The Foreign Exchange (FX) Risk Management is one of the major components of business finance and economics. It is a challenging task of corporate managers across the world. The exchange rates of various currencies evolved over a period of time taking a cue from barter trading system for commodities. Gold, British Pound Sterling (GBP) and US Dollar (USD) have emerged as reference rates in the FX market. As the countries depend on imports and exports for economic success and development, fluctuation of its local currency against major currencies has a direct impact on the profit and loss of the government, companies and firms which have FX exposure.

In India, the Indian Rupee (INR) was linked to GBP at the time of independence and its value was Rs.13.33 per 1GBP which was equivalent to 1USD = INR 3.31. Until the early seventies, the exchange market was perceived as fixed rate regime and mainly merchant transactions were transacted. With the collapse of Breton Woods agreement and floatation of major currencies, an opportunity rose for market players to trade in currency volatilities in the borderless and 24 hours market. As a first step, RBI allowed banks to undertake intra-day trading in foreign exchange in 1978 with a stipulation of maintaining “square” or “near square” position at the close of each business each day. During the period 1975-1992, the exchange rate of rupee was officially determined by the RBI in terms of a weighted basket of currencies of India’s major trading partners and there were significant restrictions on the current account transactions.

In July 1991, the economic reforms were initiated by the Government. A two-step downward adjustment in the exchange rate of the rupee was effected on July 1 and 3, 1991 with a view to placing it at an appropriate level in line with the inflation differential to maintain the competitiveness of exports. Subsequently, the Liberalised Exchange Rate Management System (LERMS) involving dual exchange rate mechanism was instituted in March 1992 following the recommendations of the High Level Committee on Balance of Payments. This was followed by the ultimate convergence of the dual rates effective from March 1, 1993. This unification of exchange rate of the rupee marked the beginning of the era of market determined exchange rate regime of rupee, based on demand and supply in the forex market. It was also an important step in the progress towards current account convertibility.
which was finally achieved in August 1994 by accepting Article VIII of the Articles of Agreement of the International Monetary Fund.

The Sodhani Committee, an Expert Group constituted by RBI in November 1994 studied the FX market in India and came up with far reaching recommendations to develop, deepen and widen the forex market. As part of important liberalisation measures, (a) banks were allowed freedom to fix their trading limits, permitted to borrow and invest funds in the overseas markets up to specified limits, accorded freedom to determine interest rates on FCNR deposits within ceilings and were allowed to use derivative products for asset-liability management purposes; and (b) corporates were given flexibility to book forward cover based on past turnover to use a variety of instruments like interest rates and currency swaps, caps/collars and forward rate agreements in the international forex market. Rupee-foreign currency swap market for hedging longer term exposure has developed substantially in the last few years.

The forex market is made up of Authorised Dealers (generally banks), some intermediaries with limited authorisation and end users viz., individuals, corporates, institutional investors and others. It is regulated by RBI. The average monthly turnover in the merchant segment of the forex market increased to US$ 40.5 billion in 2003-2004 from US$ 27.0 billion in 2002-2003; as against, the market’s average monthly turnover increased sharply to US$ 174.7 billion in 2003-2004 from US$ 130 billion in the previous year; and the balance was contributed by the Inter-bank segment.

This Thesis is a modest attempt to carryout research analysis of the instruments in Indian FX market, understand the rules and regulations, find out the correlation between different variables of foreign exchange market. And to obtain the market feed back of select Indian companies and compare with risk management practices in advanced countries selected; and develop a strategy for managing FX exposure of Indian companies in view of dynamic and volatile nature of the forex market.

The document contains 5 chapters and separate section on Appendices. The first chapter is Introductory in nature and gives definition of Foreign Exchange Exposure, Risk Management tools and background for the study. Chapter 2 includes, study of literature related to the current topic of FX risk management both in India and abroad. In addition, the methodology adopted to carry out the Research study is dovetailed
namely, background for the study by stating the problem and its importance, listing objectives, raising hypothesis, methodology including scope, data sourcing and tools for analysis. Chapter 3 covers the developments related to foreign exchange market in India; factors affecting the exchange rate movement of INR, the trend of the variables and the USD/INR exchange rate with the help of tables and charts. In Chapter 4, detailed analysis and discussions are carried out covering the practices followed in select FX markets like USA, Germany, UK, Australia, Finland, Chile, Sweden etc. The FX risk management practices by Indian companies and the responses to the questionnaire are analysed. In last Chapter 5, Conclusions from the study drawn and summarized. Suggestions and Recommendations are given.

The appendices section covers (1) Chronology of events related to FX operations - Crisis and Reforms - 1991 to 2005, (2) List of Companies Participated in Survey; (3) Questionnaire; (4) Financial Derivatives Timeline; (5) to (12) Statistical analysis of FX variables Trade Surplus as % of GDP, Import Cover, Short Term debt/Total Debt%, Debt Service Coverage ratio (DSR), External Debt, % change in external debt, FII net sales/purchases, FX Reserves Vs. USD/INR exchange rate; (13) A Primer on Technical Analysis in Foreign Exchange Markets; (14) Hedging FX Exposure in an MNC - a Case Study, (15) Glossary of FX terms; (16) Bibliography and (17) Index. The Bibliography provides 148 references that could be a rich source of information to future researchers.

The findings of the study may be useful to Indian corporates, RBI and banks. For companies, it is expected to give direction for introducing better controls and systems for management of FX exposure. This study is also expected to be of assistance to future researchers in the field of finance, economics and business management.

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