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Theme:

Ease of doing business

Study On Association between Type of Foreign Trade and the Method of Hedging the Funds Used By Importers and Exporters

Abstract

Some companies have been turn into bankruptcy as they fail to understand the nature of risks from import and export. Especially in some highly volatile markets, hedging against risk is essential. This paper intended to study effect of currency fluctuation in foreign trade. AS preference of importers and exporters is being measured. Methodology used in investigating the impact of currency fluctuation on import/export oriented businesses in Gujarat specifically in Ahmadabad region, include questionnaire and interview. To conduct this research sample size is taken as 200 which includes people aging more than 18 who deals with currency fluctuation and 50 are involved in the business of import or export in Gujrat state. Chi square test used to test hypothesis and result revels that there is no association between education qualification and hedging platform used by importers and exporters.

Key words: Currency fluctuation, foreign trade, importers and Exporters

Introduction

Companies often gain unwanted exposure to the value of foreign currencies and price of raw materials. As a result, they seek to reduce risk which comes with these exposure by making financial transaction. In actual, financial markets are largely created for just these kind of transactions where one party offloads risk to another party. Companies will hedge in various markets to offset the business risk posed by these unwanted exposures.

Literature review

(Christine Sauer, 2001) Studied large panel of industrialized and developing countries to investigate the link between exchange rate volatility and exporter's risk. Though there is empirical literature on this variables, conclusion about importance and nature is yet to discuss among researchers. Inference of the study made using different volatility measures which indicates that negative relation exist between exporters from America and Africa.

(GeorgeAllayannis, 2001) Examined weather firm's uses foreign currency derivatives for hedging or minimizing risk. Study was done on S&P 500 nonfinancial firms from 1993 to 2000. They found evidence that firms using currency derivatives and hedging, reduces exchange rate exposure. Type and level of derivative depends on firms exposure in foreign trade.

(Mahesh D.Pritamani, 2004) Studied some literatures on exposure for multinational or exporting firms, where total exposure includes both firms' specific and microeconomic effects. According to their research hypothesis firms are affected by foreign market and domestic economic variables. As well result of the study predicts that total exposure for exporters and positive total exposure for importers and multinationals are estimated with the help of hedging.

(PeterHooper, 1998) Specified a model of differential risk capabilities by import demand and exports supply sides of the market in foreign trade the theoretical impact of exchange risk on both price and demand was analyzed. Result of the study indicates that exchange rate uncertainty had significant impact on prices but minor effect on the volume of trade.

(Young SangKima, 2006) Examine operational hedging by firm and process of operational hedging related to financial hedging considering 424 firms as sample out of this 212 operationally hedged firm and reaming 212 is non operationally hedged firm. They found that firms with exports sales uses more financial hedging.

(MasahiroKawai, 1986)

(Shang-JinWei, 1999) Focused on puzzle in empirical international finance which indicates a large and negative effect of exchange rate fluctuation on foreign trade. These paper deals with problems faced by hedgers and currency hedging instrument was not observed by some countries. Finding of the study revel that evidence of validity of hypothesis was not found.

(Carter, 2013) Investigated influence of both financial and operational hedge on foreign exchange exposure of multinational corporations of USA. It is stated in the result of the study that both financial and operation hedges both can effectively decrease foreign currency exposure. It is also notable that many multinational company have asymmetric foreign exchange exposure.

(T.Barkoulas, 2002) Concluded effect of exchange rate fluctuation depends on the volume and instability of demand in foreign trade. Outcome of study state that direction and magnitude of exporters and importers depends upon the source of uncertainty and risk capability.

(RogerWare., 1998) Focused on transaction exposure to foreign exchange risk can be covered or hedged in forward or future market. But the same may not be the case of economic exposure. Study states that in uncertainty, exporters are require to hedge economic risk as well in some cases a portfolio of currency option can be constructed.

(Auboin, 2011) Studied a wide range of economic literature on association between currency and trade. Objective of paper was to investigate impact of international trade on currency fluctuation. As stated in the interpretation exchange rate volatility has negative on foreign trade. The extent of this effect depends of many factors and degree of economic integration among the countries.

(Sarris, 2009) Discussed recent world food price issues of some countries. Paper intended to find how countries are managing their basis staple food imports in time of crises. Outcome of studies states that risk level and problem faced by food importers mainly faced by low and middle income importing countries.

Objectives of the study

The basic idea for undertaking the study of fluctuations in currency market and influence on foreign exchange is to gain the knowledge about why the major developed countries currency rates influence other currencies value.

1. To understand the impacts of hedging on exporters and importers.
2. To examine the effect of currency price fluctuation on exporters and importers.

Research methodology

To conduct this research sample size is taken as 200 which includes people aging more than 18 who deals with currency fluctuation and 50 are involved in the business of import or export Specifically in Ahmedabad city of Gujrat state. To fulfill research objectives exporters and importers are ask to fill questionnaire and in some case interview of exporter is taken. Sampling method chosen for the research is non probability convenience sampling.

