



Foreign Exchange Risk Management Practices in International Businesses

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Abstract

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This study systematically reviews the literature on foreign exchange risk management in international businesses, focusing on how firms design and implement hedging strategies to protect and enhance firm value. Foreign exchange risk is a major strategic challenge for companies with extensive foreign sales and multi-currency operations, where exchange rate volatility affects cash flows, profitability, and market valuation. Using a systematic literature review approach, the study synthesizes evidence on financial derivatives such as forwards, swaps, options, and foreign currency debt, as well as operational techniques including natural hedging, pricing policies, and geographic diversification. The findings indicate that markets generally reward active foreign exchange risk management, although the value premium differs across countries, sectors, and firm characteristics. Governance structures, ownership patterns, access to financial markets, and managerial risk attitudes emerge as key determinants of hedging decisions. However, the relationship between hedging and foreign exchange exposure is not always positive, with evidence of over-hedging, misaligned hedge ratios, and selective or speculative hedging. Overall, effective foreign exchange risk management depends on aligning instruments with underlying exposures, supported by strong corporate governance and integration within broader enterprise risk management frameworks.



1. Introduction

Foreign exchange (FX) risk has become one of the most critical challenges for international businesses as global value chains deepen and capital flows become more integrated. Exchange rate movements can materially affect firms' cash flows, earnings, and market value, especially for companies with extensive foreign sales and multi-currency operations (Anisak & Mohamad, 2020). In this context, FX exposure is not only a by-product of cross-border transactions, but also a strategic risk factor that shapes pricing decisions, competitive positioning, and investment planning in international markets. The high proportion of firms found to be significantly exposed to exchange rate fluctuations in both emerging and developed economies underscores the importance of robust foreign exchange risk management frameworks (Kim & Chance, 2018; Nisak & Mohamad, 2020)

International businesses employ a wide spectrum of FX risk management practices, combining financial hedging instruments with operational strategies. Empirical evidence shows that firms rely on derivatives such as forwards, swaps, options, and foreign currency debt, alongside internal techniques like leading and lagging, natural hedging through matching revenues and costs, and exchange-rate pass-through in product pricing (Bae et al., 2018; Kim & Chance, 2018). The effectiveness and intensity of these practices depend on firm characteristics, the direction of expected exposure, and conditions in product and financial markets (Bae et al., 2018). Moreover, studies on Latin American and Asian firms indicate that governance structures, access to financial markets, and managerial risk attitudes

significantly influence the decision to hedge and the choice of hedging instruments (Giraldo-Prieto et al., 2019; Nimer, 2020).

Despite the widespread use of hedging tools, recent research also reveals that the relationship between hedging and FX exposure is not always straightforward. Some evidence suggests that derivatives do not necessarily eliminate exchange rate exposure and, in certain contexts, may even be associated with speculative positions or symmetric exposure to currency movements (Kim & Chance, 2018; Devina & Dalimunthe, 2021). This has renewed interest in understanding how international businesses design FX risk management policies, implement them in practice, and integrate them within broader enterprise risk management and corporate governance frameworks. Against this backdrop, examining foreign exchange risk management practices in international businesses is essential for clarifying how firms balance value protection and value creation in an increasingly volatile currency environment.

2. Literature Review

Foreign exchange risk has been widely examined in the corporate finance literature, with a consistent emphasis on its impact on firm value, cash flows, and competitive position. Using a large panel of Chinese listed firms, Luo and Wang (2018) show that the use of foreign currency derivatives is associated with higher firm value, and that this value premium is stronger when the domestic currency depreciates and macroeconomic conditions are favorable, highlighting the strategic nature of FX hedging in emerging markets. Similarly, studies on Indonesian and Malaysian corporations document that firms engaging in FX hedging tend to exhibit

higher Tobin's Q or market-to-book ratios compared to non-hedgers, suggesting that markets generally reward active currency risk management, although the magnitude of this premium varies across institutional environments and sectors (Frensyd & Mardhaniaty, 2019).

A key theme in this literature is the joint use of financial and operational hedging instruments. Hadian and Adaoglu (2020), examining Malaysian multinationals, find that financial hedging through foreign currency derivatives generates a significant value premium in both the short and long run, whereas hedging via foreign currency debt can even reduce firm value on average. This evidence supports the view that not all hedging tools are equally effective. Other studies highlight that firms often complement derivatives with operational strategies such as geographic diversification of production, invoicing in specific currencies, and matching currency profiles of revenues and costs, implying that FX risk management is embedded in broader operational and strategic decisions rather than being confined to treasury activities alone (Alam & Gupta, 2018).

