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CORPORATE DERIVATIVES AND EXCHANGE RATE EXPOSURE: DOES A RELATIONSHIP EXIST?

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ABSTRACT

Increasing international trade and investments had made firms' cash flows more vulnerable to exchange rate movements; therefore derivatives are widely used by corporations to minimize foreign exchange exposure. Currents study aims to identify the factors affecting firms' decision to use derivatives by using the data of 86 non-financial firms of Pakistan for the period 2004-2007. For detailed analysis firms' endogenous policies are regressed separately in order to capture endogenenity effects. Logit model is used to test the factors effecting the firms' decision to use derivatives. Results show that firms having higher foreign sales are more likely to use derivatives to reduce exchange rate exposure. Also highly financial distressed large size firms having financial constraints and fewer managerial holdings are more likely to use derivatives. Study concludes that in general firms' use derivative in order to maximize shareholders' wealth by reducing exchange rate exposure.