

# South africa vs venezuela

Finance



South Africa vs. Venezuela Introduction Foreign direct investment (FDI) requires careful thought before making a decision as changes in the external value of the domestic currency leads to changes in the real value of an investment. This suggests that FDIs are accompanied by a high degree of uncertainty and implies that the exchange rate could either encourage or discourage investments (Busse et al 2010). Comparison of Exchange Rate Systems The exchange rate systems in South Africa and Venezuela are different where South Africa has adopted a flexible exchange rate regime (MF 2013) while Venezuela's currency is pegged to the US\$ (DaCosta and Olivo 2008). In addition to other factors this situation implies that maintaining a fixed exchange rate between both countries will be extremely difficult. In fact, Husted and Melvin (2010) indicate that one of the benefits of adopting a flexible exchange rate is that countries are able to formulate their own monetary policies and the rate of exchange will automatically adjust for differentials in the inflation rates. With an exchange rate peg, as exists in Venezuela, the central bank adjusts supply of foreign exchange in order to maintain the peg with the United States dollar. The graph below shows the changes in the exchange rate between the US\$ and the South African Rand and the Venezuelan VER from 2006 to 2010. Figure 1 The information in Figure 1 indicates that the rate of exchange between the US dollar and the Rand ranged from a low of ZAR 6. 49 in 2006 to ZAR 8. 42 to US\$1 in the case of the South African currency and in the case of the Venezuelan Bolivar from a low of VER 2. 147 to a high of VER4. 3039. This is because of the differences in the exchange rate policies of the two countries. Although, the exchange rate has been stable for the most part in Venezuela there are obvious instabilities in the macroeconomic policies of the Venezuelan

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Government. The information in Figure 2 Figure 2 The information in Figure 2 indicates that the inflation rate in Venezuela is high compared to South Africa and this indicates that there is instability and uncertainty in their macroeconomic policies. This instability is a factor as it creates uncertainty in investment by allowing the relative cost of production to rise. There are three types of exchange rate risk that a company is likely to encounter when investing overseas – transaction risk; translation risk and economic risk. Transaction risk is mainly related to cash flows from receivables and payables (Papaioannou 2006)). Translation risk is the exchange rate risk that relates to the valuation of the foreign subsidiary for consolidation in the groups balance sheet (Papaioannou 2006)). Economic risk relates to risk associated with domestic revenues and expenses. Identifying the specific risk associated with the investment in Venezuela is crucial in deciding on the strategy to be used to manage the risk. The specific risk associated with this investment in Venezuela is economic risk. Our company can manage this risk by financing operations in the Venezuelan currency –Bolivars, which has a higher cost of inflation than the Rand. Exchange rate adjustments in Venezuela are not in line with purchasing power parity (PPP) and so our company's competitiveness may be eroded as a result of this. It has become a regular practice in oil exporting countries (OECs) for the central bank to intervene in foreign exchange markets in order to manage fluctuations (DaCosta and Olivo 2008). Additionally, there are surrender requirements that may affect our exchange rate risk management strategies. Comparison of the Financial Development In making the decision to invest in a country consideration should be given to its financial development. Al-Yousif (2002) found that financial development and economic growth are mutually causal.

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That is, financial development leads to economic growth and vice versa. The growth rate of both countries from 2006 to 2013 is illustrated in Figure 3.

Figure 3 Source: IMF 2013 The information in Figure 3 indicates that there has been growth in both countries with Venezuela's growth rate fluctuating rapidly from high to low and positive to South Africa experience similar changes, they were mainly positive. Both experienced declines and increases around the same time period. However, IMF (2013) indicates that Venezuela is 171 in world rankings in terms of GDP growth while South Africa is 115.

This is an indication that South Africa is more financially developed than Venezuela. Conclusion In making the decision to invest, Luiz and Charalambous (2009) indicates that of the three factors (Ownership-specific advantages; and location specific advantages) the location specific advantages are more important since it relates to economic and policy factors – key determinants of FDI. These factors include: Country governance and political risks; macroeconomic performance including monetary and fiscal policies; exchange rate policies; trade incentives/barriers; infrastructure; labor; the development and size of the market; geographic location and culture (Luiz and Charalambous 2009). References Al-Yousif, Y.

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