

A STUDY ON FOREIGN EXCHANGE RISK MANAGEMENT

SUSHMITHAA MJ, MBA II

PREETHI M, MBA I

ABSTRACT

Foreign currency risk management involves taking decisions which aim at minimizing or eliminating the negative effects of currency fluctuations on balance sheet and income statement values, a firm's receipts and payments arising out of current transactions, and on long term future cash flows of a firm. The data collected has been analyzed through various statistical tools like Karl Pearson's Correlation, Chi- square test and One-way ANOVA test. Numerous new findings has been derived from this research has helped to provide few suggestions to improve the foreign exchange risk management at Sunshare Investments Pvt Ltd in Chennai.

INTRODUCTION

Countries with diverse economic and financial structures have adopted market - determined foreign exchange rate systems. At time it has seemed too much business that they have been helpless in the fight to control the associated risks, which arise when exporting, profitability, competitiveness and the ability to service debt can all be impacted by foreign exchange volatility when paying or receiving foreign currency. Whilst exposure to exchange rate movements may be an inevitable part of everyday activity, the risk arising from such exposure can be controlled. Foreign currency exchange risk is the additional riskiness or variance of a firm's cash flows that may be attributed to currency fluctuations (Giddy, 1977, Brigham and Ehrhardt, 2005). Normally, foreign currency risk exists in three forms; translation, transaction and economic exposures.

NEED FOR THE STUDY

Sunshare Investments Pvt Ltd, Chennai is a trading company and a provider of foreign exchange payment services to small sized businesses and private clients. Share trading companies came into existence at the very start of Commodity Exchanges in India. With nationwide presence, it enables the retail & corporate investors to diversify their portfolio and enjoy the benefits of commodity trading in MCX, NCDEX, and NSEL. Our highly appreciated research team guides the investors to make wise investment decisions for Bullion, Base-Metals, Energy and agro-commodity. This project provides a number of recommendations and best practices to help them develop a plan to manage the foreign exchange risk the company faces.

SCOPE OF THE STUDY

- The scope of this study is to find the best risk management techniques for Sunshare Investments Pvt Ltd
- This scope covers the importers and exporters, who are all having foreign currencies.
- This is done through the use of a survey (questionnaire) sent out to a sample consisting of their clients.
- This study helps to identify the best techniques in order reduce the foreign exchange risk. The suggestions given by the customers (respondents) as well as the recommendations given by the researcher could help the company to improve their services.

OBJECTIVES

PRIMARY OBJECTIVES:

- To assess and mitigate on the Foreign Exchange Risk Management and to minimize potential currency losses – with respect to Sunshare Investments Pvt Ltd in Chennai.

SECONDARY OBJECTIVES:

- To identify the exposure of the clients in foreign currency.

- To make an assessment of the level and variability of risks with respect to foreign exchange.
- To identify the best technique to reduce the foreign exchange risk.
- To determine the various factors leading to selection of a technique.
- To determine the level of awareness on Derivatives (optional).

RESEARCH METHODOLOGY

The Research design used in the study is descriptive analysis

RESEARCH DESIGN

Descriptive research design is also called explanatory design. This is the one that simply describes something such as demographic characteristics. The descriptive study is typically concerned with determining frequency with which something occurs or how two variables vary together.

SAMPLE SIZE

It refers to the number of elements of the population to sample. The sample size chosen for the survey is 123.

DATA COLLECTION METHOD

- Primary and secondary sources
- Primary data- structured questionnaire
- Secondary data- review of literature

QUESTIONNAIRE DESIGN

- Direct questions
- Close end questions
- Dichotomous questions
- Multiple choice questions

TOOLS FOR ANALYSIS

- Karl Pearson correlation
- Chi square test
- One way ANOVA

ANALYSIS AND INTERPRETATION

1. Karl Pearson correlation

Null hypothesis (Ho):

There is positive relationship between levels of percentage the firm's transaction exposure is covered and level of firm's economic exposure is covered.

