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Factors Affecting the Use of Futures Hedging by Commodity Producing Firms: A Multifactor Risk Management Approach

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The objective of this paper is to review earlier research and identify the major factors affecting the use of futures hedging by commodity producers. This approach seeks to provide a conceptual multifactor model in order to gain a broader and more complete understanding of commodity producer behavior and risk management. Traditionally, the rationale for hedging has focused primarily on a few factors such as output price volatility, risk aversion, and basis risk. However, this paper seeks to bring to together all major factors found in the literature that affect the use of futures hedging by commodity producers. This should assist in bringing about a more complete understanding of futures hedging decisions and behavior regarding commodity producers. The paper focuses on factors that directly impact hedging. These include industry characteristics, business operation characteristics, management characteristics, futures hedging costs, and substitute risk management instruments. The five factors are further disaggregated into subfactors in order to more specifically explain factors affecting the use of hedging. This may be of interest to commodity producing firms and researchers, as it attempts to explain the factors which may influence a commodity producer's decision to hedge with futures.