REVEALING FOREIGN EXPOSURE OF CHINESE COMPANIES

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ABSTRACT

What does the Yuan recent appreciation have to do with Chinese companies? Does the unfavorable foreign exchange rate movement reduce the companies' profitability and value? This study computes the currency risk of Chinese corporations and surveys the risk management in practice.

INTRODUCTION

As suggested by economic theories, currency appreciation is likely to reduce a nation's trade surplus because its merchandise price will accordingly increase in international market due to the rising value of its currency. On July 21, 2005, the People's Bank of China announced that its exchange rate regime moved into a managed floating exchange rate regime. This new exchange rate policy is conducted to alleviate the pressure of the rising trade surplus.

Given the fact that Yuan has risen 9.6% since the currency was revaluated by 2.1% against the dollar in July 2005, China's monthly trade surplus still surged to a record high of US$23.8 billion in October 2006. For the first seven months of 2007, China reports $141.3 billion trade surplus with U.S., which increases approximately 81% from the same period in 2006. These data indicates that Chinese rising surplus does not seem to have been affected by Yuan's recent appreciation.

In this study, we are interested to compute the actual currency sensitivity of Chinese public corporations and tend to explore the following questions. Do Chinese firms overall have lower currency risk exposures than other countries? How do the exposures differ across industries and sectors? Do export firms have a higher currency risk than firms with domestic business only? Do firms with higher proportion of foreign sales or foreign direct investment are more sensitive to the changes of Yuan value? And have Chinese firms taken effective actions to protect their profit against the unfavorable foreign exchange rate movement?

The currency sensitivity of Chinese public corporations is computed by the regression, $r_{it} = \beta_{io} + \beta_{ix} r_{xt} + \beta_{im} r_{mt} + \varepsilon_{it}$, where r_i is the return of firm i's stock in day t, r_{xt} is the change in Yuan/$ in day t, r_{mt} is the rate of return on Shanghai Stock Exchange Composite Index. Then, β_{ix} is the firm i's currency risk exposure. Further, we will send a questionnaire to the top 50 companies with the highest currency risk exposure, conducting a survey of their risk management. The questionnaire will be sent to the firm's chief financial officer or, if there was no such function, to the controller or the treasurer. The questionnaire consists of 30 questions grouped in 5 sections, including whether the firm has hedged in the past, what currencies it has hedged, which hedging strategies the firm has used either contractual clauses, money-market hedges, or operating adjustments.