

Blades, inc. case study analysis paper

Business



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Blades, Inc. Case Study Analysis Perpetrators of Foreign Exchange

Ratcheting rates are the amount of one country's currency needed to purchase one unit of another currency and the foreign exchange market is the monetary nexus between countries that makes it possible for global trade to be accomplished more efficiently than barter. The foreign exchange market is where one countries' currency is exchanged for another because each nation uses its own monetary unit. Therefore, if people in one nation want to acquire goods in another nation, currency must be replaced from one country for the other country to accommodate the business deal.

Foreign exchange rates, at the most basic level, are derived from long-term economic fundamentals. These variables weigh and measure the value of one currency to another. Over time, these economic fundamentals and macro-factors will lead to very long-term trends. From the fundamentalist's perspective, the main factors that affect foreign exchange rates are Interest rates, Trade balance, Inflation, GAP (Gross Domestic Product), and Employment Statistics. Case Summerdale, Inc.

Needed to order supplies two months ahead of the delivery date.

The company considered an order from a Japanese supplier that required a payment of 12. Million yen payable as of the delivery date. Blades had two choices to either purchase two call options contracts (since each option contract represented 6, 250, 000 yen) or purchase one futures contract (which represented 12. 5 million yen). The futures price on yen had historically exhibited a slight discount from the existing spot rate.

However, the firm would have liked to use currency options to hedge payable in Japanese yen for transactions two months in advance.

Blades would have preferred hedging their yen payable positions because the company was uncomfortable leaving the position open given the historical volatility of the yen. Nevertheless, the firm was willing to remain unhinged if the yen became more stable someday. Ben Holt, Blades' chief financial officer (COOP), preferred the flexibility that options offer over forward contracts or futures contracts because he could let the options expire if the yen depreciates.

He would have liked to use an exercise price that was about 5% above the existing spot rate to ensure that Blades would have to pay no more than 5% above the existing spot rate for a transaction two months beyond its order date, as long as the option premium was no more than 1.

6% of the price it would have to pay per unit when exercising the option. In general, options on the yen have required a premium of about 1.5% of the total transaction amount that would be paid if the option is exercised. For example, recently the yen spot rate was \$0.072, and the firm purchased a call option with an exercise price 5% above the existing spot rate.

The premium for this option was \$0.001134, which is 1.5% of the price to be paid per yen if the option is exercised. A recent event caused more uncertainty about the yen's future value, although it did not affect the spot rate or the forward or futures rate of the yen. Specifically, the yen's spot rate was still \$0.072, but the option premium for a call option with an exercise price of \$0.

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00756 was now \$0.0001512.

However, if the company is uncomfortable leaving the position open given the historical volatility of the yen, then hedging is the best option. 3.

Assuming there were speculators who attempted to capitalize on their expectation of the yen's movement over the two months between the order and delivery dates by either buying or selling yen futures now and buying or selling yen at the future spot rate, the expectation on the order date of the yen spot rate by the delivery date would be \$0.

072, if speculations were correct. 4.

If the firm shares the market consensus of the future yen spot rate, its optimal choice, purely on a cost basis should be \$0.0072 given this expectation and given that the firm made a decision. 5. The choice I made as to the optimal hedging strategy may not turn out to be the lowest-cost alternative in terms of actual costs incurred because the firm is speculating the risk.

The firm is hedging due to being unsure of what the market will do. The perfect hedge would reduce the risk to nothing. This would be the optimal hedging strategy. 6 Assuming a TN t I have terminal en analogical standard volatile AT ten yen is about \$0.005. Based on my assessment, I believe the future spot rate is highly unlikely to be more than two standard deviations above the expected spot rate by the delivery date.

If the futures price remains at its current level of \$0.006912, the optimal hedge for the firm is \$0.007326. Irreproachableness Mercantile Group (2007). Economic Factors in Fore.

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