

Foreign exchange risk management in UK, USA and Asia Pacific multinational companies

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Abstract

The objective of this paper is to simultaneously survey the foreign exchange risk practices of large UK, USA and Asia Pacific multinational companies (MNCs). It investigated whether foreign exchange risk management practices vary internationally, including for the first time a large sample Asia Pacific MNCs. From 179 (30%) usable responses it is shown that there are statistically significant regional differences in the importance and objectives of foreign exchange risk management, the emphasis on translation and economic exposures, the internal/external techniques used in managing foreign exchange risk and the policies in dealing with economic exposures. In general, UK and USA MNCs have similar policies, with a few notable exceptions, however, Asian Pacific MNCs display significant differences. To control for regional variations in the characteristics of respondents the results are also compared by size, percentage of overseas business and industry sector. It was found that either the size of the respondent or the industry sector could also explain the emphasis on translation and economic exposure and use of external hedging instruments. © 2000 Elsevier Science B.V. All rights reserved.

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1. Introduction

Although foreign exchange risk is one of the many business risks faced by multinational companies (MNCs) its management has become one of the key factors in overall financial management. Whether the objectives of MNCs are to minimise foreign exchange losses or maximise exchange gains, they need to understand the extent of exposure they face and manage it to an acceptable level. The contribution of this paper is to consider whether there are differences internationally in attitudes towards foreign exchange risk and the methods used to manage it.

There have been a number of prior UK and USA surveys on derivative use, several case studies on foreign exchange risk management policies in the UK and USA and one survey of derivative use in the Asia Pacific region (New Zealand)¹. However, these previous studies are extended by considering only large MNCs², focusing on a much wider question of foreign exchange risk than previously examined, considering the views of many of the countries in the Asia Pacific region which have never been examined before and finally, carrying out a simultaneous international comparison between regions using the same survey questionnaire³.

The results indicate that there are statistically significant regional differences in the objectives and importance of foreign exchange risk, the emphasis in the management of translation and economic exposures, internal/external techniques used in managing foreign exchange risk and the policies in dealing with economic exposure. On the whole, UK and USA MNCs have similar policies in general, with a few notable exceptions, but Asian Pacific MNCs display significant differences in their management of foreign exchange risk. To test whether these differences could also be caused by different company characteristics the responses were also analysed by size, percentage of overseas business and industry sector. Surprisingly, the percentage of overseas business had no statistically significant effect on any of the responses. The size of the respondents was statistically related to the view and management of translation exposure while the industry sector was significant in the

¹ Rodriguez (1981) and Davis et al. (1991) surveyed foreign exchange risk management in the US and UK MNCs, respectively. Collier and Davis (1985) and Belk and Glaum (1990) considered the management of currency risk by UK companies from interviews with 51 and 17 companies, respectively. In a later study Collier et al. (1992) examined case studies on foreign exchange management by 23 UK and US companies. US surveys of derivative use include Bodnar et al. (1995, 1996, 1998), Phillips (1995). Grant and Marshall (1997) provided a UK survey of derivative use and Berkman et al. (1997) surveyed 79 New Zealand companies and then compared their results to the Bodnar et al. (1996) US survey.

² The previous evidence indicates large companies are exposed to foreign exchange risk to a greater extent than a cross section of companies and are also more likely to use hedging instruments. The survey sample had to meet two criteria; it had to be defined as a MNC (a corporation having at least one overseas subsidiary over which it has financial and management control) and it should not be a financial, banking, insurance and investment corporation.

³ The same questionnaire, written in English, was sent to all MNCs, however, for the Japanese MNCs it was translated. Confidentiality was guaranteed to respondents, however, a copy of the 600 MNCs surveyed and the questionnaire is available from the author on request.

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