

# Salem manufacturing



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SALEM Considering the case of Salem manufacturing company, it is hard to choose among the options of remaining unhedged, hedge in the forward market, hedge in the money market or hedge in the options market. But a careful study of the case can optimize these options and bring us to the right decision. Considering the Forward marketing hedge would not really be appropriate for this context as this is considered to be an open or uncovered hedge and it's success depends on the precision of prediction of the future exchange rates. Though the Salem's foreign exchange advisory service forecasts that the spot rate in those months of financial transaction will be \$1.56 per British pound, this may not hold good at that time. Since Salem is expecting a minimum acceptable margin sale price of 1,500,000 dollars and if the expected exchange rate of \$1.56 per British pound goes below \$1.50 per British pound, this would end up in a loss on Salem's side which is not desirable and moreover such a hedge can increase the tax burden too. The option of Money marketing hedge would also prove us wrong for the same reason as explained above. By locking the British pound transaction in dollars, the company can also suffer losses as dollar value goes down per British pound. The Options marketing hedge will do no better than the previous strategies when the results are considered. Offsetting the British pounds and waiting for the price to be favorable would be risky in this scenario. So the best option among those we have is to remain Unhedged. This is considered to be the best strategy as in this method Salem's exposed amount of \$1,500,000 is subjected to the movements of the relevant exchange rate. In several cases of this kind, the unhedged strategy has worked better to the hedge strategies yielding safe results. The hedge strategies usually work with special cases that come with biased conditions.

To be on a safer side, it is wise to choose the unhedged strategy than the hedged strategies as this may invite unwanted risk.