

ANALYZING THE EFFICIENCY OF THE GLOBAL FOREIGN EXCHANGE MARKET: FACTORS INFLUENCING EXCHANGE RATE FLUCTUATIONS AT HDFC LIMITED

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ABSTRACT

Foreign exchange, commonly known as Forex or FX, refers to the global marketplace for trading national currencies against one another. This study explores the structure, functioning, and significance of the foreign exchange market, which is the largest and most liquid financial market in the world. The research highlights the role of currency exchange in international trade, investment, tourism, and economic policy implementation.

The study examines key concepts such as exchange rate mechanisms, currency pairs, spot and forward markets, and factors affecting currency fluctuations—including interest rates, inflation, geopolitical events, and economic indicators. It also analyzes the impact of foreign exchange rate movements on businesses, particularly importers, exporters, and multinational corporations. Additionally, the role of regulatory bodies like the Reserve Bank of India (RBI) and international institutions is discussed in managing foreign exchange reserves and maintaining currency stability.

The findings conclude that understanding foreign exchange dynamics is essential for managing exchange rate risk, optimizing cross-border transactions, and making informed financial and investment decisions in a globalized economy.

I. INTRODUCTION

FOREIGN EXCHANGE (FOREX)

FOREX-The abbreviation of Foreign Exchange

What is Foreign Exchange?

Foreign Exchange is the purchase or sale of one nation's currency in exchange for another nation's currency. Foreign Exchange makes possible international transactions such as imports

and exports and the movement of capital between countries.

Foreign Exchange is the money in one country for money or credit or goods or services in another country. Foreign Exchange includes foreign currencies, foreign cheques and foreign drafts.

Foreign Exchange is the transaction of international monetary business, as between governments or businesses of different countries.

Foreign Exchange is the negotiable bills drawn in one country to be paid in another country.

Foreign Exchange is any currency other than the local currency which is used in settling international transactions.

Foreign Exchange is the system of trading in and converting the currency of one country into that of another country.

Foreign Exchange is the transfer of credits to a foreign country to settle debts or accounts between residents of the home country and those of the foreign country.

Definition of Foreign Exchange:

The foreign capital earned by a country's exports. Since the currency of many less developed countries is not accepted by international markets, it often becomes necessary to earn foreign exchange in order to buy imports.

-Geography Dictionary

Foreign exchange exposure and risk are important concept in the study of international finance. It is the sensitivity of the home currency value of asset, liabilities, or operating incomes to unanticipated changes in the exchange rates.

Exposure exists if the home currency values on an average in a particular manner. It also exists where numerous currencies are involved.

Foreign exchange risk is the variance of the home currency value of items arising on account of unanticipated changes in the exchange rates.

The derivative instruments like forwards, futures and options are used to hedge against the foreign exchange risk of the Multinational companies.

The original derivatives contract of International Finance is the 'Forward exchange contract'. Forward Foreign exchange is a traditional and popular risk management tool to obtain protection against adverse exchange rate movements. The exchange rate is 'locked in' for a specific date in future, which enables the person involved in the contract to plan for and budget the business expenses with more certainty.

Forward exchange market, has since the 1960s, played the role of linking international interest rates. Today, however, Forward contract have to share other instruments and markets for arbitrage and for hedging. These newer derivative instruments include Futures, Options and Swaps.

SCOPE OF THE STUDY:-

- To know what is foreign exchange and what are the various foreign exchange services.
- To know how the transactions related to foreign exchange volatility carried out.
- To have a brief knowledge about various foreign currencies and their exchange rates compare to other nations currencies.

NEED AND IMPORTANCE OF THE STUDY

The world nations are increasingly becoming more interrelated global trade, and global investment. These international result in cross country flow of world nations. Countries hold currencies of other countries and that a market, dealing of foreign exchange results.

Foreign exchange means reserves of foreign currencies. More aptly, foreign exchange refers to claim to foreign money balances. Foreign exchange gives resident of one country a financial claim on other country or countries. All deposits, credits and balances payable in foreign currency and any drafts, travelers' cheques, letters of credit

and bills of exchange payable in foreign currency constitute foreign exchange. Foreign exchange market is the market where money denominated in one currency is bought and sold with money denominated in another currency. Transactions in currencies of countries, parties to these transactions, rates at which one currency is exchanged for other or others, ramificataion in these rates, derivatives to the currencies and dealing in them and related aspects constitute the foreign exchange (in short, forex) market.

