Devise a strategy so that the ny cheese company can protect itself against foreig...

Business

Foreign Exchange Risks The resurgence of foreign trade and the volatility in the global market has resulted in the need for companies to have a strategy for foreign exchange risks management. The main reason being the foreign exchange risks affect a company's accounting and economic activities (Jain 26). However, a good strategy must include a number of things for it to be effective. Firstly, is the identification of the certain risks that have an impact on the financials. Secondly, is the measurement and collection of the foreign exchange risks data that will aid in the management of the specific risks. Thirdly, is the continuous assessment of the program's success in order to improve the system.

Fortunately, there are ways that the NY Cheese Company can hedge its risks. One way is by hedging the cash flow since it only impacts the balance sheets rather than the income statements over the life of the hedge (Jain 20). In the case of NY Cheese Company that buys cheese from the Chinese company and pays for the same using the US dollars, then it means that the foreign company will have to purchase the local currency to cover its costs. If there is a fluctuation in the dollar against the Yuan, then it means that the foreign company will have to increase the cost of the cheese exported to the NY Cheese Company in order to cover for the same. Hence, the best solution for the NY Cheese Company is to pay for the cheese supplied by the Chinese Cheese Company in local currency; thus, manage the foreign exchange risks on its own. Secondly, the NY Cheese Company can go for a short dated forward contract, which is quite effective as compared to the cash flow hedging. The main reason why forward contracts are effective is that they are easy to execute; hence, they are flexible enough and can be rolled over into a new hedge after the completion of the period.

If the NY Cheese Company manages to use the future contract a way hedging the foreign exchange risks, then it means that the company will be able to increase its revenue since there would be a reduction in the costs involved when there is a fluctuation in the currency. Similarly, the company will not have to worry about price instability. This is because the Chinese company will be obligated by the contract to sell cheese at the stipulated amount without putting into consideration the current spot rate of the dollar against the Yuan. This is the main reason why it is advisable for the NY Cheese Company to use the forward contract as a way of hedging the foreign exchange risks since it is easy to manage. In addition, since no money is paid up front while using the forward contract, it means that the NY Cheese Company will make more profit on the purchase of the $1000 cheese at the rate of $1: ¥4. 22

In the event that the exchange rate goes to $1: ¥2. 33 at the end of six months and the contract was locked in at $1: ¥4. 22, the NY Cheese Company will benefit in terms of dollars. This will be calculated as follows; G= (F-S) C where G rep. gain F rep the contracted foreign exchange rate S rep. The contracted sale amount of currency F and C rep. The contacted sale amount; therefore, the benefits will be as follows: G = (¥4. 22- ¥2. 33) $1000. NY Cheese Company will stand to gain $1890 from the contract.

References

Jain, Nidhi. Foreign Exchange Risk Management. New Delhi: New Century Publications, 2007.

Print.