Disciplined hedging by Foresight Bullion India – inspiration for others

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"Hedging helps us sleep better at night" says Viraj Didwania, the founder and Manager Director of Foresight Bullion India Private Limited (FBIL). How true the statement goes with one of the values enlisted on the website of his company that reads "We are by nature a risk averse company……." Going by scale of expansion across 6 states in just about 3 years since its inception, values embraced by the company certainly seems to be doing wonders.

Hedging core to FBIL's operations

FBIL deals exclusively in physical pure silver delivered directly to their customer's doorstep on a custom deal basis. With head-office at Nariman Point, Mumbai, FBIL has vaults in six states including Maharashtra, Chhattisgarh, Andhra Pradesh, Telangana, Karnataka and Tamil Nadu. FBIL currently delivers silver to locations such as Pune, Kolhapur, Sangli, Nasik, Solapur, Panvel, Dhule, Jalgaon, Khamgaon, Akola, Amravati, Paratwada Nagpur (Maharashtra), Raipur (Chhattisgarh), Hyderabad (Telangana), Vijaywada (Andhra Pradesh, Bangalore (Karnataka), Chennai and Salem (Tamil Nadu). With FBIL continuously scaling new heights, one aspect that has remained constant over their growth trajectory is their unwavering discipline in hedging almost every transaction through MCX silver futures contracts.

With silver prices known to be highly volatile especially when compared to other precious metal i.e. gold, FBIL dealing in silver market, has very clear take on this. One of the values posted on their website clearly states that "We will never take price risk on silver, the only risk will be the change in premium or discount." True to their values, FBIL, right from its inception has incorporated hedging operation as a crucial part of their overall business operations. While FBIL works directly with mines, refiners, importers amongst other major suppliers to ensure that the silver its customer receives is of the highest quality as per their needs, it ensures that it always imitate an opposite sell position in MCX silver futures contract whenever it enters into buy contract with its supplier. Further, whenever the silver procured from its suppliers is sold to its customer, FBIL squares-off its position in futures market by buying MCX silver futures contract. Their discipline in regards to compulsorily engaging into back-to-back hedging can be gauged from the fact that they have attuned their business hours (engaging in physical silver orders) to the MCX trade timings, so that there is no

scope for time-lag in hedging its physical market transactions. In other words, FBIL offers service to their customers from Monday to Friday with business hours from morning 10.00 a.m. to just before mid-night – completely in sync with MCX trading hours. As a result, FBIL never carries any price risk in silver. Additionally, its inventory management is very much disciplined negating any need of distress cost on urgent procurements.

Hedging is more than just price risk management

There is a host of compelling economic arguments favouring the use of derivatives to manage commodity price volatility. As seen in the case of FBIL, hedging provides a useful insurance against adverse commodity price movements, as also lowers expenses such as inventory costs. Further, price volatility that can have an adverse effect on the revenue streams and disrupt cash flows, effective hedging ensures uninterrupted and stable revenue streams.

Moreover, market imperfections, such as volatility in the prices that a firm encounters, contribute to reducing the value of the firm and thereby make price volatility an expensive proposition for the firm. The imperfections, in turn, contribute to other market deficiencies such as expensive external financing; enhancing financial distress costs; agency costs and costs of managerial risk aversion. These imperfections have an adverse impact on the firm's value. By helping in reducing the costs stemming from such imperfections, hedging enables in enhancing the firm's value.

Disciplined hedging – key to effective hedging

FBIL is a perfect example how hedging (price risk management) can be intertwined with a firm's successful business operation. Their discipline in hedging guided by the company's values has emerged as a major factor to FBIL's success. This should inspire other companies that still do not have a coherent Risk Management Policy in place, although they are well appreciative of the price risks they encounter. Importantly, it is something companies can ill-afford in the volatile environment of today. A good hedging practice - the cornerstone of Risk Management Policy - should encompass a clear picture on the part of the company about its risk profile, its risk appetite and benefits from risk aversion by hedging. Such a strategy is no longer a prerogative of the big corporates alone, but is a business necessity for the long-term sustenance of every company – big or small. ■

Authors are Managers with Multi Commodity Exchange of India Limited, Mumbai and Views expressed here are personal.