Alternate hypothesis (H1):

There is negative relationship between level of percentage the firm's transaction exposure is covered and level of firm's economic exposure is covered.

r= 0.980

INFERENCE:

Since r is positive, there is positive relationship between levels of percentage the firm's transaction exposure is covered and level of firm's economic exposure is covered.

2. Chi-Square Test

Null hypothesis (Ho):

There is no relationship between the source of foreign currency and primary source of your firm's foreign exchange rate forecast.

Alternate hypothesis (H1):

There is relationship between the source of foreign currency and primary source of your firm's foreign exchange rate forecast.

Calculated value = 131.046

Tabulated value = 12.592

Since the calculated value is greater than the tabulated value, we accept the alternate hypothesis and hence there is a relationship between the source of foreign currency and primary source of your firm's foreign exchange rate forecast.

3. One Way ANOVAs

Null hypothesis (Ho):

There is a significance difference between managing the risk in foreign currency exchange and percentage (%) of usage of foreign currency exchange techniques.

Alternate hypothesis (H1):

There is no significance difference between managing the risk in foreign currency exchange and percentage (%) of usage of foreign currency exchange techniques.

Tabulated value = 2.46

Calculated value = 953.01

Since the calculated value is greater than the tabulated value, we accept the alternate hypothesis and hence there is no significance difference between managing the risk in foreign currency exchange and percentage (%) of usage of foreign currency exchange techniques.

FINDING:

- Most of the respondents prefer Import & Export as a source of foreign currency.
- Most of the respondents say that all the time the firm manages transaction exposure.
- Most of the respondents say that the firm manages the economic exposure all the time.

- Most of the respondents say that firm's policy on transaction exposure is done by taking a view on foreign exchange rates and cover or leave transaction exposure uncovered, depending on view.
- Most of the respondents say that the firm's policy on economic exposure is done by taking a view on foreign exchange rates and cover or leave economic exposure uncovered, depending on view.
- Most of the respondents say that greater than 25% - 50% is the level of percentage of the firm transaction exposure is covered.
- Most of the respondents say that greater than 25% - 50% is the level of percentage the firm economic exposure is covered.
- Most of the respondents prefer Volatility of client's domestic currency factor which is driving firm's foreign exchange exposure management.
- Most of the respondents said that objective of firm's foreign exchange exposure management prefer Reduce quarter-on-quarter earnings fluctuations.
- Most of the respondents say firm's foreign exchange risk management policy will be revising annually.
- Most of the respondents prefer no forecast primary source of firm's foreign exchange rate.
- Most of the respondents say manage the risk in foreign currency exchange with the help of Spot.

SUGGESTIONS:

Management of Sunshare Investments Pvt Ltd can use Spot technique to manage the risk in currency exchange as it is most preferred by the customers. Frequent training programmes can be conducted to the foreign exchange trade customers to create awareness about the current

trends and the prediction for the future in the Fore. Develop a foreign exchange policy and review it regularly. Agreeing on a budgeted exchange rate for the year will guide your transactions. With your policy in place it is time to review the Fore tools that you can use to manage your exposure. Spot and Forward contracts and market orders can work individually or together to form a tailored foreign exchange strategy. Depending on your budgeted rate, your requirements and timing, your Fore Dealer will be able to suggest a strategy to suit your business.

CONCLUSION:

Exchange rate risk or foreign exchange (forex) risk is an unavoidable risk of foreign investing, but one that can be mitigated considerably through the use of hedging techniques. But this may not be the best alternative from the viewpoint of portfolio diversification, since numerous studies have shown that foreign investing improves portfolio return while reducing risk. This study has been undertaken to assess the foreign exchange risk management with reference to Sunshare Investments Pvt Ltd, Chennai. Few valuable suggestions like use Spot technique to manage the risk in currency exchange, Frequent training programmes, Develop a foreign exchange policy and review it regularly etc have helped to provided to improve the foreign exchange risk management at Sunshare Investments Pvt Ltd, Chennai.

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