some other means. Developed countries look for the cheap workforce from developing countries and developing countries look for services and products from developing countries. When a trade happened between two countries as in this case, there are many factors that come into the picture and have to be considered while the execution of the trade so that no violation of regulation happens. For any economy international finance is a significant critical factor, the local government should accordingly execute the policies so that the local players are not facing severe competition from the non-local players.

International trade is one of the most important factors of growth and prosperity of participating economies. Its importance has got magnified many times due to globalization. Moreover, the resurgence of the US from being the biggest international creditor to become the largest international debtor is an important issue. These issues are a part of international macroeconomics, which is popularly known as international finance.

### 1.3.1.CONCEPT OF INTERNATIONAL FINANCE

International Finance deals with the management of finances in a global business. It explains how to trade in international markets and how to exchange foreign currency, and earn profit through such activities. In fact, international Finance is an important part of financial economics. It mainly discusses the issues related with monetary interactions of at least two or more countries. International finance is concerned with subjects such as exchange rates of currencies, monetary systems of the world, foreign direct investment (FDI), and other important issues associated with international financial management.

International Finance is a section of financial economics which deals with the macroeconomic relation between two countries and their monetary transactions. The concepts like interest rate, exchange rate, FDI, FPI and currency prevailing in the trade come under this type of finance.

Though it is very difficult to define the term international finance, because the domain of it, are very large and infinite. Since international finance involves MNCs, national government's rules and regulations, regarding flow of capital, across the borders of the country, the international finance discipline is vivid and complex.

The term international finance is defined on the basis of various parameters:

(a) It is a discipline of financing the international economic and commercial relationsbetween countries.

(b) It includes international markets (such as international banking, euro currency market,euro bond, international stock exchanges, American Depository Receipts, GDRs, international institutions viz., IMF, World Bank, Asian Development Bank, Brics Bank, China, WTO, UNCTAD, Letters of Credit, Bill of Lading, factoring and the like, international financial instruments foreign exchange markets, Balance of Payments and International risk management.

(c) It is related to management, economic, commercial and accounting activities of MNCs,governments and private individuals.

(d) It involves conversion of one currency into another.

(e) It coordinates all financial and non-financial operations with the objectives ofmaximization of the shareholders' wealth.

### 1.3.2.NATURE OF INTERNATIONAL FINANCE:

Finance is an art and science of handling and managing monetary resources of the concern efficiently and effectively. Finance is very important part of any business and hence most of the decisions are taken accordingly. International finance records and monitors not only local finance of the nation but it refers to international level or global level. In short, international finance can be said to be focused on financial decisions, allocation decisions and profit distribution or dividend decisions

Some of the features of international financing management are listed below as international finance management has some certain distinguished features when compared with domestic finance managing, they are,

a. Foreign exchange risks: An understanding of foreign exchange is very important for the investors and managers in today's world of unforeseen changes in exchange rates. This rate is generally ignored and is lesser in domestic economies as it extends to only that particular economy, but when it comes to global level it should be very seriously taken as there is risk of violation foreign exchange rates. It may be regarded as most serious international problem.

b. Political risks: One of the major risks which a company may encounter in international finance is political risk. It may result in loss. As new acts and laws may be enforced or may change decisions taken by prior person. For example, in 1992, Eron development corporation signed a contract to build India's longest power plant, but it was later cancelled in 1995 by politicians in Maharashtra, who argued that India does not need power plant. The company spent nearly $300million on that project.

c. Market imperfections: Market imperfections is in trend nowadays, and this is one of major demerit for the concern. These are various changes in nation's law, taxation, rules and regulations and culture etc.

### 1.4 NEED FOR FOREIGN CAPITAL:

The need for foreign capital in a developing country like India arises on account of the following reasons:

a. Inadequacy of domestic capital: In view of the inadequacy of domestic capital, foreign capital is needed to meet the huge requirements of development projects in the path of rapid economic development and industrialisation.

b. The technology gap: As compared to the advanced countries there is a lot of technology gap which necessitates import of foreign technology. Such technology usually comes along with foreign capital in the form of private foreign investment or foreign collaborations. Thus, there is utmost need of foreign capital.

c. The initial risk: Due to lack of experience, expertise and heavy initial risk, there is always a lack of flow of domestic capital into lines of production. The foreign capital taking initial risk stimulates the flow of domestic capital and stock entrepreneurship.

d. Development of basic infrastructure: There is also a lack of basic infrastructure which is very essential for the economic development of the underdeveloped countries. Foreign capital helps in the development of infrastructural facilities such as transport, communication, power etc.

e. Balance of payment support: During the process of economic development, the underdeveloped countries usually face a crisis of balance of payments due to heavy imports of capital goods, technical know-how, spare parts and even industrial raw materials. Thus, foreign capital is needed to face the crisis during this period.