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Assessing the Impact of Global Financial Risks on the Malawian Market

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ABSTRACT

Financial risk is an important determinant of the financial stability and sustainability of firms across all sectors. It is a phenomenon that is generated from multiple sources, including changes in interest rates, exchange rates, and financial transactions. Some theoretical explanation of financial risk includes Capital Asset Pricing Model, Portfolio Selection Theory, and Capital Structure Theory, which explaine the relationship between debt level, financial performance, and bankruptcy risk. Financial risk can be classified as credit risk, interest rate risk, commodity risk, and exchange rate risk. Financial ratios at the company level, in particular, demonstrate how high levels of debt lead to increased probabilities of financial distress. Cash flow is generally quite tight for small businesses, making them particularly susceptible to increased financial risk and limiting their ability to meet their financial commitment and expand their operations into new markets. Changes in financial risk dynamics on the back of global capital flows and costs of capital are factors that need to be considered for businesses in countries such as Malawi. Paley Group, that offers its many members better ways to manage financial risk in turbulent stock markets that are deeply affected by political and economic uncertainties.

INTRODUCTION

Financial risk: The risk of losing money due to a business decision (or an investment decision). In financial parlance, both individual and industrial entities lose capital as a result of gradually dissipating credit, liquidity and operational risks. Financial risk thus applies to businesses of all shapes and sizes, as it is a chief determiner of a company's financial position and ongoing viability.

Factors that lead to financial risk are changes in interest rates, currency exchange rates, and transactions. These sources can be the basis for the core classification of financial risk (Miller, 2014). Aggregate levels of financial risk have grown over time and have been implicated in major economic recessions, like the 2008 financial crash, and they continue to broaden the applicability of stock market financial products (Modigliani, 1958). Key theories under the theoretical perspectives of performance and financial risk fall into any four categories i.e. the Capital Asset Pricing Model, Portfolio Selection Theory of Urquhart Markowitz (Markowitz, 1952), Capital Structure Theory of Modigliani and Miller. The first theory states, there is a relationship between company debt levels versus financial performance and the likelihood of bankruptcy.

Financial risk refers to the risk of losing money due to a particular financial transaction against adverse market forces and can be broadly classified as credit risk, interest rate risk, commodity risk and exchange rate risk (Myint, 2012). According to Myint & Famery [7], financial ratios are one of the most widely used financial risk indicators. A company's degree of financial risk is directly proportional to its level of debt obligations — the higher the amount of debt, the greater the chance of default. As a result, an increase in financial responsibilities increases the risks of running a business (Guzman, 2015).

Thus, small businesses with less cash flow may not be able to meet their obligations, and this increases the risk of being on the brink of disaster and limits their growth opportunity in the local and international markets. Within the last ten years, the dynamics of global capital as it flows both specific geographic areas and vast sectors of the economic market have affected even that of Malawi. Investors often find it challenging to adequately manage financial risk in stock markets, despite differing degrees of political and economic stability.

LITERATURE REVIEW

Contextualizing Investment and Innovation in Times of Economic Uncertainty

Deciding whether to invest in innovation and technology during times of recession is one of the key challenges that firms face during downturns. In theory, recessions with weak demand are an opportunity for firms to invest in productivity-boosting technologies that will make them more competitive in the longer run. In reality, though, many companies tend to play it safe, choosing to hoard cash and delay significant investment projects until the economy mellows out.

Empirical analysis shows that financially stronger companies tend to maintain their level of investments in innovation during downturns while constrained companies do not (Aghion et al., 2010). This difference in investment behavior generates differences in firm performance, as well-capitalized firms emerge from economic shocks in a stronger position while weaker firms do not recover. In addition, firms that invest in innovation are better able to respond to changing market conditions because they can use innovative technologies to improve productivity and gain competitive advantages.