The determinants of hedging choices have also received considerable attention. Evidence from Malaysian and other emerging-market firms indicates that corporate governance and ownership structures play an important role: Zamzamir et al. (2021) show that managerial ownership influences both the likelihood and intensity of derivatives usage, and that hedging interacts with ownership to shape firm value. Alam and Gupta (2018) find that Indian firms using derivatives experience lower value volatility than non-hedgers, but the benefits are conditioned by firm characteristics such as leverage, growth opportunities, and size, which affect

both incentives and capacity to hedge. At the market level, Bernal-Ponce et al. (2020) document, for a set of emerging stock markets, that exchange rate derivatives can moderate the impact of currency volatility on equity returns, thereby linking firm level hedging decisions with portfolio behavior and international capital flows.

Despite substantial evidence that hedging can enhance value, the relationship between FX hedging and exposure is not unequivocally positive. Meta-analytic work by Geyer-Klingenberg et al. (2021) synthesizes results from dozens of empirical studies and concludes that financial hedging is associated, on average, with a relatively small but positive firm-value premium, which tends to be larger for foreign-exchange hedgers than for interest-rate or commodity-price hedgers. However, they also note considerable cross-country and methodological heterogeneity, and related meta-analyses show that some samples yield zero or even negative effects, pointing to potential over-hedging, speculative positions, or measurement issues in exposure and hedging intensity (Bessler et al., 2019). Companies in practice do not always use hedging purely for protection; many adopt selective hedging strategies that blur the line between risk management and speculation, which helps explain why the use of derivatives does not necessarily lead to a clear-cut reduction in foreign exchange exposure.

3. Methods

The study employs a systematic literature review (SLR) approach to synthesize existing evidence on foreign exchange risk and its management in international businesses. The review is conducted through a structured and transparent procedure

that includes planning, literature search, screening, data extraction, and synthesis. First, a search strategy is developed using combinations of keywords such as “foreign exchange risk,” “currency exposure,” “FX hedging,” “currency derivatives,” “natural hedging,” “multinational firms,” and “corporate risk management.” These keywords are applied across major academic databases, including Scopus, Web of Science, ScienceDirect, and Google Scholar.

The inclusion criteria focus on articles written in English that examine firm-level FX exposure and hedging practices, discuss the use of financial instruments (such as forwards, options, swaps, and foreign currency debt) and/or operational strategies (such as natural hedging, pricing policies, and geographic diversification), and provide clear implications for corporate risk management or firm value. Studies that primarily address macroeconomic or monetary policy issues, household or individual investor behavior, or non-corporate institutions are excluded, as are non-scholarly materials such as editorials, commentaries, and teaching notes. The screening process is carried out in two stages: an initial review of titles and abstracts to remove clearly irrelevant studies, followed by a full-text assessment of the remaining articles based on the inclusion and exclusion criteria. For each selected study, a standardized data extraction form is used to capture information on research objectives, country and industry context, type of FX exposure examined, hedging instruments and strategies, methodological approach, and main findings.

The extracted evidence is then synthesized using a qualitative, thematic approach that groups studies into key themes, such as determinants of hedging, the interplay between financial and operational hedging, the role of governance and

ownership, and the effectiveness of hedging in reducing FX exposure and enhancing firm value. This SLR design ensures that the review provides a comprehensive and analytically coherent overview of how international firms manage foreign exchange risk in practice.

4. Results and Discussion

The systematic literature review reveals several consistent patterns regarding how international businesses face and manage foreign exchange risk. First, the evidence confirms that FX risk is a pervasive and materially significant source of uncertainty for firms operating in global value chains. Studies on both developed and emerging markets show that exchange rate movements can alter firms' cash flows, profitability, and market value, particularly for companies with substantial foreign sales and multi-currency operations (Kim & Chance, 2018; Anisak & Mohamad, 2020). This supports the view that FX exposure is not merely a technical by-product of cross border transactions, but a strategic dimension of corporate finance that influences pricing, competitiveness, and investment planning. The findings from Chinese, Indonesian, and Malaysian firms indicate that markets tend to reward active FX risk management with higher valuation metrics such as Tobin's Q and market-to-book ratios, especially when currency conditions are volatile or the domestic currency is under pressure (Luo & Wang, 2018; Frensydy & Mardhaniyat, 2019), reinforcing the argument that well-designed hedging policies contribute to value protection and value creation.