Expected Contribution of the Study

The study will contribute to the Government, Multinational companies, stockbroking institutes, banks, hedgers, other financial institutes and importantly to the exporters and importers who are trading into the currency market and dealing in foreign trade.

Table:1 Profile of respondents

No.	Content	Classification of respondents response (in %)		
1	Gender	Male	Female	Prefer not to say
		38.9	60.1	0
2	Preference investing in currency market	Yes	No	May be
		72.9	13.8	13.3
3	Willingness to take risk	Yes	No	May be
		65.0	17.7	17.2
4	Risk taking ability	More risk	Moderate risk	Avoid risk
		26.6	49.8	23.6
5	Types of business	Import	Export	Both
		38.1	25.2	36.8
6	Do you hedge the funds?	Yes	No	
		91.0	8.4	
7	Preference for multiple hedging	Yes	No	
		72.7	26.6	
8	Hedging helps minimizing the risk	Yes	No	May be
		66.9	14.3	18.8
9	Hedging increases the cost of hedging	Yes	No	
		68.8	15.6	15.6

Table:2 Liker scale rating

No.	Content	Highly satisfied	Satisfied	Neutral	Dissatisfied	Highly dissatisfied
1.	Ratings given for hedging the fund (%)					
	Banks	22.1	18.2	55.2	4.5	0
	Agency	7.8	59.7	29.2	3.2	0
	Sub broking firms	9.1	33.1	50.6	7.1	0
	Stoke brokers	3.2	46.1	38.3	11.0	1.3
2.	Satisfaction level regarding whole process of hedging (%)					
	Controls the risk	14.9	46.1	36.4	1.3	1.3
	Smooth operations	11.0	58.4	27.9	2.6	0
	Maintaining liquidity	13.6	46.8	35.7	2.6	1.3
	Cost occurrence	9.7	48.1	37.0	5.2	0
	Legal documentation	11.0	52.6	31.8	3.9	.6
3	Preferable method for hedging	Future	Forward	Option	Others	
		40.3	31.8	27.3	.6	

Hypothesis:1

HO: there is no relationship between educational qualification of the person and choosing the platform for hedging the funds.

H1: there is relationship between educational qualification of the person and choosing the platform for hedging the funds.

Table:3 Cross tabulation

EDUCATIONAL_QUALIFICATION * PLATFORM_FOR_HEDGING_FUNDS					
		PLATFORM_FOR_HEDGING_FUNDS			
		Banks	Agency	Stock broker	Sub broker
EDUCATIONAL_QUALIFICATION	Schooling	1	2	0	0
	UG	6	4	1	1
	PG	7	0	6	0
	Diploma	3	2	3	0
	professional degree	4	3	4	1
Total		21	11	14	2

Table:4 Chi-Square Tests			
	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	13.153[a]	12	.358
Likelihood Ratio	17.355	12	.137
Linear-by-Linear Association	1.410	1	.235
N of Valid Cases	48		

Interpretation

Null hypothesis is accepted as chi square value is more than 0.05. There is no relationship between educational qualification of the person and choosing the platform for hedging the funds. Investors should consider hedging at least a portion of the foreign-currency exposure within their equity allocation, based on convenience of a low-cost hedging program or hedged equity product.

Hypothesis:2

Ho: there is no association between import export business and the method of hedging the funds

H1: there is association between import export business and the method of hedging the funds

Table:5 Cross tabulation

EXPORT_IMPORT_BUSINESS * PREFERABLE_METHOD_OF_HEDGING

		PREFERABLE_METHOD_OF_HEDGING			Total
		Future	Forward	Option	
EXPORT_IMPORT_BUSINESS	Yes	24	20	3	47
	No	0	0	1	1
Total		24	20	4	48

Table:6 Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	11.234[a]	2	.004
Likelihood Ratio	5.223	2	.073
Linear-by-Linear Association	4.898	1	.027
N of Valid Cases	48		

Interpretation

Null hypothesis is rejected as chi square value is less than 0.05. So inference can be drawn that there is association between import export business and the method of hedging the funds. Most of exporters and importers are preferring future and forward contract over option and swap.

Conclusion

Currency hedging options and futures contracts are tools through which you can buy or sell specified quantities of pairs of currencies at a future date (which is predetermined). The price or exchange rate is decided on the date of purchase. The hedging are similar to options and futures in the stock market, aside from the fact that currency pairs are the underlying assets.

Most of exporters and importers find hedging costly and says that it increases the cost of transaction but it is a safe mode when you are dealing in foreign market.

Hedging is a way of avoiding risk but it comes with a specified cost there are transaction cost as well processed charges involved but of course, hedging can also decrease your profit.

One should keeping mind

1. Hedging is not a magic trick that guarantees you money no matter in which direction market is going.
2. Hedging is a way of liming or minimizing the potential loss of an adverse price instabilities in the future.

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