Managing Exchange Rate Risk

Brand: Mehta Solutions
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Short Description
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Description

Managing Exchange Rate Risk CAST STUDY solution

Managing Exchange Rate Risk
Mahindra International (India) imported spares of an engine from a US manufacturer for $ 5,000 per annum at a price of $ 2.5 per piece. The average exchange rate during 2001-02 was Rs. 47.70/$. The Indian company imported the spares also from a British

manufacturer. In fact, it had diversified its import in view of reducing the risk associated with the supply. The import from the USA was competitive in view of the fact the same spares imported from the UK was slightly costlier. The American spares cost Rs. 119.25 per piece, while the British spares cost Rs. 120.00 per piece. In 2002-03, US dollar appreciated to Rs. 48.40 with the result that the cost of American spares turned higher than the British spares. In the sequel of the appreciation of US dollar, the Indian importer cut its demand from 2,000 pieces to 500 pieces. The loss to the US exporter was colossal. But at the same time, the Indian Importer suffered a lot. It had to pay a higher price for the US spares in terms of rupee. And also, it had to divert its import from the USA to the UK insofar as the pound sterling did not appreciate during this period. All this happened in the wake of the exchange rate changes.

Questions:

1. Mention the loss borne by the US exporter in the sequel of appreciation of dollar.

2. What strategy the Indian importer needs to follow to hedge the exchang