Global Factors and movements in FOREX and their impact on MSME type Indian Industries

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ABSTRACT

India is one of the emerging economies in the world and has been emerged as an important nation after the globalization. Due to the globalization, the local industries are also directly or indirectly synchronized with the economy of the world. Any movement in global market has an impact on the local industries of India. The major movement in foreign exchange (FOREX) and other global factors, such as recession in the world has an impact on the Indian industries and due to the same, the work practices of local industries has been changed. To combat against such global factors and movements in FOREX, the government of has to rely on 'Atmanirbhar Bharat' and 'Make in India' concept to develop India as a global brand.

Keywords : Atmanirbhar Bharat, Economy, Forex, Global factors, Make in India, MSME

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1. INTRODUCTION

Immediately after independence, India launched an ambitious program of economic development based on industrialization [1,2]. The basic objective was long term self reliant and sustained growth, driven basically by the development of heavy and basic goods industries. But public sector was envisaged to assume the commanding heights of the economy [1]. Naturally, Indian economy was a partially closed economy during the era of planned development from 1950-51 to 1989-90 [2,3]. The country adopted import substitution strategy of growth and the exchange rate was an administered price. Foreign exchange transactions were heavily controlled, since the foreign exchange scarcity was one of the serious constraints to growth [1,2,3]. Past few years are the witness of rapid economic growth led by industrialization in emerging economies of the world and India is a part of the same.

In the post 1980 era, strategy of growth has come under close scrutiny. Rapid growth of Asian Tigers induced policy makers and analysts to evaluate the appropriateness of the policy of growth pursued by India. *India, which was most developed Asian country after Japan at the time of independence, has been left behind by Asian Tigers in the race for development in the era of planned development*. The growth performance of Indian economy during the period is considered as measly relative to that of Singapore, South Korea, Malaysia, Thailand and Indonesia [4,5]. Even after three decades of planned development, the country faced shortages of even the basic goods like food, sugar, milk, cement, steel and conveniences like LPG and two wheelers [3]. Even though the imports of such heavy and basic goods as machinery, steel, cement, railway engines, heavy electrical equipment and wagons could be substituted by domestic production, yet the import dependence rather than being reduced was further deepened because both import substitutes and new items of exports embody high import intensity. The goal of self reliant growth was more a mirage than reality. Policy of open economy and export led growth strategy in South East Asia succeeded much more than the Indian policy of closed economy and import substitution [4,5].

In 1990–91, India adopted new economic policy of liberalization, privatization and globalization to open up the partially closed economy [1]. Economic reforms naturally focused primarily on international trade in the first phase with a view to integrate Indian economy into world economy. The policy shift warranted the liberalization of imports, promotion of exports and replacement of administered by market based exchange rate policy [6]. *The degree of success of new policy may be evaluated by the analysis of comparative growth of income, exports and imports in all the above three periods.*

The Indian economic environment is going through a sea change. This is being brought about by the government's economic policies of liberalization, privatization & globalization (LPG) in 1991 [6]. Due to many domestic and global players in the market, customer becomes the focal point of each business enterprise [4,6]. Each business enterprise is forced to put its best to capitalize the market. This results in stiff competition, which in turn demand running the business by adopting innovative practices for managing the business in international scenario. Intense competition, use of the financial instruments and use of information technology are the most important contributory factors that have made revolution in the way any business is to be conducted.

The new economic policy was necessitated by the worst economic crisis, which was never witnessed by the country after independence [3]. The most visible sign of the country's economic crisis was its extremely low foreign exchange reserves of Rs. 2400 Crores which was reached in early 1991 [3,7]. The reserves were just enough to buy from abroad only three weeks requirements. The situation became even more precarious when international agencies lowered the country's credit rating. The second major aspect of the economic crisis was the rapidly increasing burden of national debt, which exceeded 60 percent of GNP in 1991 [3,7]. The fiscal deficit of the previous five years forced the government to borrow increasingly to meet shortfall in the revenue account. Borrowing added to the already prevailing debt burden.

The new economic policy has four components, viz., (i) Liberalization, (ii) Privatization, (iii) Globalization and (iv) Stabilization [6]. The new economic policy provides freedom to the entrepreneur to enter any industry, produce any product, and earn any amount of money [3,7]. Another plank of the new economic policy relates to widening the role of private sector in economic activities. Till now, private sector has been functioning under administrative controls. With dismantling of controls private sector can become more market friendly orientation.

Giving global thrust is yet another aspect of the new economic policy. A number of measures have been taken to integrate our economy with the world economy. Devaluation of the Rupee in July 1991, for example, was intended to do away with the artificially controlled high exchange rate of the rupee, and to bring it down to the realistic level in terms of the domestic and the world price levels [3,7]. Similarly, the Rupee has been made fully convertible on current account of the balance of payments. Further, custom duties on imports have been lowered to level them with the rates prevailing in the world market. No less important is the easy entry for the foreign direct investment being made possible under the new policy. Finally, with the country becoming member of the WTO, world market is thrown open to Indian products.

1.1 Foreign Trade (Development and Regulation) Act, 1992. It was passed to provide for the development and regulation of foreign trade by facilitating imports into, and augmenting exports from India and for matters connected therewith or incidental thereto [8]. The statement of objects and reasons to the above enactment brings out the essence of governmental thinking and legislative intent by acknowledging the fact that foreign trade is the driving force of economic activity [8]. Technology, investment and production are becoming increasingly interdependent upon each other and foreign trade brings these elements together and spurns economic growth [8]. This act replaces the Imports and Exports (Control) Act, 1947.

