

LUFTHANSA: to hedge or not to hedge..

WHAT HAPPENED?

- Heinz Ruhnau decided to hedge half of the transaction price using forwards at the rate of 3.20DM/USD.
- The DM/USD exchange rate went to 2.3DM/USD by Jan 1986.
- Ruhnau was accused of “reckless speculation” with Lufthansa’s money. He faced harsh criticism by both the German Transportation Board and Lufthansa’s Board. In general he was accused of making four mistakes:
 1. Purchasing Boeing aircraft at the wrong time – the dollar was at an all time high.
 2. Choosing to hedge half of the exposure when he expected the dollar to fall. He should have trusted his instincts and gone for all or nothing.
 3. Choosing to use forward contracts instead of options. The options would have allowed Herr Ruhnau to protect himself against continued increases while preserving the flexibility of exchanging DM for dollars if the exchange rate develops according to his beliefs. Unfortunately Herr Ruhnau, as many others, felt that options were too exotic.
 4. Purchasing Boeing aircraft at all. The German government (Lufthansa’s major shareholder) had a vested interest in Airbus, Boeing’s main competitor.

WHAT DO WE LEARN?

The hedging decision is very important. It relies on a thorough analysis of both a firm's business and financing risk.

- What are the direct and indirect costs of different risk management strategies?
 - The direct costs are relatively straightforward to measure, but the indirect costs are not. What were the indirect costs for Ruhnau?
- There is a fine line between speculating and hedging.
- The consequences of the decision to hedge (speculate?) can be very serious so we need to carefully weigh the alternatives.
- The risk management decision can influence all stakeholders.
- External restrictions (e.g. covenants) may impact risk management alternatives.