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Effectiveness of Case-Research Method in Explaining the Intricacies of Forex Risk Management

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***Abstract*: The paper explores the relevance of case-research method in understanding the critical parameters, factors and variables relevant in a complex situation and their *inter se* relationships. After examining the literature on the case research method the paper takes up the subject of forex risk management as a topic of study and attempts the case-research method to the understanding of this topic. The authors have compiled 64 cases relating to the topic and through a detailed analysis of these cases have arrived at the critical parameters and their inter-relationships. With a clear understanding of these, the authors have been able to come up with the framework of a generic strategy to manage the forex risk of firms. The authors conclude that case-research method is quite effective in unraveling the intricacies of a complex managerial situation.**

***Keywords*: Case-research Method. Recognition of Patterns. Inductive Logic. Validation through examples. Generic strategy for Forex risk management.**

I. INTRODUCTION

Harvard Business School (HBS) is credited with pioneering the case-method of teaching as pedagogy to bring real-life experience to the class-room. To sustain this pedagogy HBS evolved a rigorous discipline of case-writing. World over many schools adopted this pedagogy and many academicians followed the vigorous pursuit of case-writing resulting in volumes of cases in almost every aspect of business education. At the same time many schools and many academicians disputed the credibility of case-method of teaching for its unorthodox methodology. In short the case-method of teaching continues to be as controversial as it is popular. The fate of case-research method is no different. The case-research method follows the path of searching for patterns from a cluster of cases. The protagonists of case-research method argue that the process of reinforcement of the patterns through each new observation implies the logic of induction. The antagonists of case-research method raise the epistemological question that such inductive logic is never comprehensive and does not lead to the core of reality. Be that as it may, this paper is an attempt to explore whether the case-research method is effective in gaining insight into a fairly complex situation. The complex situation is chosen as the one involving forex exposure management.

II. REVIEW OF LITERATURE

According to Fidel (Fidel, 1984) case-research method is relevant where (a) the number of variables and factors are large, (b) no prior knowledge or law exists to determine the relative relevance of the variables and factors and (c) the relationships between factors and variables can be observed directly. The method of case-research moves from one case to another gathering information, knowledge and experience; it moves from individual or specific case to generic situations, gradually, through evidence (Becker, 1970). Validation is through the observations of the pattern of behavior and hence its predominant choice in qualitative research (Gold, 1958; Bogdan & Taylor, 1975). Case research cannot be completely pre-determined or pre-planned. The researcher may or may not have clear idea or expectation about the patterns of

behavior to begin with. Mostly the researcher has to observe the data and identify patterns; as he /she observes more and more situations, continuous validation would take place which would enable the researcher to make appropriate postulations. Hence it is necessary that data gathering must be as comprehensive as possible lest some significant aspects are left unexplored. The process of case research consists of three elements: design of the study, data gathering and data analysis. The process of analysis is characterized by controlled comparison (Diesing, 1970). Can the case-research method be used to gather insight into a complex situation?

Forex risk management is a fairly complex situation. The exchange-rate between two currencies, at a given point of time and space, is a reflection of the intrinsic strengths of the economies, their inter se interactions and the environment in which the transactions take place. This definition envisages some salient assumptions: (a) The exchange-rate is always between two distinct currencies and hence relative. (b) It is temporal and transient at a given point of time and space; it is never universal nor static. (c) It is a reflection of the intrinsic strengths of the two currencies in transaction; in the absence of transactions the exchange-rate does not exist. (d) The exchange-rate also depends heavily on the external market conditions where the transactions take place. (e) It depends significantly on the perception of each of the economies by the international community; this is perhaps not stated in the definition but it is derived from the situations of international transactions. (f) This definition does not consider trade barriers and restrictions.