Foreign exchange transactions take place whenever a country imports goods and services, people of a country undertake visits to other counties, citizens of a country remit money abroad for whatever purpose, business units set up foreign subsidiaries and so on. In all these cases the nation concerned buys relevant and required foreign exchange, in exchange of its currency, or draws from foreign exchange reserves built. On the other hand, when a country exports goods and services to another country, when people of other countries visit the country, when citizens of the country settled abroad remit money homewards, when foreign citizens, firms and institutions invest in the country and when the country or its business community raises funds from abroad, the country's currency is bought by others, giving foreign exchange, in exchange. Multinational firms operate in more than one country and their operations involve multiple foreign currencies. Their operations are influenced by politics and the laws of the counties where they operate. Thus, they face higher degree of risk as compared to domestic firms. A matter of great concern for the international firms is to analyze the implications of the changes in interest rates, inflation rates and exchange rates on their decisions and minimize the foreign exchange risk. The importance of the study is to know the features of foreign exchange and the factors creating risk in foreign exchange transactions and the techniques used for managing that risk.

OBJECTIVES OF THE STUDY

- To study and understand the foreign exchange in **HDFC Limited**.

- To study and analyze the revenues of the company when the exchange rates fluctuate.
- To analyze income statement and find out the revenues when the dollars are converted into Indian rupees.
- To study the different types of foreign exchange exposure including risk and risk management techniques which the company is used to minimize the risk.
- To present the findings and conclusions of the company in respect of foreign exchange risk management

SOURCES OF DATA

Primary data:

The primary data information is gathered from **HDFC Limited** executives.

Secondary data:

The secondary data is collected from various financial books, magazines and Weizmann Forex Ltd as part of the training class undertaken for project.

LIMITATIONS

- The study is confined just to the foreign exchange risk but not the total risk.
- The analysis of this study is mainly done on the income statements.
- It does not take into consideration all Indian companies foreign exchange risk.
- The hedging techniques are studied only which the company adopted to minimize foreign exchange risk.

II. LITERATURE REVIEW

INTRODUCTION TO FOREIGN EXCHANGE AND

ITS ADMINISTRATIVE FRAME WORK

Definition of International Trade:

International trade refers to trade between the residents of two different countries. Each country functions as a sovereign state with its own set of regulations and currency. The difference in the nationality of the export and the importer presents certain peculiar problem in the conduct of international trade and settlement of the transactions arising there from.

Important among such problems are:

Different countries have different monetary units;
Restrictions imposed by counties on import and export of goods:

Restrictions imposed by nations on payments from and into their countries;

Different in legal practices in different countries.

The existing of national monetary units poses a problem in the settlement of international transactions. The exporter would like to get the payment in the currency of own country. For instance, if American exporter of New York export machinery to Indian rupee will not serve their purpose because Indian rupee cannot be used as currency inn rupees. Thus the exporter requires payment in the importer's country. A need, therefore, arises for conversion of the currency of the importer's country into that of the exporters country.

Foreign exchange: Foreign exchange is the mechanism by which the currency of one country gets converted into the currency of another country. The conversion is done by banks who deal in foreign exchange. These banks maintain stocks of foreign currencies in the form of balances with banks abroad. For instance, Indian Bank may maintain an account with Bank of America, new York, in which dollar are held. In the earlier example, if Indian importers pay the equivalent rupee to Indian bank, it would arrange to pay American export at New York in dolor from the dollar balances held by it with Bank of America.

Exchange rate:

The rate at which one currency is converted into another currency is the rate of exchange between the currencies concerned. The rate of exchange for a currency is known from the quotation in the foreign exchange market.

In the illustration, if Indian bank exchanged us for Indian rupee at Rs.67.73 a dollar, the exchange rate between rupee and dollar can be expressed as

$$\text{USD } 1 = \text{Rs } 67.73.$$

The banks operating at a financial center, and dealing in foreign exchange, constitute the

foreign exchange market. As in any commodity or market, the rates in the foreign exchange market are determined by the interaction of the forces of demand and supply of the commodity dealt, viz., foreign exchange. Since the demand and supply are affected by a number of factors, both fundamental and transitory, the rates keep on changing frequently, and violently too.

Balance of payment: It represents the demand for and supply of foreign exchange which ultimately determine the value of the currency. Exporters from the country demand for the currency of the country in the forex market. The exporters would offer to the market the foreign currencies have acquired and demand in exchange the local currency. Conversely, imports into the country will increase the supply of currency of the country in the forex market. When the BOP of a country is continuously at deficit, it implies that demand for the currency of the country is lesser than the supply. Therefore, its value in the market declines. If the BPO is surplus, continuously, it shows the demand for the currency is higher than its supply and therefore the currency gains in value.