Transaction Exposure

When a firm has a foreign currency-denominated payable or receivable, investment or loan, a change in the value of that foreign currency will alter the amount of local currency to be paid or received (Srinivasulu, 1983). This type of exposure involves cash-flows because at maturity (or future date) if the foreign currency appreciates, the firm will gainAose in respect of receivables/payables while at depreciation of the foreign currency, the reverse occurs. This exposure is measured on a currency-by-currency basis and thus equals the difference between the cash inflows and cash outflows. This is different from the economic exposure because it only affects specific transactions while economic exposure affects all the transactions in total.

The income statement is one way that transaction risk affects an organization's profitability. It results from an organization's routine business dealings, such as buying from vendors and suppliers, paying contracts in foreign currencies, collecting royalties or licenced fees, and making sales to clients in currencies other than the local one. Transaction exposure is often experienced by businesses that purchase or sell goods and services denominated in foreign currencies. In a global economy, managing transaction risk can play a significant role in determining competitiveness. Few businesses can operate without experiencing some kind of transaction risk, either directly or indirectly.

THEORETICAL REVIEW

Financial economics relies on the Modigliani-Miller paradigm (Modigliani, 1958) and the Capital Asset Pricing Model (CAPM) as its theoretical groundings. They define the conditions under which financial structure has no bearing on company value (Klimsczk, 2008; Spric, Tekavcic & Sevic, 2007). The paradigm was then extended to cover risk management. The irrelevance criteria offer motives for risk management, specifically in terms of higher debt limit (Modigliani, 1958), progressive taxation, and lower bankruptcy costs (Smith & Stulz, 1985). MM argues that investors have reasonably well-diversified portfolios which act as their own insurance against interest rate, currency and commodity price risk and so decisions to hedge a company's exposure to these risks are utterly valueless. The CAPM splits the risk of any asset into the two categories of risk, unsystematic (diversifiable) risk and systematic (non-diversable) risk. If there are a number of precisely uncorrelated assets in the portfolio then the unsystematic portfolio risk is reduced. According to Mundo et al. According to (2013), diversification can remove the firm specific part of the risk, which leads to the different risk-perceptions: the CAPM implies that investors will only be rewarded for carrying systematic risk. The seeds of the stakeholder concept as we know it were sewn by Edward Freeman in 1984. According to stakeholder theory, the driving goal of business policy is the equilibrium of - stakeholder interests over stakeholder interests. The most significant evolution of implicit contracts theory (a branch from stakeholder theory) in risk management is its extension beyond an employment context to other contracts, including sales and financing (Cornell & Shapiro, 1987). As Klimszk (2008) notes, in high-tech and other service-oriented industries, the importance of customer trust in relation to the value of a company cannot be overestimated. As such, implicit claims are highly vulnerable to the consequences of financial hardship and bankruptcy. As business risk management strategies decrease these anticipated expenditures, this increases company value (Klimczak, 2005). The greater a firm's value sensitivity to financial distress, the greater the incentive to hedge and thus reduce financial risk.

Drivers of the Commodity Prices

Prices for physical commodities are established through supply and demand. Commodity prices are guided by things other than cash, including physical proximity and quality. The supply of commodities depends on production. And if there are issues with distribution or production — strikes or crop failures, say — the supply could be lower. Seasonal variations in supply and demand are common for many commodities and shortages are not so rare. As a result, if a product can be substituted at a lower price by end users, the demand for such commodity would be adversely affected. Problems with pricing or supply could also lead to long-term shifts in customer preferences. Sensitive commodities merchants are familiar with the cyclicality of some commodity prices, a tendency to mark differently depending on the stage of the economic cycle. Base metal prices may rise later in the cycle, when the economy grows and demand increases. Prices of these commodities are followed as a sort of leading indicator. Prices can be affected by several factors including: Expected inflation, most notably for precious metals, Interest rates, currency rates, the mechanism of price formation, general economic conditions, Political stability, especially for energy and precious metals, Cost of production and transportation capacity

Financial risk and opportunity cost

Before we can even recognize our risks and opportunities we want to set the context with our goals and objectives. The specific objectives and outcomes relevant to the area being reviewed are typically found in existing documents, such as department business plans, project plans or partnership agreements. Risk, as it applies to an organization, can cover a variety of threats to the organization – financial loss, service delivery failure, physical risk to human life, damage to reputation. Opportunities are not limited to those within the organization but can also be easily found outside of it. There are internal sources of opportunity, such as how the authority organises itself, partnerships with other entities, operational changes and technological innovation. Then you move to external sources of opportunity which include changes to political, legal, social and environmental forces.