What are the factors influencing the exchange-rate between two currencies? Exchange-rate is a reflection of the relative competitiveness of two economies and so it is most likely to be affected by the relative size of the economies, relative factor-endowments and relative economic achievements. Jeffrey Sachs argued that, in addition to these, the economic geography of a nation has significant impact on its economic performance (Sachs, 2005). Sachs attributes the difference in economic achievements of two countries to differences in productivity and competitiveness spread over a long period of time. Gravity Model of international trade (Tinbergen, 1962) with focus on the size of the economies, Theory of comparative advantage (Ricardo, 1817) and Hechscher-Ohlin Model (Learner, 1955; Ohlin1967) have been able to explain the exchange-rate phenomenon only partially. The stage of economic development that a country is in at a given point of time would have significant impact on its economic health. In the context of international business the relative stages that two countries would impact the relative competitiveness of the two countries (Porter, 1990). Robust political systems, processes and practices would lead to stable economic management and growth of an economy (Sharma, 2007; Khan, 2006). Similarly the existence of institutional infrastructure would contribute to the steady growth and economic management of a country (Abdellatif, 2003). Socio-cultural aspects of a society have significant impact on its ability to transform and grow (Kroeber and Kluckhohn, 1952; White, 1992; Fukuyama, 2002). Statesmanship and leadership exhibited by a country, its ability to articulate soft power among the international community, the size and influence of its diaspora etc would make a country unique among the international community (Nye, 1990, 2004, 2008; Fraser, 2005). All these factors are also expected to influence the exchange-rate of the currency of the country. Influence of such myriad factors makes the prediction of the exchange-rate extremely difficult.

True to nature, every economy and every firm is in a state of continuous evolution, in a state of flux; none is static. Differential perception of competitiveness of economies taken two at a time manifests in forex fluctuations relating to those two economies at that point of time. Such fluctuations impact different firms differently depending upon the intrinsic properties of the firms. Forex exposure management is the management of the consequences of these factors and hence very complex. Case-research method is recommended as a powerful tool to situations where the number of variables involved is large and the relationships are complex. Given this background forex exposure management should be an apt field to apply the case-research method to gain insight into the dynamics of the situation.

III. RESEARCH QUESTION & METHODOLOGY

In understanding the dynamics of forex exposure management of firms, the questions that naturally emerge are: *What are the critical factors that influence or cause the forex exposure of firms? What are the critical variables that are relevant in managing the forex exposure of firms?*

In order to engage the case-research method to explore these questions, the first task is to compile cases of firms where critical situations of forex exposure management have been handled. A study of these cases would perhaps throw light on the business situations, impacting factors, firm responses and the net result. Search for such cases yielded the situations handled by multi-national corporations and firms with global operations. Indian firms were conspicuous by their absence in this cluster because there were not many Indian firms with presence in multiple currency areas till the late 1990s. The

global firms were there in the arena of international trade for quite some and most probably have perfected the art of managing forex exposure over a long period of time. As a result a study of the cases involving them would lead to developing some framework of handling forex exposure situations.

Subsequently it would be worthwhile to look at Indian firms in sectors where international business has blossomed significantly to understand the special circumstances therein and to know how the firms were managing the situations. With larger sample-size, the patterns should emerge with increasing clarity and conviction.

IV. ANALYSIS AND DISCUSSION

Cases of forex exposure management were compiled from secondary sources. Initially the search was for cases where critical forex situations were present. The search yielded 27 cases of which 25 pertained to leading foreign firms; 2 were Indian firms. Then the search was extended to contemporary Indian firms. The insights from the study are analyzed in the following paragraphs.

a. Cluster-1: 7 firms were net-exporters in the first cluster. 6 of them experienced domestic currency appreciation. Toyota and Toshiba, the Japanese automakers were producing in Japan and exporting to the rest of the world. Domestic currency (Yen) appreciation made their cars costly to the buyers outside Japan, adversely impacting the exports. These firms, over a period of time, created production systems in other countries where the currencies have not appreciated as much to make their final products competitive in the global market. Embraer, the aircrafts manufacturer from Brazil was hit adversely by domestic currency appreciation. The firm tried to hedge the situation; this did not succeed and the firm had to suffer. GHCL (Textile div) and Ashima were Indian firms hit by appreciation of Rupee during 2003 to 2008. These firms managed to overcome the situation by cleverly sourcing cotton from countries where it was cheaper and selling the output in countries where they were costly. Harmony Corp of South Africa was in mining and refining of gold. When gold prices went up internationally, the firm's exports gained in value. Since gold contributed significantly to South Africa's GDP, its economy buoyed and this led to the appreciation of its currency. This enhanced the domestic cost of the firm eating into the real profitability of the firm. There was no way to hedge the rise in the domestic costs and hence the firm had to suffer. The net exporter to have experienced depreciation of domestic currency was Pemex Corp of Mexico. The firm was into oil exploration in Mexico and sold its output outside Mexico. So the Peso depreciation vis-à-vis the dollar further reduced its domestic costs without hampering the revenue; the situation was beneficial to the firm.

