

Lotus Bakeries – An Approach to the Organization

¹Clara de Brito Lança, ²Lana Knops, ³Adalmiro Pereira, ⁴Tânia Teixeira, ⁵Liliana Fontes

^{1,2} ISCAP-P Porto

^{3,4} ISCAP-P Porto; CEOS member

⁵ ISCAP-P Porto

ABSTRACT: To manage financial risks, companies widely use international risk management instruments such as forward contracts, futures, options, and swaps. These financial instruments help reduce uncertainty linked to foreign currency transactions and aim to stabilize cash flows. Their effective use supports the company's objective of maximizing shareholder value.

The objective of this paper is to analyze the international activity of Lotus Bakeries from a financial perspective. As a company operating in multiple foreign markets, Lotus Bakeries represents a relevant case for studying international risk management instruments and for linking theoretical concepts from international financial management with findings from academic research.

KEYWORDS: Lotus; Hedging; Financial Risks; Exchange rates

1. INTRODUCTION

Globalization has led to a growing number of companies operating beyond their national borders. As firms expand internationally, they are exposed to specific financial risks that domestic companies do not face, especially exchange rate risk. Changes in exchange rates can have a direct impact on cash flows, costs, revenues, and overall financial performance. As a result, international financial management has become a strategic function for multinational companies.

2. LOTUS

Lotus Bakeries is an international company operating in several foreign markets. Due to its international activities, the company conducts sales and purchases in different currencies. Consequently, fluctuations in exchange rates may affect the value of its future cash flows. This situation is known as exchange rate risk in international financial management.

One of the main financial risks faced by international companies is transaction exposure. Transaction exposure arises when receivables or payables are denominated in foreign currencies, and their value changes between the date of the transaction is agreed upon and the date it is settled. This type of risk can have a direct impact on the company's cash flows and short-term financial performance.

As a result, managing exchange rate risk is a key issue for Lotus Bakeries. International financial management instruments can be used to reduce uncertainty related to exchange rate movements and to help stabilize the cash flows generated by international operations.

2.1 Analysis of international risk management instruments used by companies

International companies operating in several countries are exposed to exchange rate risk due to transactions denominated in foreign currencies. To manage this risk, firms can use various international risk management instruments. These instruments aim to reduce uncertainty related to exchange rate movements and to stabilize cash flows generated by international activities.

2.1.1 Application to Lotus Bakeries

According to its Annual Report 2023, Lotus Bakeries identifies and monitors financial risks arising from its international operations, including foreign exchange risk. The Group states that it applies a structured financial risk management policy and focuses on limiting volatility rather than generating gains from currency fluctuations. This approach is consistent with the main objectives of international financial management, which prioritize risk reduction and cash flow stability.

2.1.2 Hedging policy and natural hedging

The Annual Report 2023 indicates that Lotus Bakeries primarily relies on natural hedging to manage its foreign exchange exposure. Natural hedging consists of matching cash inflows and cash outflows in the same currency, for example by aligning sales revenues and operating costs within the same currency area. This method allows the company to reduce its exposure to exchange rate fluctuations without systematically using financial derivatives.

The Group also refers to a neutral hedging policy, meaning that hedging decisions are taken with the objective of reducing risk and stabilizing cash flows, rather than speculating future exchange rate movements. When natural hedging is not sufficient and a remaining net exposure exists, the company may consider the use of derivative instruments. This approach reflects a prudent and conservative financial strategy.

2.1.3 Interest rate risk and interest rate swaps

Lotus Bakeries is exposed to interest rate risk due to its financing structure. According to its Annual Report 2023, the Group manages this risk by maintaining a balanced mix of fixed-rate and floating-rate debt. This strategy allows the company to partially benefit from favorable movements in market interest rates while limiting excessive volatility in its financial expenses.

When necessary, Lotus Bakeries may use interest rate derivatives, such as interest rate swaps, to adjust the balance between fixed and variable interest rates. Interest rate swaps make it possible to transform variable-rate debt into fixed-rate debt, or vice versa, depending on market conditions and the Group's risk management objectives. This approach is consistent with the Group's neutral hedging policy, as the objective is to stabilize financing costs rather than to speculate future interest rate movements.

2.1.4 Forward contracts

Forward contracts are commonly used by companies to manage exchange rate risk. A forward contract allows a firm to fix an exchange rate today for a transaction that will occur at a future date. This instrument helps reduce uncertainty by locking in the value of future receivables or payables denominated in foreign currencies.

In the case of Lotus Bakeries, forward contracts represent a relevant tool for hedging short-term transaction exposure related to international sales or purchases. By fixing exchange rates in advance, the company can better forecast its cash flows and protect itself against unfavorable currency movements.

Although the Annual Report 2023 of Lotus Bakeries does not explicitly detail the use of all international risk management instruments, futures contracts and options are discussed in this paper as theoretical tools commonly used by multinational companies, in line with international financial management literature.