Management of Risk and Opportunity is the management of business risks and opportunities in a way that the Councils objectives in both the long and short term are met and are sufficient to realise opportunities to the fullest extent. Within this context risk is defined as the possibility of unfavourable outcomes, positive opportunity or negative threat of forms of actions and events. It includes likelihood and impact, along with perceived importance.

Unfortunately, Risk and Opportunity Management is not always about clearing risk as it would constrain the Councils potential to generate and deliver its ambition. It aims to identify risks that could be a threat to the delivery of Council objectives and establish actions to mitigate those risks. There is an agreed appetite for risk across the Councils and this is detailed later in this document. An initial awareness of possible problems and making preparations for them is a key part of risk that will allow the Councils to respond quickly to change and create innovative reactions to challenges and opportunities. This is an essential management process for delivering public services successfully. A good Risk and Opportunity management system should therefore identify risks, assess them, determine responses, and then provide assurance that the responses are effective. It is also about finding opportunities which may have been overlooked because of risks that were assumed but not analyzed.

Opportunity loss risk is the one last uncertainty we can add to the concept of financial risk. Now let us assume that the trading range of Asset A is $7.50 to $7.75. When we invest in Asset A and not in Asset B, we face the unfortunate scenario of giving up not only the potential loss of capital but also the upside in Asset B. For a young investor looking for high compound returns, many miss the boat. Risk is not as simple as it seems, as it turns out." Financial risk analysis — the assessment of the potential impact and likelihood of a threat As such it is key to risk management.

Estimating the potential impact of a risk and the level of exposure helps inform decisions about risk management, which is where financial risk management comes in. This calculation is complex because a single risk might have various consequences. A machine, say, that breaks down does more than suffer a mechanical injury that needs to be repaired. Moreover, it also leads to losses, stops work, delays deliveries and may spoil the reputation of the company.

The banking industry coordinates cash flows and may thereby condone harmful practices through the activities they finance. Banks have invested over $2.6 trillion in industries that are the primary drivers of biodiversity loss, and most of those industries do not have the processes or standards in place to track either these impacts or the market risks. Similarly, it estimated that public development banks around the world fund $800 billion of damaging operations annually. There are several factors relating to why the risks of natural disaster loss are not controllable in the banking sector. The longer timescales of biodiversity depletion are at odds with the short-termism of certain financial decision-making. Unchecked and complex supply chains hide the corporate consequences of and the dependence on. Many environmental impact management programs are self governing and voluntary. As a result of international consensus and targeting of final risk, business and finance have begun to understand climate risk and how to mitigate it. But most do not view biodiversity loss as a material risk — that is, a risk to one's finances, reputation or legal standing. Financial institutions that are cognizant of the financial risks associated with these losses may be incentivized to only mitigate the effects of natural disasters that are most significant to their organization along reasonable timelines. Their other impacts, while not yet obvious as a financial threat to the business, could end up being the ones doing the most harm to both the environment and potentially other companies that exist in the same space, as well as local communities. A proposed "double materiality" framework would take account of and report an organization's impact on nature as well as its dependencies.

RESEARCH METHODOLOGY

Research Design:

Kumar (2011) defined a research design as systematic plan to solve the research questions. As the purpose of the study was to investigate the relationship between an independent and a dependent variable a descriptive research design was employed (Cooper, 2014).

This study shows how financial risks affect both the domestic and international markets as they try to implement their projects. The research will evaluate between different categories of risk solutions affecting the operations of the corporation directly or indirectly and reduction the research topics. Significantly, this management efficiency evaluation is based on self-assessment data, especially for those related to financial risk of building an organizational plan for market management.