There were not any *Net-importers* in the cluster. There were 18 firms with *significant imports and exports* in multiple currency areas. Of these 5 were MNCs (Avon International, Pepsico, McDonald, Vodafone and SKF). Each of these firms had the strategy of finding their net position in terms of exports and imports in each currency area and taking a decision to hedge or not.

Daimler Chrysler and BMW, both based in Europe, found their competitiveness declining with appreciation of Euro. Markel, a US firm was selling its products to European customers at constant European prices. When the dollar appreciated the firm could not maintain the policy and make profits. The firm had no natural hedge to cover. Laker Airways a British firm had its expenses in dollar (salaries, loan payments etc) while its income was in dollar and pound. When dollar appreciated the firm suffered. General Motors, USA had substantial exposure to Canadian dollar and Argentina's Peso. When dollar appreciated the firm hedged its exposure to Canadian dollar; tried to create natural hedge for Argentina's Peso by promoting exports of materials, parts and components from Argentina to various plants of GM across the globe. Corus Steel and GM, UK were impacted by the appreciation of the pound. Both firms tried to hedge exposure through short-term strategies. General Motors, USA faced major competition from Japanese automakers. Each Japanese carmaker had a significant component of Yen in its costs. Whenever yen depreciated, the Japanese carmakers gained in competitiveness; they shared part of the benefits with their customers by reducing the prices. This adversely impacted General Motors. Fluctuations in Yen were very frequent. In order to counter this impact on a long term basis General Motors decided to increase its exposure to Yen.

Lufthansa had a contract with General Electric to buy engines on a regular basis; the contract spelt out how the risk of exchange-rate movement will be shared between the two firms. The contract between Mitsubishi and Chrysler also had similar covenants.

One case explored the collapse of the South Korean Chaebols during the South Asian crisis. The Chaebols had leveraged themselves very high (with debts as high as 10 times the equity) in various currencies and with short-term maturity. These

funds were invested in long-term projects. Since such a phenomenon was happening across the country among all Chaebols and all South Korean banks, the South Korean currency, Won, lost its value significantly. The Chaebols found it difficult to service because (a) the invested funds were slow in giving returns and (b) the devaluation had made servicing much more difficult. As a result many of the Chaebols did not survive. The case of Perfect Pieces is somewhat similar, albeit at a much smaller scale. This Australian company making roof-tiles had its costs in Yen, New Zealand dollars, US dollars besides Australian dollars. Its revenues were in Australian dollars and US dollars. There was significant mismatch between the quanta of inflow and outflow in terms of currencies and in terms of time-frames of the cash-flows. This had made the financial situation of the firm very complex and risky.

Zero Exim firms: Kodak, USA, in 1985, did not have any foreign currency exposure. With the appreciation of US$, the firm faced increased competition from Japanese firms. Similar situation was faced by a South European firm (making toys) in 2000 with the appreciation of Euro. This firm realized the long-term impact and shifted its operations to South Asia.

Careful analysis of the narrative of these cases yielded insight into the critical factors influencing the forex exposure situation as well as to the pattern of behavior of the firms in the face of forex exposure. These are tabulated below in two levels of abstractions. Level-1 lists the primary observations; these have been refined to get the generic inferences which are shown in Level-2.

Table-1: Observations from the Analysis of 27 Cases where critical Forex situations were present.

