

# Financial risks



Financial Risks Table of Contents Reference 5 Bibliography 5 What did BMW do in order to manage global financial risk and why? BMW is among the top market leaders in automobile industry, whose product range is highly versatile. As the company has its subsidiaries distributed in different parts of the world, hence BMW is highly exposed to foreign exchange risk. These foreign exchange exposures can be categorized into three types, which are as follows:

Translation Exposure is also known as accounting exposure, which is used to measure the impact of fluctuation of international currencies on the balance sheet of a company. Whenever the currency appreciates (over valued) or depreciates (undervalued) will increase or decrease the effect of loss or profit made by the subsidiary (Shim, Shim & Siegel, 2008, pp 365).

Transaction exposure is linked with the future gain or loss which the company will be making related to future obligation settlements. To handle transactional risk, a company goes for different hedging techniques, but hedging is more profitable in the short term as compared to long term (Shim, Shim & Siegel, 2008, pp 365).

Economic exposure is the most sensitive exposure because its effect is far broader as compared to the others. The extent to which economic exposure will affect a company depends on the nature of the company or the industry in which the company is. These economic factors can be macro economic factors which have their impact world wide or can be micro economic factors like socio-economic factors or political factors specifically to a particular country (Shim, Shim & Siegel, 2008, pp 365).

By undertaking all these exposures, BMW decides its marketing and production strategy to reduce down its foreign risks.

The main motto of any organization is to reduce cost of production and to increase profit for the stakeholders. As through marketing, the management tries to increase revenue, so such strategies are being made through which BMW can increase their sale in those countries where currency is appreciating or is over valued and they will restructure their marketing plan for the countries where currency is depreciating or are undervalued. Same strategy is adopted while launching new product into market; BMW introduces its new products when currencies are appreciating so that they can collect revenue as high as possible. Thus the process is more or less like a long term call option. BMW remain highly cautious for finalizing their marketing expenditure. Company always keeps in mind that marginal expenditure made on any unit should be less than the marginal profit per unit.

Strategy for production is just the reverse of marketing strategy as the company always tries to lower down production cost as far as possible. BMW expands its production capacity where currency is depreciating and cost incurred for production of per unit is high; in the same way company keeps a check on production for those subsidiaries where currency is appreciating. This is similar to a long run put option.

Thus, deciding the foreign exchange risk, BMW take many factors into consideration. A single wrong decision leads to huge loss because it has been found that companies don't go bankrupt for not hedging their future loss but they go bankrupt due to excessive hedging. So before taking any step toward hedging, BMW take into account the degree of fluctuation of the foreign currency in which they already have subsidiaries or the company is planning to establish a new one.

## Reference

Shim, J. K. Shim, J. K. & Siegel J. G. (2008). Currency risk Management. Financial Management.(pp 365) 3rd ed, Barronis.

## Bibliography

Kim, Yong-Cheol & McElreath, Robert, 2001. Managing operating exposure: a case study of auto mobile industry.