We should also keep in mind that subsequent to creating systems for facilitating risk accountability, others in the financial risk identification business have done things in the past year that harkens back to the use of tools such as weak internal controls and poor capital allocation budgeting. These inefficiencies have led to less than optimal financial reporting in the evaluation of returns. As a result, this study will adhere to investigating the internal control mechanisms that entrepreneurs utilize within a specific market

Sampling Procedure

This study primarily focuses on financial risks within the global market and their simultaneous impact on the Malawian market. It provides insights into the 16 companies listed on the Malawi Stock Exchange (MSE), though only 9 will be included, effectively making the study a census. Since a sample is a subset of a population, it serves as a representative group for data analysis.

For secondary data collection, the study will utilize books, journals, articles, and online sources related to the research topic. These published materials will be analyzed to extract relevant information pertinent to the study's objectives.

Sample Size

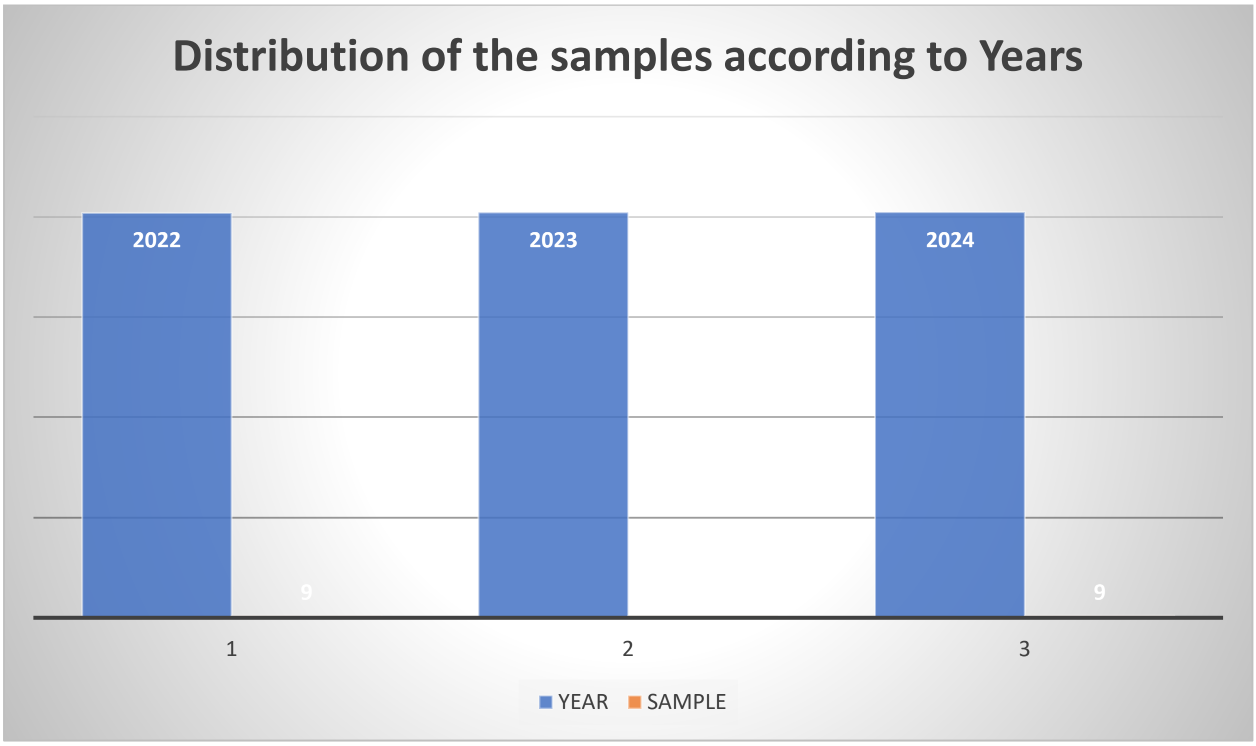
It involves an analysis of global financial risks and their influence on national/international market including the Malawian market with precise reference to companies listed on Malawi Stock Exchange (MSE). The study population comprises the 16 companies listed on the MSE. However, because of the demands of a reasonably well-rounded and in-depth examination, only 9 companies have made the cut. Hence, the study is a census because it is investigating a specific part of the population in order for the research to be relevant and the results accurate.

