Exchange rate risk

Finance

Exchange Rate Risk Question Exchange rate risk entails volatility of foreign currency exchange rate in the market that affects firms operating internationally (Madura, 2012). The exchange rate risk affects international firms in three major ways namely transaction exposure, translation exposure, and economic exposure. The translation exposure entails the potential of the consolidated financial statements of a company been affected negatively when assets and revenue from foreign countries are translated to domestic currency (Madura, 2012). The transaction exposure on the other hand entails effect on financial obligations of receiving or making payments that are denominated in foreign currency. Economic exposure involves potential negative effect on business future cash flows from foreign subsidiaries due to fluctuation of exchange rate (Madura, 2012).

Question 2

The various hedging strategies that GBATT can employ to cushion exchange rate risk entails futures contract, forward contract, and options contract (Madura, 2012). GBATT can employ the futures contract to avoid exchange rate risk by entering into a contract with a financial institution on the price and quantity of foreign currencies that will be applied at a specific date. Similarly, the forward contract can be applied by specifying the price at which the foreign currency will be exchanged at with a financial institution in a contract. The options strategy on the other hand will involve entering into an agreement that will give GBATT to sell the foreign denominated currencies but not an obligation at a given rate to domestic currency at specific date. Consequently, the three hedging strategies will enable GBATT to avoid exchange rate volatility.

Question 3

One of the firms that employ hedging strategies to cushion exchange rate risk is Coca Cola Company to reduce translation exposure from its foreign subsidiaries (Coca-Cola. com, 2012). In addition, Dell Corporation has adopted hedging strategies to cushion exchange rate fluctuation (Dell, 2013).

References

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