8. Conclusion

In an attempt to resolve the exposure puzzle, this study investigates the relationship between unanticipated changes in exchange rates and firm value, and the potential impact of firm-level internal corporate governance factors on this relationship. This section summarizes key contributions of this study to the current literature and provides direction for future research.

8.1 Contributions of the study

This study provides the following contributions to the existing literature. Firstly, the literature has offered various explanations for the insignificant empirical findings of the relationship between exchange rate changes and firm value. One of the explanations provided by the literature is the measurement bias due to different return measurement horizons (Bodnar & Wong, 2003; Chow et al., 1997; Dominguez & Tesar, 2006) and the choice of exchange rate (Fraser & Pantzalis, 2004; Rees & Unni, 2005). This study contributes to this area of the extant literature by arguing that exposure puzzle can be attributed to the measurement biases due to the use of spot actual changes in exchange rate for estimating the exposure by existing studies. This thesis provides new evidence that the intervention by central bank, through its effects on exchange rates, has a major impact on the level of firms’ exchange rate exposure.

Secondly, an alternative explanation for exposure puzzle mentioned by researchers is that managers conduct hedging and risk management techniques to reduce the exposure (Allayannis & Ofek, 2001). This study draws from the literature of hedging theories and corporate governance, and suggests that firm-level internal corporate governance may explain some of the ambiguity in the existing empirical literature. To the best of our knowledge, this study is the first to provide evidence that strong firm-level internal governance, in which the agency costs and monitoring problems are lower, is associated with reduced level of exchange rate exposure. Another contribution of this study is to explain why currency
derivative usage is ineffective for some firms by providing evidence that the use of currency derivatives is associated with greater reduction in exchange exposure for firms that have strong firm-level governance as compared to weakly governed firms. This study has important implications for managers, shareholders and other investors who are associated with the assessment of the firm’s exposure to exchange rate risk. Corporate managers can use the approach suggested in this study to accurately measure the exposure of their firm. Firms can reduce their exchange rate exposure by improving the structure of corporate governance mechanisms. The strength of firms’ internal governance can also help investors to make their investment decisions.

8.2 Limitations and Future Research Directions

There are a few limitations inherent in this study. Firstly, the mandatory disclosure requirements of ownership structure of Indian firms under Clause 35 of listing agreement have undergone a significant change since March 2001 and are not comparable to the prior reported data by firms. This restricts the analysis of this study to the post-2001 period only. Secondly, the direction of the impact of indirect intervention by central bank through policy changes could not be determined because of data limitations. This study assumes that the shareholders are rational and they want managers to engage in optimal hedging activities. This study uses firms’ ownership structures as firm-level internal governance mechanisms to measure the degree of agency and monitoring problems. Future research might consider other measures of firm-level internal corporate governance such as compensation structures of managers. The standard market model of Jorion (1990) used in this study to estimate the exposure does not include firm-specific controls which might be a possible alternative for future research. Future research may also focus on the exposure of unlisted firms taking their earnings and cash flows as a proxy for firm value.