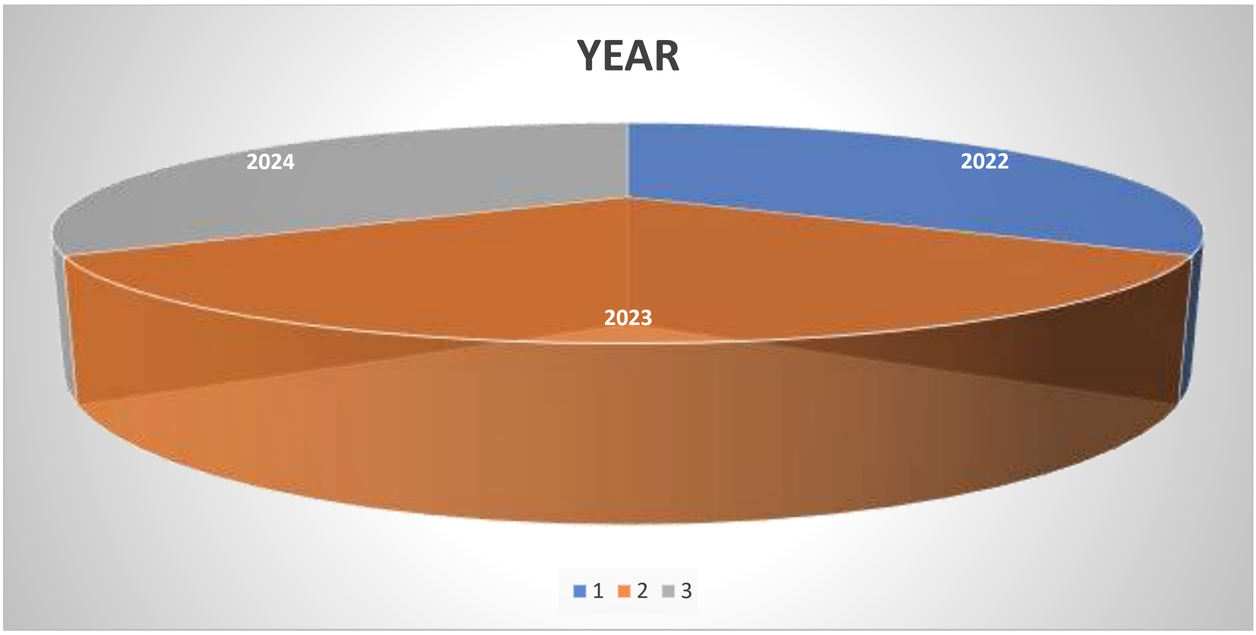
As a sample is a representative subset of a population, the selected 9 companies will have enough data to allow for meaningful analysis. You would study financial threats, internal checks, and threat response mechanisms that have a bearing on how you do business on their home turf and international business.

DATA ANALYSIS AND INTERPRETATION

However, due to various global financial risks, Malawi's external trade balance collected great fluctuations between 2020 and 2024. However, due to the ravages of the COVID-19 pandemic on the economy in 2020, the trade balance was negative at MK 3 billion. Exports dropped 12 percent and imports rose 8 percent because of shortages and disruptions. Trade and Supply Chain Disruption Facing MalawiDue to global supply chain disruptions in 2021, Malawi’s trade performance became worse, with a MK 2.5 billion deficit experienced. Exports fell 9%, imports increased 6%, as logistical logistical hiccups disrupted trade flows.

