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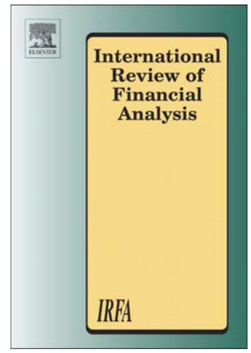

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Exposure, Hedging, and Value: New Evidence from the U.S. Airline Industry

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Abstract

For a variety of reasons, the U.S. airline industry is a natural sample to analyze the relation between corporate risk exposure, hedging policy, and firm value. First, we find that airline exposures to fuel prices are higher when fuel prices are high or when they are rising. Second, we analyze the relation between exposure coefficients and the percentage of next year's fuel requirement hedged by airlines. In response to higher fuel price levels, rising fuel prices, and higher levels of exposure to fuel prices, airlines tend to increase their hedging activity. Finally, we explore the previously documented jet fuel hedging premium illustrated in Carter, Rogers, and Simkins (2006). We find a positive hedging premium in our analysis; however, the interaction of hedging and exposure does not affect firm value. We conclude that airlines increasing hedging activity because of higher fuel price exposure are not valued higher compared to those airlines employing more stable hedging policies.

JEL Classification: G32, L93

Key words: Corporate risk management; Hedging; Selective hedging; Risk exposures; Firm value; Airline industry

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