

# Xian-janssen pharmaceutical (china) and the euro – case study

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## Xian-Janssen Pharmaceutical (China) and the Euro -Case study

1. How significant an impact do foreign exchange gains and losses have on corporate performance at XJP? What is your opinion of how they structure and manage their currency exposures?

Foreign exchange gains and losses could have a significant impact on the corporate performance of any firm. XJP faces foreign exchange risks in form of transactional and operational exposures in the course of its procurement of raw materials and finished products from its J&J Europe unit. In order to minimize this risk, XJP has followed a hedging policy. In spite of XJP hedging a minimum of 80% of its anticipated currency exposures, it was subjected to huge quantum of translational exposure.

XJP made huge foreign exchange losses in 2003 which of was balanced by gains from housing fund adjustment and inventory valuation reversal. If XJP continues to make foreign exchange loses even in 2004 as it made in case of 2003, it would not be able to reach its annual targeted revenue.

If XJP starts making losses, due to foreign exchange losses, then it will have to increase the prices of its drugs. This would reduce its sales and especially in case of the tender sales which accounts to around 80% of the total market. The decreased sales could in turn affect the profitability and thus the future growth of the company. Similarly gains through foreign exchange could help the company perform better by supplying the products in the domestic market at a competitive price. This could also increase the margins in the tenders for XJP.

XJP is following a good practice of hedging their currency exposure by hedging from 80 to 100% of its anticipated currency exposure. However in spite of hedging, their purpose is not getting served as they are making huge foreign exchange losses.

2. Johnson & Johnson has roughly 200 foreign subsidiaries worldwide. It has always pursued a highly decentralized organizational structure, in which the individual units are responsible for much of their own performance from the top to the bottom line of the income statement. How is this reflected in the situation XJP finds itself?

XJP traditionally used to import 100% of its raw materials and finished products from J&J Europe. When XJP was purchasing its materials and products from J&J Europe's Belgian treasury centre, it used to make all its payments in Euros; as a result XJP was incurring currency risks and expenses internally. But now, XJP has slowly started to license the manufacturing of generic drugs from local players and started procuring the drugs locally. It has done this because the value of the euro was rising up against the Rmb. XJP has still not been able to completely procure all its requirements from the domestic markets, as a result it is to a great extent still dependent on the European unit. As a result, though it has been hedging its risk of the strengthening Euro against the Rmb, it has not been able to successfully nullify or at least reduce its foreign exchange losses to a decent level.

This indicates that J; J follows a policy of decentralized organizational structure where the parent company does not strictly control its subsidiaries and the subsidiary companies are responsible totally for their overall performance.

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3. What is the relationship between actual spot exchange rate, the budgeted spot exchange rate, the forward rate, and the expectations for the Chinese subsidiary's financial results by the U. S. parent company?

The actual spot exchange rate represents the prevailing exchange rate of a currency in the market as on the current date and time. Any person can get the currency exchanged at the actual spot exchange rate. However a budgeted spot exchange rate is mainly for the purpose of accounting. A company fixes a spot exchange rate for the purpose of budgeting by taking various factors into consideration.

In case of XJP, during the time of budgeting, XJP allocates certain amount of money in Rmb for the purpose of importing raw materials and finished products from its European counterpart. When this allocation is done, it estimates the value of Rmb against the Euro. This estimated figure is the budgeted spot exchange rate.

Unlike actual spot exchange rate the forward rate basically arises due to the forward contracts. In such contracts the rate of the currency might be fixed today while the settlement might be done on a future date. This is one of the hedging strategies.

The US parent company expects its Chinese subsidiary (XJP) to show a 20% increase in its revenue as it has done in the past few years.

4. If you were Paul young, what would you do?

It is of at most importance to maintain the cost advantage that XJP has right now in the market due to which it has a 98% success rate in tender acquisition. Understanding this basic concept, I would follow those tactics <https://assignbuster.com/xian-janssen-pharmaceutical-china-and-the-euro-case-study/>

that would help reduce or maintain the same price of the drugs in the market.

Firstly, I would consider the option of increasing the procurement of raw materials and finished drugs from the local market rather than importing from the European market. Such a thing could drastically reduce the foreign exchange risk. It could also reduce the cost of XJPs drugs.

Secondly, I would implement proper hedging system in place so that the foreign exchange risk could be minimized or even nullified. This could reduce the foreign exchange losses that the company has been incurring due to the weakening dollar.

### Summary

The foreign exchange gains or losses of a company could affect the performance of a company for better or worse. Hence the risk of incurring foreign exchange losses should be hedged.