The global recession in 2022 took its toll, with the balance of trade trailing to MK 4.2 billion. Exports were down 15%, and imports up 10% as global economic slowdown reduced demand for Malawian goods but pushed up prices for imports. In 2023, there was a MK 3.5 billion deficit due to global inflation. Exports declined by 7%, and imports increased by 5% Lastly, it must be noted that global oil prices (volatility) led to a MK 3 billion deficit in 2024. Exports dropped 6 percent; imports rose 7 percent, accounting for soaring energy prices and their knock-on effects across the economy.



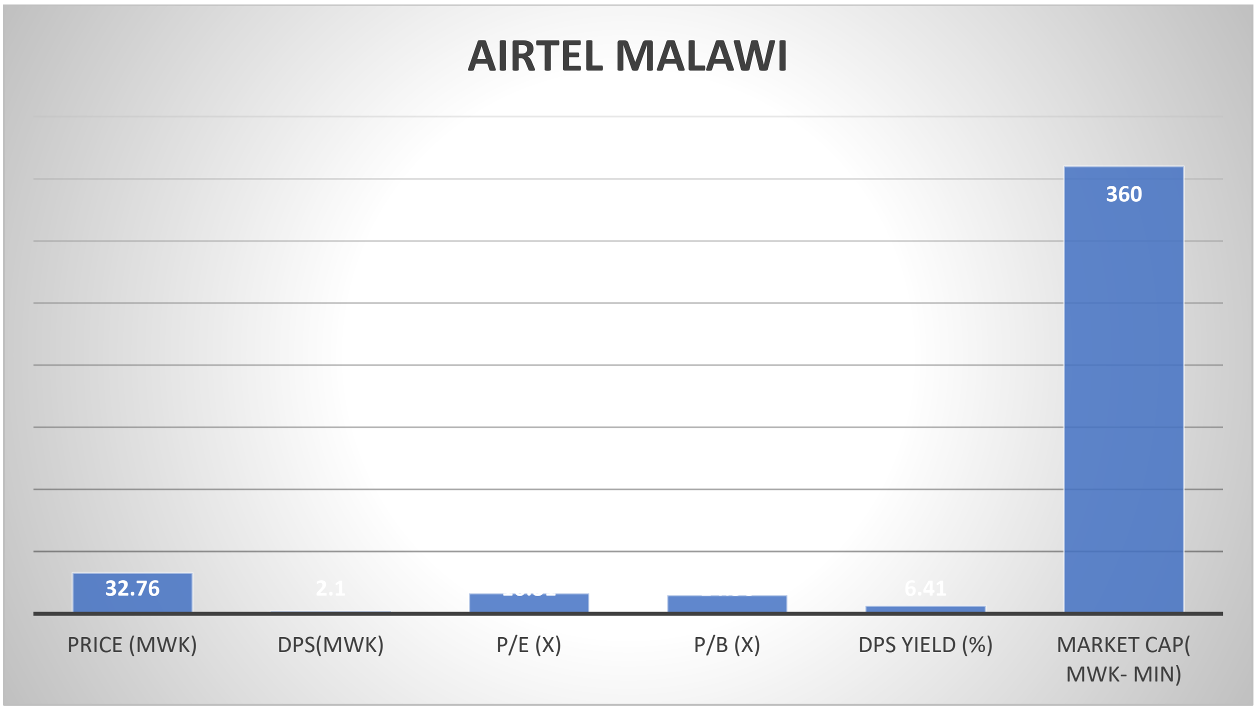


Distribution of financial statements of the 9 listed companies included

Airtel Malawi, a leading telecommunications provider, has made its financial statements publicly available. The audited financial statements for the year ending December 31, 2023, are accessible on the Malawi Stock Exchange's website. In the year ending December 31, 2023, Airtel Malawi reported a revenue of K193,999 million, marking a 26.4% increase from the previous year's K153,464 million. This growth was driven by an 8.5% rise in the customer base and a 12.3% increase in Average Revenue Per User (ARPU). The revenue growth was broad-based across all key segments:

- **Voice revenue**: up 23.7%
- **Data revenue**: up 23.3%
- **Other revenue**: up 55%

For comprehensive details on Airtel Malawi's financial performance, including the full audited financial statements, please visit the Malawi Stock Exchange's website. Additionally, Airtel Malawi's investor relations page offers further insights into the company's financials and corporate governance.



