His pain is your gain: Inter-firm linkages and Exchange rate exposure
A discussion

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Part I

Exchange rate and Firm Internationalisation

From a Trade-centric to a Finance-centric view of Exchange Rate

Tradables/Non-tradables vs. FXBorrowers/Non-borrowers

The "traditional" world: EXR determined by international trade

- A tradables sector and a non-tradables sector
- Exchange rate: relative price between the tradables and non-tradables
- Fluctuations of the exchange rate impact profitability of the tradables sector

The "modern" world: EXR determined by global financial flows

- Capital account transactions dominate
- FX market driven by trade in financial assets
- FX borrowers and non-borrowers

What happens when firms borrow in a foreign currency?

Large literature triggered by EM crises of 1990s and early 2000s

Dollar borrowing is risky

- Currency mismatch on firms' balance sheets
- Firms are vulnerable to exchange rate fluctuations
- Local currency depreciation can wreak havoc

Fear of floating

- CBs of EMs averse to letting their currencies "float"
- Actively intervene in FX markets to stabilise exchange rates
- Example: RBI "manages" the INR/USD; protect the *exposed* firms

Part II

Novelty of the paper

New angle: The buck doesn't stop with the "exposed" firms

One firm's disaster is another firm's bounty

- In a market economy, any shock (e.g. currency depreciation) plays out in a general equilibrium framework
- When an *exposed* firm gets distressed due to a local currency depreciation, its *unexposed* rivals benefit
- An *exposed* firm doing badly after a depreciation is not merely a function of credit stress; its rivals use the opportunity to improve their competitive position

"Silver lining" to an exchange rate shock. Currency effects go beyond trade and exposure related risks.

Important policy implications

There doesn't have to be a "fear of floating"

- **Traditional "trade-centric" world**: Protect the domestic firms and give them export subsidies
- **Modern "finance-centric world"**: Protect the FX borrowers and manage the exchange rate
- **This paper**: In a competitive setting, non FX borrowers gain from a currency depreciation

There is no rationale for CBs to pick out the losers and defend the exchange rate.

Part III

Suggestions for improvement

Issues: Identifications

An *exposed* firm

- A firm that borrows in dollars may have a hedged exposure
- Either a natural hedge from dollar revenues, or through financial derivatives.
- Modern firms may have multiple avenues of *exposure*
- Augmented Market Model might help better to capture *exposure*.

A domestic firm

- Those that do not have dollar debt, assets or revenues.
- But what if the firm uses imported inputs? Or exposed to import parity pricing?

Issues: Pitching the paper

- In a market economy with a normal competitive process, there will always be winners and losers
- When there is a shock, the more vulnerable firms will struggle and those unaffected by the shock will fare better
- Why does this matter?

Issues: Suppliers

- When an *exposed* firm loses out, its suppliers benefit.
- Supplier-customer relationships will depend on relative bargaining power
- Foxconn and Apple vs. thousands of smaller suppliers
- If a firm is facing credit stress, its suppliers or vendors could fare badly

- How to identify suppliers of a firm?
- Paper: Regulation mandates firms to reveal their customers
- Is there such a regulation in India? What about other EMs?
- What about identifying competitors? Why would a firm voluntarily disclose its rivals or suppliers?

Part IV

IV.Other interesting angles

Potential areas to think about

- In EMs like India, there are family firms.
- A business group may have firms which benefit from depreciation because they are exporters with no foreign debt.
- This might have positive spillover effects on other group firms (it may have nothing to do with rivals or customers).

- Can the same idea be applied to firms in the tradables vs non-tradables sectors?
- If a net-exporter loses out from a currency appreciation, what happens to its domestic rivals? what happens to its rivals who are net-importers?
- Every tradable firm has many non-tradable suppliers.