



Single Currency – a Prospective Tool to Enhance Export Performance

KEYWORDS

Currency-risk, hedging, Derivatives, Export Performance

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ABSTRACT

It has become imperative for the firms to understand the nuances of currency risk for tackling it in a holistic way. The challenges posed by volatile currency have been discussed everywhere, especially in the event of two great economic phenomena. If a single currency is accepted globally for all inter-country transactions, losses incurred on account of currency risk could be substantially reduced. This study purports to analyze the implications of such decisions for business houses. It also extended to evaluate the impact of such implications on the performance of the respondent-firms. The variables given to measure implications in the structured questionnaire were grouped into three factors namely Costs, Benefits and Time. While costs included alignment and adjustment costs, the benefits included the elimination of transaction costs and exchange rate risks. The findings also indicated that currency decisions were good predictors of Export Performance.

INTRODUCTION

Financial risks, understood better as the risks to a corporation which emerge from the price fluctuations – directly or indirectly influence the value of a company. Managing risks is one of the primary activities of a firm that operates internationally. (Ghosal, 1987). A combination of greater deregulation, international competition, interest rates and foreign exchange rate volatility, together with commodity price discontinuities starting in the late 1960s, heightened corporate concerns, which have resulted in increased importance of financial risk management in the decades that followed. Whether it is a multinational company and its exposure to exchange rate changes, a transportation company and the price of fuel, or a highly leveraged company and its interest rate exposure, the manner and extent of managing such risks has often played a major role in the success or failure of a business. Political, economic and financial market forces have prompted the EU member nations to seek ever closer economic, monetary and political integration at the end of the century — by way of the single currency (Rehman, 1997). The global slowdown impacted India when the Indian economy was beginning to mature and when the firms were gaining confidence to do business globally. The export firms were, since then witnessing the impact of volatile currency, shrinking global demand and increasing import prices. Players, big or small, optimize their positions by discounting the arbitrage opportunities spread across the world in order to hedge currency risks.

LITERATURE REVIEW

(1997) Rehman presented the cost-benefit analysis of Euro. One set of literature had studies relating to factors that determine Export Performance (Cavusgil and Zou 1994; Sousa 2004) studies that laid foundation to conceptualize Export Performance (Shoham 1996; Madsen 1998). The second set consisted of studies pertaining to analyze the currency risk. This consisted of descriptive studies that evaluated the strategies using which the firms managed currency risk. The literature also had studies that analyzed the derivative practices of the firms. Indian scenario, the studies conducted earlier were all descriptive in nature. (Vij 2009; Sarkar & Sivakumar 2008).

METHODOLOGY

The initial profiling of firms yielded following information.

TABLE 2
DEMOGRAPHIC PROFILE OF THE FIRMS

PARTICULARS	PERCENTAGE%
EXPERIENCE	

0-10	23.33
11-20	46.66
21-30	16.66
31-40	13.33
TURNOVER (CR)	
0.15-0.99	20
1-1.50	20
1.51-2	3.33
2.1-2.5	6.66
ABOVE 2.5	50
NUMBER OF EMPLOYEES	
UPTO 100	46.66
100-200	20
200-300	26.66
300-400	6.66
SOURCES OF FINANCE	
borrowings	10
owned funds	53.55
both 1&2	23.33
domestic borrowings	3.33
foreign borrowings	3.33
mix of all listed above	6.66
SETTLING EXPENSES	
Indian Rupees	76.66
Others	23.33

Using simple random sampling technique, the structured questionnaire prepared for this study was circulated among the firms found in the data base provided by FIEO (Federations Of Indian Exports Organizations). After thorough scrutiny, 121 firms finally participated in the survey. Nearly 76% of the firms had mis-match in the currency. This indicates that the revenue and the payments were not denominated in the same currency. By this it can be understood that all these firms had to convert all their receipts into home currency for all their operations. The firms in the study also had firms which did not have well defined risk development Policies.

Tools of Analysis

Factor Analysis was employed to reduce the variables to factors. In order to test the predicting power of these factors on export performance, the reduced factors were regressed on export performance of the firms.

Cost Benefit Analysis

The variables were put to factor analysis and the analysis revealed the following information. The reliability and validity tests were conducted to find the effectiveness of such an analysis. The reliability and validity scores were satisfactory

and the effectiveness of factor analysis was confirmed thus.

**TABLE 2
PRELIMINARY ANALYSIS OF THE DATA**

Tests	Parameter	Value	Interpretation
Reliability Test	Cronbach's Alpha	0.849	The Data Collected Are Considered Reliable If The Value Of Alpha Is More.
Validity tests – Inter Item Correlation	Determinant	2.41	The data is not a correlation matrix
Sampling Adequacy tests	Keyser Meher-Ohlin Test	0.454	The data can be considered for factor analysis
Sphericity	Bartlett's test	0.00	

The Principal Component Analysis was performed based on Promax method and it was found out that 68% of the variance in the export performance could be explained by factors relating to single currency. The 15 variables entered were reduced to 3 factors and the details are presented in the table.