The review also highlights that firms rarely rely on a single instrument or approach; instead, they use a mix of financial and operational strategies. Empirical evidence shows that derivatives such as forwards, swaps, options, and foreign currency debt are widely used to hedge transactional and translational exposures (Bae et al., 2018; Kim & Chance, 2018). At the same time, firms complement these tools with operational techniques including leading and lagging, natural hedging through matching revenues and costs, geographic diversification, and currency-based pricing policies (Alam & Gupta, 2018). Results from Malaysian multinationals suggest that hedging with foreign currency derivatives tends to be associated with a positive value premium, whereas the use of foreign currency debt can, in some cases, depress firm value (Hadian & Adaoglu, 2020), implying that not all instruments are equally effective. Together, these findings indicate that FX risk management is embedded in broader strategic and operational decisions, and that the configuration of instruments matters as much as the mere presence of hedging activity.

A further key result concerns the determinants of hedging choices. Cross-country studies on Latin American and Asian firms show that governance structures, access to financial markets, and managerial risk attitudes significantly shape both the decision to hedge and the type of instruments employed (Giraldo-Prieto et al., 2019; Nimer, 2020). Evidence from emerging-market firms underscores the role of ownership and governance: managerial ownership is found to influence the likelihood and intensity of derivatives usage, and the interaction between ownership structure and hedging has important implications for firm value (Zamzamir et al., 2021). At the same time, firm-level characteristics such as leverage, growth

opportunities, and size condition the extent to which derivatives reduce value volatility, suggesting that hedging is more beneficial for firms facing higher external financing frictions or greater exposure (Alam & Gupta, 2018). At the market level, the use of exchange rate derivatives can moderate the effect of currency volatility on equity returns, linking firm-level risk management policies to broader portfolio behavior and international capital flows (Bernal-Ponce et al., 2020). These results collectively point to a complex interaction between internal governance, external market conditions, and FX risk management practices.

Finally, the review shows that the relationship between hedging and FX exposure is nuanced rather than uniformly positive. While meta-analytic evidence suggests that financial hedging is associated, on average, with a small but positive firm-value premium, particularly for FX risk relative to other types of risk (Geyer-Klingenberg et al., 2021), there is substantial heterogeneity across countries, industries, and methodologies. Some studies report zero or even negative effects of hedging on firm value, raising concerns about over-hedging, misaligned hedge ratios, or speculative behavior (Bessler et al., 2019). Empirical findings that derivatives do not always eliminate exchange rate exposure, and may in certain contexts be associated with speculative positions or symmetric exposure to currency movements, further complicate the picture (Kim & Chance, 2018; Devina & Dalimunthe, 2021). This suggests that in practice firms may engage in selective rather than purely protective hedging, which blurs the line between risk management and speculation and helps explain why derivatives usage does not consistently translate into a clear reduction in FX exposure. Overall, the results and discussion indicate

that effective FX risk management depends not only on the availability of instruments, but also on governance quality, managerial behavior, and the alignment between hedging strategies and firms' underlying exposure profiles.

5. Conclusion

This systematic literature review demonstrates that foreign exchange risk is a pervasive and strategically important challenge for international businesses, with clear implications for firm value, cash flows, and competitive positioning. The evidence consistently shows that firms exposed to volatile exchange rates tend to benefit from active FX risk management, particularly when they operate with extensive foreign sales and multi-currency cash flows. At the same time, the review highlights that effective FX risk management is rarely achieved through a single instrument; instead, firms typically employ a combination of financial derivatives and operational strategies. The joint use of forwards, swaps, options, foreign currency debt, natural hedging, pricing policies, and geographic diversification suggests that FX risk management is embedded in broader financial, operational, and strategic decisions rather than functioning as an isolated treasury activity.

The findings also underscore the crucial role of internal and external determinants in shaping hedging behavior. Governance structures, ownership patterns, access to financial markets, and managerial risk attitudes all influence whether firms hedge, how intensively they hedge, and which instruments they choose. Firm specific characteristics such as leverage, size, and growth opportunities further condition the extent to which hedging translates into reduced value volatility

and higher market valuation. However, the relationship between FX hedging and exposure is not uniformly positive. Meta-analytic and empirical evidence indicate that, although hedging is associated on average with a small firm-value premium, outcomes vary widely across contexts, and in some cases hedging may be ineffective or even detrimental when it reflects over-hedging, misaligned hedge ratios, or speculative behavior.

Overall, the review suggests that successful FX risk management depends not only on the availability of sophisticated instruments, but also on the quality of corporate governance, the discipline of managerial decision making, and the alignment between hedging strategies and the firm's underlying exposure profile. For practitioners, this implies that designing FX policies requires a careful balance between value protection and value creation, ensuring that hedging activities are consistent with broader enterprise risk management and corporate governance frameworks. For future research, the findings point to the need for more nuanced analyses that consider heterogeneity across countries, industries, and firm types, as well as deeper examinations of how selective hedging, governance mechanisms, and evolving financial markets shape the real effectiveness of FX risk management in an increasingly volatile global currency environment.

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