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Moreover, the \$115 million reversal of inventory from Mitosis which would be repurchased over the next 4 h year also presented a large amount of cash flow that could have large fluctuations if left unprotected. This amount will be paid out in yen, so it won't really be affected by the Yen's exchange rate as Tiffany can just use cash flows from its sales in Japan to pay. Therefore their main concern as far as exchange rate risk is not the money they have to pay back but the amount of US dollars they get after they have paid off the above obligations in yen and then sold the yen left over for US dollars.

For the inventory they have to repurchase their once would be that they have enough cash coming in, in yen, from sales. Thus the main objective of Tiffany risk management policy is to minimize the future cash flow fluctuations with respect to its investment needs.

In Dalton to the mentioned exchange rate exposure, Tiffany could face additional economic exposure such as a be cheaper in Japan. However, economic exposure risk is less easy to measure and hedge.

Alternative Ways to Manage Exchange Rate Risk For Tiffany to hedge its Y,'\$ exchange rate exposure, it can choose either foreign currency options or future/forward contracts. A company due to receive foreign currency at a known time in the future can hedge its risk by buying put options, which matures at that time, on that foreign currency. This guarantees that the value of the foreign currency will not be less than the exercise price, while allowing the company to benefit from any favorable exchange rate movements.

A forward contract, however, locks in the exchange rate for a future transaction, therefore limiting any downside loss, while taking away any upside gain. As well, an option gives the holder the right but not the obligation to sell yen at the predetermined strike price while a forward contract is an obligation. An option provides a type of insurance whereas a forward contract locks in the exchange rate for a future transaction.

It also costs nothing to enter into a forward transaction, while options require that a premium be paid up front. We recommend that Tiffany purchase Yen puts to protect against the downside risk of the possible depreciation of Yen, although this risk management instrument is more expensive, Tiffany can retain the upside gain if Yen continues to be strong, as has been the situation for the past 10 years.

On the other hand, Tiffany does not need to fully hedge the Y,\$ risk, as Tiffany has many other international operations that would provide some degree of natural hedging of the US currency to various foreign currency fluctuations.

Tiffany should purchase the put option with maturity as close as possible to the inventory repurchase schedule, while the retail income will need to be managed quarterly or yearly.