Level-1	Level-2
• Forex risk emanates from the movements of Forex-rates. The movements can be in the form of appreciation or depreciation of the domestic currency. The movements can be short-term or long-term in nature. • Forex risk impacts the firm through the medium of the cross-border transactions of the firm. The transactions are (a) Commercial – exports or imports, (b) financial – debt servicing (principal and interest payments), and (c) Investments – dividend payments, FDI, capital repatriation etc. • Special situations have been observed where even without cross-border transactions a firm is impacted by exchange-rate movements. Such instances are observed in relatively open economies where the fortune of a purely domestic firm is also impacted by competition from foreign firms resulting from the appreciation of the domestic currency. • The nature of impact of forex risk depends on the type of firm. Firms are found to be of different types: (a) Producing in one country and exporting to one country; (b) Producing in one country and exporting to many countries; (c) Producing in many countries and exporting to many countries; (d) Importing from one country; (e) Importing from many countries; (f) no imports , no exports; etc. • Firms are observed to respond in a combination of the following options: (a) Using natural hedges (b) using internal hedges and (c) using external hedges; (d) business restructuring; (e) changing the business model etc.	• The major factors causing the forex risk of a firm are: ○ The initial conditions of the firm: In each currency area of its operations whether the firm is a (a) net exporter-X, (b) net Importer - M or (c) zero in exports and imports – Z. ○ The nature of the forex triggers (the external stimulus): (a) whether the domestic currency is appreciating or depreciating vis-à-vis each currency of the firm's operations; (b) whether the currency movements are of short-term nature or long-term nature. • The strategic response of a firm would be a combination of the following options ○ Using natural hedges ○ Using internal hedges ○ Using external hedges • The choice of the combination will be situation specific. A careful analysis of the various cases can lead to a set of prescriptions. This can form a Forex Exposure Strategy Matrix.

b. The second Cluster consisted of 37 cases set in the Indian context from the sectors of IT, Gems & Jewelry, Pharma, Textiles, Engineering, FMCG and Energy. These cases were analyzed with the insights gained from the earlier cluster.

The Net-Exporters (X): All firms of the IT sector and the Gems & Jewelry sector were net-exporters operating in multiple currency areas. Invoicing was either in US dollar or Euro while the input costs were in Indian Rupees except the raw materials for diamonds [roughs] which were imported. Most of these firms did not have foreign currency loans. They remitted the proceeds to their head offices regularly. Reliance Industries Ltd, a firm in the energy sector sold its output to the oil distributing companies, in dollars, as deemed export; so RIL was also a net exporter. In a regime where Indian Rupee had only depreciated over the years, these firms enjoyed favorable forex environment. Only during 2004 to 2007 when Indian Rupee appreciated, were these firms alarmed and since then they have been resorting to hedging[2] selectively.

The Net-Importers (M): Bombay Dyeing and Century Enka from the textile sector, BPCL and IOCL from the energy sector are found to be net-importers. All have to import petro-based products. The former two firms have been engaging hedging techniques actively for several years. The latter two, dominant public sector undertakings with names in the Fortune 500 list, have also started using hedging techniques in recent years.

Firms with Significant Exports and Imports (XM): All the firms of Pharma, Engineering and FMCG sectors, and two firms from the Textile sector are found in this cluster. Majority of the firms (20 out of the 37) are in this cluster. Most of the firms in this cluster operate in multiple currency areas. Invariably, all of them find the net exposure in each currency area, explore natural hedging and then take a conscious decision regarding hedging. The decision, in each currency, would be whether to hedge the net exposure and to what extent.

Zero Exim Firms (Z): Four PSUs – NTPC, NHPC, GAIL and PGCL – are found in this cluster. These firms have forex exposure only through the large FC (foreign currency) loans they carry[3]. Every time the Rupee depreciates, these firms end up paying more INR toward interest and principal payments. They have not been resorting to hedging or any other forex risk mitigation strategies. Possibly they never felt the need since they are able to pass on the resultant losses to their customers without any dilution[4].

The inferences from the first cluster of cases are further reinforced by the observations from the second cluster. The insight gained from the cases has resulted in the following matrix where strategy prescriptions are logically arrived at for each of the situations.

