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Interest Rate Risk Management in Large Finnish Non-financial Companies

Financial risk management is an essential function in every company, although it does not always receive the attention it deserves. This study examines an important area of financial risk management, namely interest rate risk management, and provides insight into the interest rate risk management practices of large Finnish non-financial companies.

A web-based questionnaire was sent out to the150 largest Finnish non-financial companies, of which 67 decided to take part in the survey. Cross tabulation was the most important tool in the search for relationships between the selected variables. The χ^2-test, a nonparametric test, was the statistical test used. The data was collected in October-November, 2004.

The results show that most large companies take a systematic approach towards interest rate risk management, but the risk assessment is largely concentrated on the financial position of the company, although interest rate risk has a much wider scope than that. The companies could not agree as to what the optimal scope of interest rate risk management would be. Many companies simply use the absolute level of interest rate expenses as a measure of the success of their interest rate risk management. In general, interest rate risk management seems to have become more common in the past ten years.

Our results show the companies use a wide variety of methods in their interest rate risk management, but they could not agree on a single method that would be clearly superior to the others. Simple methods are used a lot, but their use is often complemented by more sophisticated methods. Most firms use derivatives in hedging their interest rate risk, and an interest rate swap is clearly the most often used instrument.

The paper also suggests a model of the factors affecting the approach a company takes towards interest rate risk management. The best explanatory variables are the size of the company's loan portfolio and the existence of a written interest rate risk management policy. However, in general, the relationships between the explanatory variables and the resulting interest rate risk management policy turned out weaker than anticipated.

Additionally, the determinants of the perceived success of interest rate risk management have been studied, and it seems that low hedging degree and the non-cyclicity of the industry

are associated with higher perceived success. On the average, the companies seem to be satisfied with the success of their interest rate risk management policies.

The results of this study bring new knowledge in the area of interest rate risk management in large Finnish non-financial companies. Although the results have a limited scope in some aspects, they serve as a portrayal of how interest rate risk is managed today in the targeted companies.