Corporate Exchange Risk Management: Theme and Aberrations]: Discussion
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trade will be translated into volatility of net earnings (just as are volatile relative prices of money.) It may be possible to identify a combined optimal portfolio of currencies and commodities for a firm if stable covariances exist between exchange rates and some commodity prices (each expressed in some numeraire currency.) Such an approach would see firms more insulated from effects of volatility of their own terms of trade. The individual investor buying claims on the firm would not however gain any protection from real risk in Eaker's sense unless his own terms of trade correlated perfectly with the firm's. This is unlikely for many reasons, not the least of which is the fact that most firms are buyers of labor services while most investors either are directly, or are representatives of, sellers of labor services.

REFERENCES

John H. Makin, "Portfolio Theory and the Problem of Foreign Exchange Risk," *The Journal of Finance* (May, 1978) 517–34.

DISCUSSION

R. G. HAWKINS:*: Professor Rodriquez's paper has two major merits. First, it shows, using a massive amount of data, that companies—on average—behave the way the theory of risky asset management predicts they should behave (at least half the time). Second, it indicates in which types of foreign currency assets and liabilities the changes actually occur, which provides several suggestions for additional research. Certainly the second is a unique contribution.

It could be said that the issue of foreign exchange was topical in the late 1960's and early 1970's but, by 1980, who cares? The foreign exchange markets are working fairly smoothly; there are not massive flows of speculative funds, and this data of a bygone era is interesting but irrelevant. I do not hold this view. The data and the summary measures developed in the paper involve useful tests—albeit tentative—of several hypotheses of corporate behavior in periods of stress in foreign exchange markets. This has lasting value. Furthermore, the findings of the paper are consistent with, and provide a partial explanation of, the "overshooting" observed in exchange rate movements—a matter which has recently received attention in academic research.

I will identify the strengths of the paper before turning to its weaknesses.

The paper provides a terse report, on a massive data collection project, which was supplemented by interviews of corporate treasurers. It is an efficient paper.

The paper utilizes perhaps the only systematic data available at the company level, account specific, by currency, for several dates. It was an ambitious project at the outset, and the fact that it was completed denotes unusual perseverance. It overshadows in extent and thoroughness other studies on currency speculation based on micro-data.

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Another strength is a largely successful attempt to develop summary indexes and statistics which are at least compatible with theoretical concepts, and which aid in describing and articulating the general tendencies evidenced by this massive set of numbers. The paper carefully specifies the process by which shifts of funds between foreign currencies take place, and the motives and avenues for accomplishing the shifts. These are related to modern theoretical constructs such as efficient markets and interest arbitrage theories. But more important, the conclusion and policy implications, carefully wrung out of the findings, are useful and provide some support for the notion of "overshooting" in exchange rate adjustments to shocks.

Two findings are of broad interest. One is that, overall, corporate foreign exchange managers are asymmetrically risk averse. They are conservative (attempt to avoid open long positions) in perceived weak currencies but do not take equal advantage of potential gains from long positions in strong currencies. This is consistent with the findings of other studies—and to human nature: to err is human, but you may be fired. On the other hand, to be correct is satisfying, but will not make one chairman of the board.

The second interesting conclusion is that companies utilize certain accounts to make adjustments in their foreign currency positions—notably internally generated funds and cash transfers by the company, but almost completely ignore other possible avenues—e.g. forward contracts and borrowing/lending in different money markets. This is less surprising than the author apparently thinks, and no doubt reflects different transactions cost (defined to include search costs). It is also likely that accounts receivable were not systematically adjusted because customers were also trying to lead and lag, and the multinationals were serving as financial intermediaries through trade credit adjustments.

Some of the shortcomings of the study should now be identified. They affect mainly the strength which one can ascribe to the conclusions. These criticisms should not be taken as reflecting negatively on the study, or that different methodology would lead to different or even stronger conclusions. Any attempt in this area must have weaknesses, to be borne in mind in accepting the conclusions.

First, the paper, at least for certain purposes, sets up criteria to classify currencies as weak or strong (against the dollar) for an eight year period (1967–74). While the dollar was generally weak against several of the currencies, it was also strong at certain times. Establishing 8 years as the *only* timeframe upon which to categorize a currency as weak or strong for the full 8 years may be misleading in some cases.

Second, the data on corporate accounts refers only to the end of quarters. As the paper notes, currency crises (or strengths and weaknesses) do not always coincide with quarter ends. The data, then, may miss massive intraquarter movements in funds, and catch only the data which have been window-dressed at the quarter ends. While I doubt that seriously compromises the conclusions, it cannot be deemed trivial.

Finally, and perhaps the most serious, is the loss of information in the summary statistics. These focus on direction of change and on average percentage change.

In the process, any information about the *magnitude* of the changes is lost. Thus, conclusions as to the relative share of total funds movements which can be attributed to multinationals must be extremely equivocal.

To conclude, the study represents a significant contribution and deserves the attention of those interested in the field. It is a short and efficient presentation of the results of a massive data-grubbing effort.