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PT Kalbe Farma and Weakening of Rupiah

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ABSTRACT: The exchange rate is one of the biggest economic issues because the fluctuation of the exchange rate could harm any businesses as they use different currencies in their daily operations. This case study aims to analyze the strategies used by PT Kalbe Farma, Tbk, a pharmaceutical company listed in the Indonesia Stock Exchange, regarding the weakening condition of Rupiah. Pharmaceutical companies rely hardly on the usage of imported raw materials, and the weakening condition of Rupiah would negatively affect their net profit. The strategies used by PT Kalbe Farma, Tbk, successfully increased the net profit by 4.5% in 2018.

Keywords: exchange rate, fluctuations, weakening of Rupiah

1 INTRODUCTION

The exchange rate is one of the biggest economic issues because the fluctuation of the exchange rate could harm any businesses as they use different currencies in their daily operations. In 2018, Federal Reserve continued to raise its US benchmark interest rate, in line with increasing inflation. Rupiah faced considerable pressure with the rising of US interest rate, touching above IDR 14,500 per US Dollar. Correspondingly, Bank Indonesia's benchmark interest rate was hiked several times, up by 175 basis points to 6.0% in 2018. As a result, Indonesia closed the year with a moderate 5.17% growth, slightly higher than the GDP growth in 2017 (5.07%).

The weakening condition of Rupiah above IDR 14,500 per US Dollar is being judged as the failure of economic policy by domestic manufacturers, which rely hardly on the use of imported raw materials. The continual increase in production cost in a short time could indirectly decrease the product demand and hence affect the net profit.

One of the industries that is affected by the weakening condition of Rupiah is the pharmaceutical industry because 90-95% of the raw materials are imported from some countries, such as China, India, Japan, and some European countries, using US Dollar as the currency.

PT Kalbe Farma, Tbk is one of the pharmaceutical companies, which is affected by the weakening condition of Rupiah. This paper aims to analyze the strategies used by PT Kalbe Farma, Tbk in order to overcome the situation.

1.1 *PT Kalbe Farma, Tbk.*

PT Kalbe Farma, Tbk started back in 1966, guided by "Panca Sradha", the company's living values. Since then, PT Kalbe Farma, Tbk, has grown and developed to become one of Indonesia's most respected companies and went public in 1991, listed in the Indonesia Stock Exchange. Through organic growth and mergers & acquisitions, PT Kalbe Farma, Tbk expands its business interests and transforms to become the provider of an integrated healthcare solution through its four business divisions: the prescription pharmaceuticals, consumer health, nutritional, and distribution & logistics divisions. All of these business divisions manage a comprehensive portfolio of prescription pharmaceuticals and OTC drugs, nutritional, and medical devices, serving over one million outlets across Indonesia. In the international market, PT Kalbe Farma, Tbk has established its footprint in ASEAN and Africa countries. After more than five decades, today, PT Kalbe Farma, Tbk, is known as the largest publicly listed pharmaceutical company in Southeast Asia, with a market capitalization of IDR 71 trillion and IDR 21 trillion sales turnover by the end of 2018. Some of PT Kalbe Farma, Tbk products are "Fitchips", "Blackmores", "Komix Herbal", "Zee", "Extra Joss Shake", "Hydro Coco", "Hemapo", "Herzemab", and generic drugs.

1.2 *Multinational corporation's exposure to currency risk*

According to Butler (2016), there are several types of multinational corporation's exposure to currency risk. First, economic exposure, which is defined as the change of value because of the unexpected change in the exchange rate. Second, transaction exposure, which is defined as the change of contractual future cash flow caused by an unexpected change in the exchange rate. Third, operating exposure, which is defined as the change in non-contractual future cash flow caused by an unexpected change in the exchange rate. Fourth, translation exposure, which is defined as the change in financial accounting report caused by an unexpected change in the exchange rate.

1.3 *Financial market hedges*

There are also several types of financial market hedges (Butler, 2016). First, currency forwards that is defined as a contract, which binds the exchange rate for purchasing or selling certain currency on a specified date in the future. Second, currency futures that have the same function as currency forward but binds legally and the counterpart that still holds the contract at the due date must send the amount of currency at the specified price on the specified delivery date and be traded in the secondary market. Third, money market hedges, which is defined as a technique to protect the value of a currency using a very liquid and short-termed money market instruments such as Treasury Bills, Banker's Acceptances, etc. Fourth, currency options, which is defined as a contract that gives the buyer a right (but not an obligation) to buy or sell a certain currency at a certain exchange rate on or before a certain date. Fifth, currency swaps, which is defined as an exchange of interest rate (and sometimes the principal) in the currency for the same currency. Sixth, operational hedges is a hedging strategy without financial instruments by using plant location, product sourcing, market selection, and promotion.

