Currency risk management report report example

Business, Company

Currency Risk Management Report

Background

Mulberry is a bag manufacturing company that is found in Britain the company deals with the manufacture of luxury bags that are not largely exported. However, the bags perform well in the local domestic market. The company manufactures luxury bags that are usually highly demanded by the girls and women. This company has evaluated South Africa and found out that the country is viable for a business venture. There is a large population of ladies in colleges and women and therefore the company is assured of demand for the fashionable bags tailored to this group of people.

Funds required

The investment in South Africa required a minimum of 2 million pounds. This amount is required to buy the machines that are required to make the bags. In addition, this amount will be used to pay the laborers that are required in the company to be started. There are other expenses that require to be met. Such expenses include taxes to the South African government, cots of purchasing land where the company will be located and the costs of paying for the resources that are necessary to facilitate the operation of the company. Such expenses include water and electricity expenses. All these costs approximately can sum up to 2 million pounds.

Expected annual return.

The return from this investment is attractive. The company projects that it will sell an amount total of 0. 03 million pounds of bags per year. The expected return from this investment is approximately 12 percent rate of return. From the observation, it can be seen that it will take a few years for the company to recover the amount it has invested in the country. Therefore the risk of investing in this venture is very low. South Africa is a fast developing country and therefore it is expected that the demand for luxury bags in the country will be sustainable.

Potential risks.

The risks involved in this investment are many. However, the good management of the company can overcome the risks. The first risk is the competition that is present in South Africa. There are many firms that engage in the manufacture of bags in South Africa. Therefore, it is important that the company develops products that are able to compete favorably in the South African market (Connel, 2004). If the company does not secure market, it is likely to be driven out of the market.

The other risk that id faced by the company is lack of raw materials. The fact that there are many firms that are located in the country means that the competition for the raw material is very high. Therefore, the costs of raw materials will be very high due to the high competition. Therefore, the company should be ready to source out for other sources of raw materials to ensure continuous production (Bradley, 2002).

The company is also likely to experience high costs of production in the country. This is due to the fact that the costs of labor in the country are very high. This is based on the fact that the country has put in place labor laws that ensure minimum wages for each worker. The high wages are likely to result to high production costs and the prices of the bags in this country are likely to be high (Rohr, 1986). As a result, it is possible that the company will experience low demand for its products if it does not emphasize on efficiency that can facilitate the reduction in the production costs.

South Africa is a country that is growing at a faster rate. The gross domestic product of the country has been on the increase. This means that the demand for luxury goods like bags will continue to increase in future. Therefore there is a market for any company that engages in the production of luxury bags. Generally, there are many college and university ladies who have the tastes for the luxury bags (Bradely, 2002). The other population that can be targeted in this case is the women. This group of people has a good taste for the luxury bag. Fortunately, Mulberry is has the experience and ability to produce high quality bags that are fashionable. In addition, the company is able to develop bags of different colors to enable the ladies and women to select the colors that they wish. This is likely to make the products of the company more competitive in the market.

Market opportunity.

The group targeted by the company involves the individuals who are very responsive to fashion changes. One of the abilities of the company is that it is able to produce high quality fashionable products. There is hope that the company will be able to out compete favorably in the international business market (Zoneff, 1986). This advantageous position of the company is likely to facilitate the good performance of the company in the South African market.

Entry mode

The best entry mode of the company in South African market is through joint ventures. This is the suitable entry mode due to the fact that there are many competitors in the market. This means that the company will have to collaborate with an existing firm in the South African market to facilitate access to the market (Jain, 2011). Through this strategy, the company will be able to capture a greater proportion of the customers in the market. In addition, the company will avoid some fixed costs hence the company will be in a position to lower its total production costs. By this, the prices charged for its products will be lower as compared to the prices of the other firms. Therefore more customers will purchase the company's products hence increasing the total revenue.

Sources of financing

The sources of financing this project are many. The fact that the venture is attractive and profitable assures the lenders that the company is in a position to repay the loan. The first source of financing is the commercial banks. The commercial banks in United Kingdom are willing to finance any international projects that are viable (Kavaliova, 2007). The company can therefore request for funding from the commercial banks. The loan can then be repaid with the interest rate in future. The investment is able to repay the loan that will be secured.

There are also government agencies in United Kingdom that are there specifically to encourage foreign investment. These agencies are willing to lend money at lower interest rates as compared to the commercial banks (Levy, 1982). These agencies are attractive sources of financing to the company since the cost of borrowing is low.

One of the major challenges that the company will is likely to face is the fluctuation of exchange rates. The South African currency keeps on fluctuating hence posing risks to international companies that have to import raw materials. In addition, the change in exchange rates is likely to lower the returns of the company since the south African land will be required to be converted into sterling pound to pay the shareholders of the company (Zoneff, 1986). Therefore proper risk management decisions are necessary. The exchange rate risks are generally managed by the use of hedging techniques.

In the above case, the company expects to get a profit of 0. 03 million pounds. This amount is equivalent to 0. 36 million South African rand. This is assuming that 1 sterling pound is worth 12 South African rand. The risk arises here in that the sterling pound may appreciate such that it is worth 13 South African rand. If the 0. 36 million South African rand is converted to sterling pound, the amount totals to 0. 0277 million sterling pounds. This represents a loss of the profit caused by the fluctuating exchange rates. To avoid such losses, the management will put in place risk management policies.

Hedging instruments to manage currency risks.

There are various hedging techniques that can be applied in this case. The first hedging technique is the forward market. In this case, the company can agree with a foreign exchange dealer on the future exchange rates (Fischer, 1996). This is if the company expects the South African currency to depreciate. This will help in making the income of the company more certain.

Even when the exchange rates fluctuate, the profits of the company will remain constant.

The other method of hedging is use of future market this is similar to the forward markets since the exchange rates are agreed upon today but the real exchange takes place at a future date (Logue, 2009). The future market is more developed than the forward in that this market is more standardized. In addition, these markets can involve transactions involving large amounts of money.

The use of options is also a suitable method to hedge against risks. This is a contract that will give the company an option to buy the sterling pounds at an agreed upon rate. The advantage with the options is that if the company realizes that it is likely to lose by exercising the contract, it will not implement the contract and hence it loses the premium paid for the contract (Fischer, 1996). However, if the contract is such that it benefits the company, then the company will accept the contract hence will avoid the risk of declined profits due to the depreciation of the South African rand.

The company can also ensure that the loans that it borrows are in terms of domestic currency. This will avoid the risks of having to pay in foreign currency that has appreciated. This can increase the costs of the company.

Evaluation of the hedging strategies and conclusion.

Generally, the future markets are the best hedging strategy that can help this company. This is because the market for futures is standardized such that the terms of the contract are easy to understand and enforce (Toit, 1981). In addition, the future market can facilitate exchange for a large volume of currencies. However, a combination of these hedging strategies where necessary can do wonders for the company.

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