**TABLE 3
GROUPING OF THE VARIABLES AND THE CORRESPONDING LOADINGS**

Factors	1	2	3
Exchange rate volatility has become the major area that has to be managed these days			0.843
Maintaining a stable policy is the best		0.517	
The hedging policy has to be monitored and changed regularly to minimise currency risk		0.826	
Single currency requires a lot of time for countries to align		0.830	
The process of initiating countries use single currency is expensive	0.848		
Firms do not get benefitted because of lack of knowledge of the inherent benefits			0.551
Hedging costs could be reduced due to adopting a single currency		0.730	
All countries may not agree to this	0.842		
Negotiating across the world could delay the process			0.831
It is not an immediate solution.			0.872
Derivative markets may take a blow if single currency is advocated	0.882		
The inherent weakness of other currencies too may have an impact on the single currency		0.800	
Economically stronger countries tend to get the maximum benefit than the weaker countries	0.909		
The bargaining power of a country ultimately decides the benefit		0.704	

The impact of a single currency on the trade balance of a country is huge	0.896		
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The first factor comprised of all the statements that explained the cost of abandoning the present system and adopting a completely new currency. The second factor grouped all the variables that explained the benefits of hedging, if multiple currency and the benefits of a single currency. The third factor grouped all the variables that examined the time-element of such decisions. The costs of implementing the decisions included alignment costs and adjustment costs. Some firms would have already entered into derivative agreements. These firms tend to lose money because of their positions in the derivative market. Similarly banks and other financial institutions would have gone long or short in derivative market. This tends to make the institutions face losses.

The benefits derived out of implementing single currency are also plenty. First the firms need not hedge their exposure. Any export firm considers it diligent to hedge their exposures against any adverse effect of exchange rate fluctuations. The firms have the alternate choice between financial and operational hedges. Majority of the Indian firms resort to financial hedges, like derivatives or take up natural hedges like price-adjustment. Operational hedges have not been feasible for many of the firms as 80% of the firms come under the category of Small and Medium Enterprises. These hedges always come with a cost. Hence an uniform currency is likely to benefit these firms more. Funds tied up in hedges could be utilized for effective investments.

The time frame of the decisions is another decisive factor. If the benefits are more than the costs, then the policy could be considered for implementation. But the time taken by the firms and the financial institutions for alignment should not be too high. Smaller firms with not too many countries of operations may not take time to switch over, but for multinationals with a higher spread of countries in their export-basket may take more time. The costs of alignment too could be higher for the multinationals. Thus the analysis of the data reveal the fact that although the benefits of a single currency are more than the costs, the time-frame within which the entire change has to be implemented decides the trade-off.

The model developed here analyzes the impact of the perceptions of the sample towards currency risk on their export performance.

The impact of the factors relating to currency on the Export Performance of the firms was analyzed using the statistical technique of Multiple Regression. The export performance was measured using the variable Annual turnover. The output of the Principal Component Analysis was saved in the form of regression scores. Later these scores were used for regressing on the annual turnover to determine their ability to predict the turnover of the firms. The regression scores revealed the following information.

**TABLE 4
CORRELATION COEFFICIENTS OF THE FACTORS**

Factors	Standard Deviation	1	2	3
Cost dimension (1)	8.65	1.000		
Benefit dimension (2)	9.123	-0.54**	1.000	
Time-zone (3)	1.06	-0.23*	-0.56**	1.000

**** indicates significant at 0.01 and * indicates significant at 0.05 significance level**

The inter-factor correlation was found to be significant at the given levels. The regression analysis revealed the following information.

TABLE 5

**REGRESSION ANALYSIS – RESULTS,
DEPENDENT VARIABLE (ANNUAL TURNOVER)**

Independent variables	Standard coefficient (B)	Significance (p)
Cost	0.206*	0.03
Benefit	0.356*	0.02
Time-horizon	0.153	0.00

R² = 0.356, p = 000, F = 10.01, * indicates significant at 5%,

The regression analysis revealed that the model is significant at 5% level with the adjusted R² at 0.356 and the p value came out to be 0.00. This explains the predicting power of risk management activities with regard to their export performance.

BUSINESS IMPLICATIONS

This model was able to bring out the predicting power of the currency risk management and single currency decisions on the export performance of the firms. This implies the amount of seriousness allotted by the export-firms on managing currency risk. No business house is taking the risk of leaving the exposure unhedged. Earlier schools of thoughts however discouraged managers of corporate to engage in managing risks. The recent developments in the financial sector have encouraged the managers to spend time and money on managing risks arising out of an open position in the business. The policy makers of the world could take this as an urgent issue to implement single currency for helping the exporters to do business confidently. It also implies that uncertainty has become one of the impending issues of today's trade. This study was conducted as a preliminary step to understand the perception of exporters towards bringing out uniform currency. The generalization of the findings could be possible only if this study is extended to other exporters. While this sample represented one geographical location of the state, the others too need not necessarily possess a divergent view on the currency risks.

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