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Tekijä-Författare-Author Tang, Xiaona			
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Tiivistelmä-Referat-Abstract This paper explores optimal hedging policies for multinational corporations that have flexible production sourcing and financial hedging capability. The sources of risk examined are exchange rate movements and uncertain foreign currency cash flow, and th firm's aim is to hedge such risk exposure, and at the same time to maximize its firm value. The objective of this paper is to find the optimal hedging policies - what, how, and when should a multinational corporation implement financial and/ or operational hedging, and to what extent should each type of hedging policy be. Following Mello, Parsons and Triantis (1995), and Chowdhry and Howe (1999), the firm's ability to exploit its competitive position depends on the degree to which its flexibility is matched by the construction of an appropriate hedging strategy. The firm's need for hedging is directly related to the degree of production flexibility, and the production plan it chooses is a function of the hedging strategy it employs. Multinational corporations will engage in operational hedging only when both exchange rate uncertainty and demand uncertainty are present. Operational hedging is less important for managing short-term exposures, as demand uncertainty is lower in short term; also operational hedging is less important for commodity-based firms, which face price but not quantity uncertainty. Multinational corporations are likely to use financial instruments to a greater extent to hedge short term exposure and rely on operational hedging more heavily to hedge long term risk. The optimal financial hedging policy cannot be implemented with forward contracts alone, but with foreign currency call and put options and forward contracts together.			
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