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Economic exposure to exchange rate risk and financial hedging: Influence of ownership as a governance mechanism

[Ekta Sikarwar, Roopak Gupta](#) 

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Abstract

Purpose

The purpose of this paper is to examine the potential non-linear relationship between family ownership as a governance mechanism and exchange rate exposure of firms that use financial hedging.

Design/methodology/approach

The exchange rate exposure is estimated using two-factor Jorion (1990) model for a sample of 312 Indian firms over the period from 2001 to 2016. The cross-sectional regression model is used at the second stage to investigate the effects of family ownership on exposure for the firms that use currency derivatives.

Findings

The results suggest a significant non-linear cubic relationship between family ownership and exchange rate exposure. Exchange rate exposure increases with family ownership at low and high levels (as a result of improper hedging) and decreases with family ownership at intermediate levels (as a consequence of value-enhancing hedging).

Practical implications

The study has practical significance for firms to understand the circumstances in which currency derivatives usage is ineffective in alleviating exposure. Firms that have high or

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This study provides new evidence that the relationship between family ownership and exchange rate exposure is non-linear for firms that use financial hedging which has not been investigated before in the prior literature.

Keywords

India

Family ownership

Exchange rate exposure

Financial hedging

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