Inflation: inflation in the country would increase the domestic prices of the commodities. With increase in prizes exports may dwindle because the price may not be competitive. With the decrease in export the demand for the currency would also decline; this in turn would result in the decline of external value of the currency. It should be noted that it is the relative rate of inflation in the two countries that cause changes in the exchange rates.

Interest rates: The interest rate has a great influence on the short-term movement of capital. When the interest rate at a center rises, it attracts short term funds from other centers. This would increase the demand for the currency at the center and hence its value. Rising of interest rate may be adopted by a country due to money conditions or as a deliberate attempt to attract foreign investment.

Money supply: An increase in money supply in the country will affect the exchange rates through causing inflation in the country. It can also affect the exchange rate directly.

National income: An increase in national income reflects increase in the income of the residents of the country. The increase in the income increases the demand for goods in the country. If there is underutilized production capacity in the country, this would lead to increase in production. There is a change for growth in exports too. Where the production does not increase in sympathy with income rises, it leads to increased imports and increased supply of the currency of the country in the foreign exchange market. The result is similar to that of inflation viz., and decline in the value of the currency. Thus an increase in national income will lead to an increase in investment or in the consumption, and accordingly, its effect on the exchange rate will change.

Resource discoveries: When the country is able to discover key resources, its currency gains in value.

Capital Movements: There are many factors that influence movement of capital from one country to another. Short term movement of capital may be influenced by the offer of higher interest in a country. If interest rate in a country rises due to increase in bank rate or otherwise, there will be a flow of short-term funds into the country and the exchange rate of the country will rise. Reserves will happen in case of fall in interest rates.

Bright investment climate and political stability may encourage portfolio investment in the country. This leads to higher demand for the currency and upward trend in its rate. Poor economic outlook may mean repatriation of the investments leading to decreased demand and lower exchange value for the currency of the country.

Movement of capital is also caused by external borrowings and assistance. Large-scale external borrowings will increase the supply of foreign exchange in the market. This will have a favorable effect on the exchange rate of the currency of the country. When a repatriation of principal and interest starts the rate may be adversely affected.

Other factors include political factors, Psychological factors and Speculation, Technical and Market factors.

III. FINDINGS

- There is not much change in percentage of operating profit, PBDIT, PBT & PAT.
- As currency of other country is increased or decreased there exists volatility in net operating income.
- As foreign exchange rate is sensitive phenomena that affect the profitability of the company, the company should make study of the impact of exchange rate volatility on its profitability in different foreign markets.
- To have expanded knowledge on impact on company's profitability when foreign exchange rates changes, various statements like cash flow, funds flow, etc need to be checked.
- Total revenues are assumed as 80% domestic and 20% foreign and total expenses are assumed as 80% foreign and 20% domestic, thus this factor affects both incomes and expenses when exchange rate is increased or decreased.

IV. SUGGESTIONS

- Often, foreign ships travel through India and dock their vessels at various ports / harbors in the country. One of the major requirements during such temporary stays, is that of FCY Cash that has to be made available to the Captain of the Ship for covering Crew wages or for other expenses on board the ship.
- These requirements are usually met through a facility called "Cash to Master". To collect this cash, the master of the ship has to approach the branch with his passport and a duly filled up application form. This product is available only in United States Dollars, Pounds Sterling and Euro Currencies.
- Foreign exchange facilities can be availed by customers at any of our branches transacting in Foreign Exchange. You can buy FCY Cash, TC's and FCY DD's from

any our branch and also encash your TC's and Cash at our branches.

- Foreign Exchange can be availed against payments by Cash, Cheque or Pay Order/ Demand Draft. A maximum of Rs. 49,999/- (as per Indian Tax Laws revised 2014 also) will be accepted in cash and any amount above Rs. 49,999/-, against a Pay Order or Cheque after clearance of the same. You need to carry the required Documentary Proof for issuance of Foreign Exchange.

V. CONCLUSIONS

- This study reveals the net income of the company when exchange rate fluctuates.
- From the study we can depict the changes in the expenses and revenues of the company.
- One of the important conclusions is that the revenues and expenditure of the company will change as there is a change in the exchange rates.
- This study helps to know how the volatility in exchange rate impact on company's profitability.
- Hence this study helps to take necessary action when variance in exchange rate affects the profitability.

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