Table-2: The Forex situations and the Strategy prescriptions. (Forex Exposure Strategy Matrix)

Scenario Type	Initial Condition (Type of Firm)	External Stimulus (Trend of Local Currency)	Impact on Firm	Strategy Prescription	
				When the Forex trend is Short-term	When the Forex trend is Long-term
Type-1	X:Net Exporter	A: Appreciation	Exports fetch less Foreign currency. Less Profitable operations	Find natural hedges. Consider hedging for the residual exposure	Explore restructuring of the firm to outsource production
		D: Depreciation	Exports fetch more Foreign currency. Favorable situation	No action required.	No action required.
Type-2	M:Net Importer	A: Appreciation	Imports will be cheaper. Favorable to the firm.	No action required.	No action required.
		D: Depreciation	Imports will require more Local Currency. Hence costly.	Find natural hedges. Consider hedging for the residual exposure	Explore import substitution.
Type-3	XM: Substantial imports	A: Appreciation	Mixed results	Assess the exposure in each currency area. Choose the strategy relevant to X, M or Z as the case may be	

	and exports	D: Depreciation			
Type-4	Z: No imports, No exports	A: Appreciation	Operations of the firm will lose its competitiveness vis-à-vis imports.	Find natural hedges. Consider hedging for the residual exposure	Outsource or re-locate operations.
		D: Depreciation	Operations will be cheaper. Scope for arbitrage exists	No action required.	No action required.

c. Table-3 shows the distribution of the firms in clusters 1 & 2 among the various categories. The figures indicate that net-exporters constitute about 25 % of the each of the clusters. The sectors of IT and Gems & Jewelry have only net-exporters. Among the total of 64 cases only 4 (6.25%) are found to be net-importers. These are found among the textile and the energy sectors. Firms with substantial exports and imports (X-M category) are found to form the dominant segment (67 % in cluster-1, 54 % in Cluster-2 and 59 % overall). Firms with nil forex exposure tend to form the smallest segment (less than 10 %).

On a scrutiny of the nature and size of the firms in the X-M category, it is seen that (a) larger firms tended to be in this category; (b) firms operating in multiple-currency-areas tended to be in this category; (c) older/established/mature firms tended to be in this category. This leads to a postulation that a firm in its early stages of growth, may be in X or M categories. When the firm grows large and operates in multiple economies and currency areas it tends to move into the X-M cluster. This is true for most of the MNCs and contemporary Indian companies.

Table-3: Distribution of firms among various categories

Sector	Nature of the firm				Sector total
	X	M	X-M	Z	
Cluster-1: Firms with prior Forex exposure	07(25.9%)	0	18(67%)	02(7.4%)	27 (100%)
Cluster-2: Contemporary Indian firms	09 (24.3%)	04 (10.8%)	20 (54.0%)	04 (10.8%)	37 (100%)
Clusters 1 &2	16 (25%)	04(6.25%)	38 (59.4%)	06(9.37%)	64 (100%)
Sector-wise break-up of Cluster-2 firms					
IT	4 (10.8%)	0	0	0	4 (10.8%)
Gems & Jewelry	4 (10.8%)	0	0	0	4 (10.8%)
Pharma	0	0	7 (18.9%)	0	7 (18.9%)
Engg	0	0	9 (24.3%)	0	9 (24.3%)
FMCG	0	0	2 (5.4%)	0	2 (5.4%)
Textile	0	2 (5.4%)	2 (5.4%)	0	4 (10.8%)
Energy	1 (2.7%)	2 (5.4%)	0	4 (10.8%)	7 (18.9%)

d. The study shows that most of the firms – both international and contemporary Indian firms - do engage hedging as a strategy to manage forex exposure in the short-term. Almost all the hedging instruments available in India are of short-term nature and hedging has its costs also. Besides, not all situations of forex exposure are resolved through hedging. So firms are judicious and discrete about hedging. This is supported by Soenen and Madura (Soenen & Madura, 1991) by stating that hedging is not the final answer for all situations of forex exposure and that firms may have to look beyond hedging in many situations.