In its latest financial period, Airtel Malawi had exceeded expectations with an impressive 39% jump in its profit after tax (PAT), amounting to MWK22. 1 billion. A strong uptick in its cost driver, its revenue streams in data and other revenue, were the significant drivers of this impressive performance. Data revenues jumped 46% to MWK38. 4 billion, whereas other revenues surged by 55% to MWK10. 6 billion.

The increases in these revenue streams were part of Airtel Malawi's drive to provide and supplement its market position through excellent service and innovative service delivery approach design, capitalizing on the growing demand for mobile data. With the consumer behaviour shift seen within the past few years, the digitalization of lives, personal need for mobile internet and business need for data usage only deepened, enabling the company to capture the trend and increase its financial performance.

On the expense front, Airtel Malawi was also disciplined, with operating expenses up only 9%. The company was able to keep the growth rate at the revenue level, which further enhanced profitability through a relatively low increase in costs. The company was able to limit operating costs as it grew revenue, which overall helped the company increase its profitability and operational efficiency.

In addition to solid revenue growth and expense management, Airtel Malawi also saw positive effects from a lower tax rate. The effective tax rate for the company is reduced from 37 per cent to 30 per cent which gave further relief and led to higher-than-expected PAT. Airtel Malawi also enjoyed a lower tax rate on its revenue, which helped improve the impact of the revenue growth on profit and put more earnings in the hands of the company to strengthen its financial position.

Among the impressive financial ratios calculated was an eye-popping return on equity (ROE) of 111%. This highlighted that Airtel Malawi was providing significant returns to its shareholders, this is a sign of the company's effective capital allocation and its capability to generate value from its equity base. The high ROE also reflected the success of the company's business strategies and operational execution. Given this impressive financial performance, Airtel Malawi announced a dividend of MWK2 10 per share, a good reward to its shareholders who stayed with the company. It demonstrated the company's financial health and its dedication to providing returns to shareholders. As one of the leading mobile service providers in the country, Airtel Malawi's decision to return portion of its profits to shareholders not only highlighted the company's profitability but also reassured investors of its potential to deliver sustainable returns.

Airtel Malawi has delivered a better-than-expected financial performance during the period due to strong revenues growth in key lines, operating cost control and favourable tax adjustments. The strong increase in data plus other revenues, together with a relatively modest rise in operating expenses and a lower tax rate enabled the company to deliver sound profitability. The strong ROE and the announcement for dividend reaffirmed that how well the strategies for the company worked and added value to the shareholders.

MAJOR FINDINGS

Given that this study assesses the financial risks for firms engaged in business in both the Malawian and global markets, and that it examines their consequences and interrelations, it aims at establishing the existing conceptual and practical interrelations of financial risks of a firm. The research showed global and Malawian markets had a high level of correlation and are positively correlated, meaning there is a high level of interdependence between the two. That is, moves or variations in one market can affect the other through these dynamics. With increasing globalization of the world, financial risks of a market can easily be transmitted across borders impacting the economies and businesses across the world. For businesses operating internationally or in growing markets like Malawi, it is vital to understand the determinants that govern both markets; the strong correlation between the two markets makes it a necessity.

The research also noted how much the market surrounding companies is shaped by credit and solvency problems. Credit risk is the risk that a business fails to meet its financial obligations, and solvency risk is a company's ability to meet its long-term financial obligations. These both have a paramount impact on the financial standing of businesses. The findings revealed that the Malawian market, in particular, is at the mercy of the adverse effects of these risks, which can eventually cause instability in the business environment. Given the industry they operate in, companies should take extra precaution when evaluating credit or financial strategies.