2.1.5 Futures contracts

Futures contracts are like forward contracts, as they also allow companies to lock in an exchange rate for a future date. However, futures are standardized instruments traded on organized exchanges. This standardization reduces counterparty risk and increases market transparency.

Futures is an available instrument for multinational companies, particularly when liquidity and reduced default risk are important considerations.

2.1.6 Currency options

Currency options give companies the right, but not the obligation, to buy or sell a foreign currency at a predetermined exchange rate. These instruments are useful because they protect firms against unfavorable exchange rate movements while allowing them to benefit from favorable changes.

International financial management literature often highlights options as suitable instruments for companies seeking downside protection while maintaining flexibility in their hedging strategy.

2.2 Scientific Article Analysis

This scientific article analysis is based on the abstracts and the main conclusions presented in the academic literature.

Articles analyzed

- Smith, C. W., & Stulz, R. M. (1985), *The determinants of firms' hedging policies*, *Journal of Financial and Quantitative Analysis*.

- Allayannis, G., & Weston, J. P. (2001), *The use of foreign currency derivatives and firm market value, Review of Financial Studies*.

Objective of the articles

The objective of these two articles is to explain why international companies use hedging instruments and to analyze the effects of hedging on firms' financial outcomes.

Smith and Stulz (1985) focus on the motivations behind corporate hedging decisions, while Allayannis and Weston (2001) examine whether the use of foreign currency derivatives affects financial stability and firm value in multinational companies.

Main ideas and findings

According to Smith and Stulz (1985), companies hedge financial risks mainly to reduce uncertainty and stabilize cash flows. The authors explain that fluctuations in exchange rates and interest rates increase earnings volatility, which makes financial planning more difficult. Hedging is therefore presented as a risk management tool rather than a speculative activity.

Allayannis and Weston (2001) complement this analysis by showing that multinational firms using foreign currency derivatives tend to have lower exposure to exchange rate risk. Their results also suggest that hedging can be associated with higher firm value compared to firms that do not hedge. By reducing cash-flow volatility, hedging contributes to improved financial stability and supports long-term performance.

Taken together, the two articles highlight that firms generally use hedging instruments to manage net financial exposure, often combining natural hedging strategies with the selective use of financial derivatives.

Link with international financial management

The conclusions of these articles are fully consistent with the principles of international financial management. International firms operate across different currency areas and are therefore exposed to exchange rate and interest rate risks. Hedging instruments are used to reduce these risks, stabilize cash flows, and support sound financial decision making.

Both articles emphasize that the primary objective of hedging is risk reduction, which aligns with the concept of neutral hedging commonly presented in international finance theory.

Application to Lotus Bakeries

The findings of the academic literature can be directly linked to the financial risk management strategy of Lotus Bakeries, as described in its Annual Report 2023. The Group explains that it applies a neutral hedging policy, focusing on reducing volatility rather than speculating on financial markets.

Lotus Bakeries primarily relies on natural hedging by matching cash inflows and outflows in the same currency. When a remaining net exposure exists, the company may use financial derivatives to manage this risk. In addition, the Group maintains a balanced mix of fixed-rate and floating-rate debt, using interest rate derivatives when necessary to stabilize financing costs.

This approach is consistent with the conclusions of Smith and Stulz (1985), who explain why firms hedge, and with Allayannis and Weston (2001), who show that such hedging practices can support financial stability and firm value. Overall, the academic literature provides strong support for the cautious and structured international risk management strategy adopted by Lotus Bakeries.

3. CONCLUSION

The objective of this paper was to study an international company from a financial perspective, with a focus on international risk management instruments. Through the case of Lotus Bakeries, this work highlights how international activities expose firms to specific financial risks, particularly exchange rate and interest rate risks.

The analysis shows that international companies can rely on different instruments to manage these risks. Lotus Bakeries applies a prudent and structured risk management approach, based on a neutral hedging policy. The Group primarily uses natural hedging to reduce foreign exchange exposure and relies on financial derivatives only when a remaining net exposure exists. In addition, the company manages interest rate risk by maintaining a balanced mix of fixed and floating interest rates, using interest rate derivatives when necessary to stabilize financing costs.

The scientific literature supports this approach. Academic studies show that companies hedge mainly to reduce uncertainty and stabilize cash flows, rather than to speculate on financial markets. Overall, the case of Lotus Bakeries illustrates the importance of international financial management in supporting financial stability and sound decision making in a globalized environment.

REFERENCES

Scientific articles

- Smith, C. W., & Stulz, R. M. (1985). *The determinants of firms' hedging policies*. Journal of Financial and Quantitative Analysis.
- Allayannis, G., & Weston, J. P. (2001). *The use of foreign currency derivatives and firm market value*. Review of Financial Studies.

Company sources

- Lotus Bakeries. (2023). *Annual Report 2023*.
- Lotus Bakeries. (2023). *Annual Report 2023: financial supplement*.