1.4 *International pricing strategy and the price elasticity of demand*

Constant foreign currency price holds the price in foreign currency constantly, while the exchange rate differences are charged to consumers. Meanwhile, constant domestic currency price holds the price in domestic currency constantly, causing changes in profit margin according to the exchange rate. If the product sold having an elastic demand curve (Ed > 1), it is better to use the constant domestic currency price strategy (Butler, 2016).

2 DISCUSSIONS

The volatility of Rupiah against US Dollar, causing PT Kalbe Farma, Tbk, underwent an economic exposure and further transaction exposure, which is changes in contractual future cash flow value caused by an unexpected change in the exchange rate. Financial strategies applied by PT Kalbe Farma, Tbk in overcoming the weakening of Rupiah against US Dollar.

2.1 *Natural hedging*

According to PT Kalbe Farma, Tbk's Financial Statement, on September 30, 2018, the company has a credit facility in US Dollars and an outstanding amount of cash, bank, and certificate deposit IDR 700 billion (equivalent to USD 48 million). The company also has an account payable from foreign suppliers of 385 billion Rupiahs (or 32% of the account payable). These are the forms of natural hedging done by companies whose majorities of raw materials are imported. By doing natural hedging and mitigating the risk through cash balance, PT Kalbe Farma, Tbk, has a cash balance in US Dollars, as shown in the Balance Sheet on September 30, 2018. This is in line with the statement in Annual Report year 2017, in which PT Kalbe Farma, Tbk, reduced risk of exchange rate fluctuation by buying enough foreign currencies to purchase imported raw materials, monitoring foreign currency movements intensively, and planning the right time to purchase. This natural hedging strategy is relatively prosperous, shown in the Financial Statement on September 30, 2018, where PT Kalbe Farma, Tbk, posted a foreign exchange profit of IDR 40.8 billion.

2.2 *Raw materials supplies*

PT Kalbe Farma, Tbk bought more raw materials (to accommodate 3-4 months of needs) when the exchange rate was predicted to increase, as a strategy to overcome the movement of Rupiah against US Dollar. This is shown in the Financial Statement on September 30, 2018, in which raw material supplies reached 114 days.

2.3 *Product sales price*

By increasing the selling price, PT Kalbe Farma, Tbk intends to maintain the margins amid the uncertainty of the exchange rate, which could have increased the purchase price of raw materials. Though there was an increase in raw materials' purchase price, the company still could increase its sales by 3.9% during January - September 2018. In terms of Cost of Goods Sold (COGS), there was an increase in COGS of 6.07%, as shown in the Financial Statement on September 30, 2018, compared to the year 2017. On the purchasing side, constant foreign currency prices applied, in which the purchase price is fixed, but the exchange rate changes. On the contrary, the constant domestic currency price applied in the selling side, in which the selling price is fixed even though the exchange rate changes. If this happens when Rupiah weakens against US Dollar, PT Kalbe Farma, Tbk. will experience losses; therefore, the company also increases its selling prices.

2.4 *Export sales*

To reduce the risk of exchange rate fluctuations while taking advantage of the weakening Rupiah against US Dollar, PT Kalbe Farma, Tbk was targeting an increase in export sales of 1%/year. In 2017, exports contributed 5% to the total sales, while according to Financial Statement, on September 30, 2018, export sales from January - September 2018 contributed 6% to the total sales. Some products of PT Kalbe Farma, Tbk in over-the-counter medicines category such as "Procold" and "Extra Joss" are in high demand in the African market, while nutrition products category such as "Diabetasol" is in high demand in the Philippine market. The most significant contributor to export sales was health products (40%), then followed by prescription drugs (35%) and nutrition products (24%), while the remaining was from distribution and logistics. The rise in export sales benefited PT Kalbe Farma, Tbk, in terms of US Dollar revenue, which could minimize exchange rate fluctuation risk.

3 CONCLUSIONS

The financial strategies carried out by PT Kalbe Farma, Tbk in overcoming the weakening of Rupiah against US Dollar vary, ranging from natural hedging, increasing raw material inventories when the exchange rate is predicted to increase, increasing selling price to offset the increase in purchasing price of raw materials due to the weakening Rupiah against US Dollar, and increasing export sales. In addition, PT Kalbe Farma, Tbk could also implement other strategies such as using a forward contract because PT Kalbe Farma, Tbk has foreign exchange line facilities from several banks (Bank Central Asia: USD 5 million, Permata Bank: USD 1.5 million, CIMB Niaga: USD 1 million, Hongkong and Shanghai Banking Corporation: USD 5 million, Bank Negara Indonesia: USD 200 thousand, Bank of Tokyo - Mitsubishi UFJ: USD 15 million, and Bank Mandiri: USD 8 million. The foreign exchange line is a facility given by a bank in order to buy/sell foreign currency as a mean of hedging. Several transactions could be done through foreign exchange line facilities, such as spot, forward, or swap contracts.

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