Voyages Soleil: The Hedging Decision

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I. WHAT IS HEDGING?

II. HEDGING METHODS

III.APPLICATION OF HEDGING IN TOURISM

I. WHAT IS HEDGING?

1. Definition of hedging
2. Hedging in tourism

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1. Definition of hedging

- A hedge is used to reduce any substantial losses/gains suffered by an individual or an organization.
- Investors hedge one investment by making another.

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2. Hedging in tourism

The deep economic meaning of the exchange rate can fully be grasped when analyzing the strategic content of the decisions of firms operating on the international market. Those firms usually operate on the currency market because they need a large amount of foreign currency: banks satisfy such requests through the opening of credit lines in currency.

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To insure themselves against the risk of economic loss due to unexpected changes in the exchange rate, operators undertake hedging activity, both firms and banks. When banks carry out their intermediary services they buy important sums of foreign currency and are thus interested in hedging operations on their own account, and not just to cover the clients' demand.

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II.HEDGING METHODS

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1. Hedging with a forward contract

a) Definition

Contract to buy or sell an asset at a given price on a specific date in the future. Investors use this instrument to avoid major losses if the price of the asset changes dramatically before it is exchanged.

b) Purchase forward contracts

A forward contract is like a futures contract or derivative. It is an agreement to buy or sell a currency at a fixed price on a certain date.

c) Evaluate the forward contract at the agreed-upon time.

- The price of Dollar goes up compared to Pound
- The price of USD goes down
- The exchange rate between the dollar and the pound stays the same

d) the forward contracts as a way to hedge against currency drops and spikes

Like any derivative, a forward contract is a great way to ensure you don't lose a lot of money if a currency you have a sizable position in drops in value.

e) Formula of real cost of hedging in accounts receivable

2. Hedging with a futures contract

a) Definition

Futures contract is a commitment (agreement) between two parties - the buyer (long party) and the seller (short party) to buy a product (underlying) that the delivery will occur at a fixed time in the future with a agreed price in advance.

b) Special characteristics

Example

3. Money market hedge

a) Definition

b) Characteristic

Examples

4. Currency option hedge

a) Defenition

b) An Example of Hedging with Put Options

c) Advantages and Disadvantages of Hedging using Options

5. Alternative Hedge Techniques

a)Leading and lagging

b)Cross hedging

c)Currency diversification

III.APPLICATION OF HEDGING IN TOURISM

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1. Exchange risk

a) Definition

b) Exchange risk in tourism

c) Hedging methods for Interest rate risk:
- Transaction risk
- Translation risk
- Economic risk

2. Interest risk

a) Definition

b) Hedging methods for Interest rate risk:
- Forwards
- Futures
- Swaps
- Options

3. Credit risk

a) Definition

b) Hedging methods for Credit risk

c) Credit risk in tourism

d) Example

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