V. SUMMARY & CONCLUSIONS

1. There are three critical variables that influence the incidence of forex exposure on firms:

   a. The initial conditions of the firm: whether it is a net-exporter (X), or a net-importer (M), or has Zero Exports and Imports (Z). Large firms with operations in multiple currency areas as well as MNCs would have significant imports and exports. Such firms need to be seen in each of the currency area whether it is X, M or Z.

   b. The External stimulus: Whether the domestic currency is experiencing appreciation or depreciation. Short-term trends will be visible immediately and would need to be taken into account. Long-term trends would emerge only gradually.

   c. The Firm Response: This will depend on the earlier two parameters, the resources at the command of the firm and the accumulated learning of the firm.

2. Based on the four possibilities in the initial conditions and the two possibilities of currency movement, eight (8) scenarios are possible. Type-3 consists of diversified and global firms. When viewed in each currency area Type-3 situation gets resolved into a set of Type-1, Type-2 or Type-4 situations. So in essence there are only three types and two forex trends leading to six basic scenarios in all. It is possible to describe the impact of each of these scenarios and suggest an appropriate strategy for each of the scenarios. This is shown in Table-2.

3. A firm, in its early stages of existence, may be a net exporter(X), net-importer (M) or zero-exim (Z). However as the firm grows, diversifies and becomes global in its operations, it would have significant transactions across continents and currencies. It would then have significant imports and exports. This study indicated that majority (60%) of the firms fell into this category (Type-3: XM). It is reasonable to presume that this type is the most generic type into which every firm would eventually grow into.

4. The generic short-term strategy for forex risk management can be described as under

   a. Assess the exposure in each currency area separately.

   b. Explore the prospect of natural hedges and take advantage to the maximum extent.

   c. Consider the net (residual) exposure in each currency area for hedging

   d. The hedging decision consists of (i) to hedge or not, (ii) to what extent, & (iii) method of hedging.

5. Hedging techniques as engaged by firms are of short-term nature only. If the forex exposure is of long-term nature and a firm needs to find a long-term solution, it has to resort to strategies like restructuring its business, changing its business model etc. (See Table-2 for details).

6. Has the case-research method been effective in unraveling the intricacies of forex exposure management? The present study of 64 cases – first a cluster of 27 cases with prior experience of managing forex exposure situations and thereafter another cluster of 37 contemporary Indian cases – has enabled the identification of the critical factors influencing the forex exposure of the firm as well as the behavior pattern of firms towards such situations. From these insights it has been possible to relate the impact of the factors and the responses that would be effective in mitigating the exposure situations. This understanding has enabled the prescription of strategic responses to various forex exposure situations leading to the development of a forex-exposure-strategy-matrix. With this background it is reasonable to conclude that case-research method has been fairly effective in unraveling the intricacies of forex exposure management.

VI. END NOTES

1. The 64 cases which formed the basis of this research are compiled from various sources: books, papers, articles, annual reports, websites etc. A detailed listing of the sources runs into more than 180 items of reference. This listing is not included along with this paper to avoid clutter.

2. Hedging refers to the techniques employed by firms to minimize the impact of forex exposure. Since the focus of this paper is on exploring the intricacies of forex risk management through case-research method, no attention has been devoted to the method of hedging engaged by firms.

3. The PSUs – NTPC, NHPC, PGCL and GAIL – are not totally from free forex exposure. Each of them had debts denominated in Foreign Currency in the range of 30 % to 50 % of their total debts. To this extent each of them had forex exposure through debt-servicing. Strictly speaking, these firms cannot be categorized as Zero-Exim firms. This aspect has been temporarily ignored only for the sake of simplicity in explaining the cluster.

4. These firms have not been feeling the heat of forex losses because they have been able to pass on the losses to their customers. The possible reasons to this situation were (i) electricity pricing in the country had not yet become competitive (ii) the transactions were government to government (G-to-G) where such refinements were, perhaps, not being monitored till then. But the fact remains that there was the cascading effect of such losses on the energy prices and subsequently on the goods and services that utilized the energy. The impact could be minimized by appropriate intervention at the right stage.

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