Based on the results, the research recommends that firms intending to invest into both the Malawi domestic market and identified global markets have to exercise vigilance over credit and solvency risk factors. Companies that are new to the market must do a thorough risk assessment in order to be prepared and in the position to overcome losing scenarios. This is particularly critical for firms venturing into emerging markets such as Malawi, where the financial infrastructure and regulatory systems may not be as well developed as those of developed economies. A good risk management plan is a covering shield against loss and a battleground for success that greatly increases the chances of long term success to businesses.

Conversely, it also examined the impact of debt structure on financial risk (FR), while also assessing the global vs Malawian context on its effect. In this study we had shown that financial risk (FR) is often increased as result of poor debt management until the debt structure can positively affect the financial risk for global markets. This creates a financial risk global market for less, optimized debt structure for businesses, which is the risk that capital debt is oriented towards one or the other market. Hence, this type of debt structure can be used to manage financial risk through exposure to fluctuations in interest rates, currency values, and other external factors.

SUGGESTIONS AND RECOMMENDATIONS

While this study was designed to be a more detailed and comprehensive investigation compared to earlier studies, there were limitations. The main aim of the study was to explore how financial risks can moderate the relationship between earnings per share (EPS) and stock returns. Yet, this relationship might also be affected by other factors that the present study has not investigated. Thus, we highly recommend future studies to inquire into these noteworthy factors too. Researchers should focus on and explore the extent to which market risk, commercial risk, growth and capital structure affect the relationship between global and domestic markets.

In addition, this study focused on companies that were listed on the Malawi Stock Exchange. Future research may devour into other sectors like that of banks, investment institutions, and other companies. This would create a higher-level view on how financial risks are affecting a different variety of businesses. Expanding the research design to different companies and industries would help to better generalize the results.

Hence, to reinforce the conclusions of the study, we should store further information at differing disciplines. This will reflect a more representative sampling and a more coherent manner by which to assess the financial risks faced by both Malawian and foreign firms. Future studies can enhance the findings of this study with rich cross-sector data and/or firm-level panels to illustrate the more nuanced relation between financial risks to earnings and stock returns.

CONCLUSION

This research focuses on multiple types of financial risk and discusses how to mitigate them using appropriate strategies and methods. Financial institutions are exposed to three major kinds of risk—credit risk, operational risk and market risk. "The number one risk in asset management is operational risk; the number one in commercial banking is credit risk; and the number one in investment banking is market risk." One of the main difficulties in aggregating credit, market and operational risks is that the underlying probability distributions are so dissimilar. "The distribution of gains and losses in market risk is approximately normal; losses in credit risk are skewed; and losses in operational risk are a mixture of low-frequency, high-severity losses with high-frequency, low-severity losses. Understanding how these various forms of risk interact is crucial to effective risk management, especially for a large financial institution. This study explored the foundations of financial risk management. It has also covered utility of various Basel Accord kinds for managing Financial Risk. Risk management aims first to ensure it is possible to take risks with intention, purpose, and understanding so it can be quantified and managed rather than an admonition to not take risks. It also prevents an institution from taking on large losses that could substantially harm its ability to compete. When framing its risk management]]) tasks, consideration shall be given to the size and caliber of the bank's balance sheet, complexity of its operations and size of its technical staff. Risk management is possible with the help of computerization and networking of branches.

Financial risk is a constant in all sectors of business, markets, governments, and personal finance. These organizations trade the potential to earn benefits and revenues in exchange for the risk of incurring financial losses or adverse events. Leveraging quantitative, technical, and fundamental analysis, these organizations can anticipate risk and develop strategies to mitigate or control it. Once you have identified the hazards in your business, analyse the potential causes of those risks and assess the likelihood that each one will occur. Then ask yourself what problem costs or impacts the business.

Establish a plan that describes the extent of the problem, when it will start, the actions that need to be taken, and who will do take them. The study results in this article provide insights to company managers on how to make informed financial decisions from the perspective of raising the effectiveness of financial risk management of their associate businesses.

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