1.2 FOREX. The foreign exchange rate exposure of a firm measures of the sensitivity of its cash flows to changes in exchange rates [9]. However, since cash flows are difficult to measure, most researchers have examined exposure by studying how the firm's market value, the present value of its expected cash flows, responds to changes in exchange rates. Exchange rate exposure certainly has the potential to be a significant risk factor for firms [9]. Exchange rate is the combination of two words: rate and exchange. Rate refers to the value/price at which transactions take place, and exchange is the process of buying and selling. The process of buying and selling necessitates determination of price of commodities or service entailed in exchange [9]. The conversion rate is defined as exchange rate. Purchasing power of national currency in foreign markets is expressed in foreign currency, generally US dollars, Euro or a basket of 10 currencies. The foreign currency is the medium of exchange in external market. Exchange rate is the external price of domestic currency. Purchasing power of foreign currency in national market is measured in domestic currency [10].

2. REVIEW OF LITERATURE

The impacts of FOREX movement on industry, trade and economy of nation have been well documented by various researchers and international organizations of repute [9, 10]. The background research and the literature review for this paper has been compiled from the available research papers and legislative information available on the official websites of the WTO, research journals, etc. and also from the articles and papers (published / unpublished) by various eminent jurists and authors.

For getting the idea of what has been done in the area of movement in FOREX (mainly the US dollar) and its impact on the business, trade and nations, various research papers, case studies and research reports have been referred.

The literature addressing foreign exchange rate exposure is almost entirely focused on firms operating in developed economies. Foreign exchange rate exposure is perhaps all the more important for developing economies, as movements in the exchange rate can affect export sectors, and perhaps even the entire economy. The present study addresses the issue of foreign exchange rate exposure in the traditional Indian industrial segments. Foreign exchange revenues are the component of the total revenue of both these Indian industries and the performance of both these sectors depends greatly on the FOREX trend.

As pointed out by Jorion [11], the volatility of exchange rates is substantially larger than that of interest rates or inflation. There have been several empirical studies of the foreign exchange rate exposure of U.S. firms (for example, Jorion [11], Bodnar and Gentry [12], Amihud [13], Choi and Prasard [14], Griffin and Stulz [15], and Allayannis [16]. Most of the studies have typically found low or negligible levels of exposure for most firms, even when the firms examined have significant foreign operations. None of these studies were based explicitly on a model of firm behavior, however, so it is difficult to interpret their findings of low exposure in terms of economic behavior.

For example, Jorion [11] examined U.S. multinational firms and found that only 5% of them exhibit significant exposures. Although the evidence for firms domiciled in other countries was somewhat stronger, it was still relatively weak. For example, He and Ng [17] and Glaum, Brunner and Himmel [18] investigated Japanese and German firms, respectively, and found a greater relation between stock returns and exchange rate movements. But even in these countries, where presumably the large firms have relatively more foreign trade than do their U.S. counterparts, the percentage of firms with significant return exposures was still less than would be expected. Brown's [19] study of the hedging practices of a U.S. firm found that the firm hedged twenty-four different currencies due to both extensive foreign sales and the importation of a major portion of their manufacturing inputs.

He and Ng [17] examine the currency exposures of a limited sample of Japanese firms, loosely defined as multinationals, over a short time-horizon that spans the 1979–1993 period only. Surprisingly, they report that currency exposure is predominantly positive throughout the 1979–1993 periods for about 25% of the firms in their sample. Such uniform currency exposure could be linked to the selection period. Further, it is rather difficult to infer about the currency exposure of Japanese firms over a longer period and for firms with different foreign involvement characteristics. Study of He and Ng [17] suffers from the same data, empirical design, and testing limitations as most of its U.S. predecessor studies do.

Second, the small observed exposures may be due to the complexity of the firms' foreign exchange exposures since exchange rate risk can vary over time as well as cross-sectionally. For example, it can vary with the level of a firm's foreign trade, the demand elasticity of the firm's product, or the competitive reactions of other firms in the same industry. Allayannis [16], Bodnar, Dumas, and Marston [20], Allayannis and Ihrig [21], and Francis, Hasan and Hunter [22] examined time-varying exposure at the industry level. They provided evidence that exchange rate exposures increase with the level of foreign trade and decrease with firms' ability to mark up prices and pass through the impact of exchange rate movements to customers. These studies indicated that it is important to measure exposure in a specification that allows it to vary both cross sectionally and over time [16, 20, 21, 23, 24].

Third, with the rapid development of hedging instruments since the 1980s and considering the political risk, more firms are actively involved in the management of foreign exchange risk [25]. However, a survey of derivative usage by Bodnar, Hayt and Marston [26] indicated that although many firms engaged in currency hedging, they hedged selectively. Further, Guay and Kothari [27] found that the potential effects of hedging with derivatives were small compared to firm size. Hentschel and Kothari [28] found no differences in risk for firms that hedge with derivatives versus those that do not. Given these evidences, it is unlikely that hedging can completely insulate firms from currency risk [29,30].

Starks and Wei [31] argued that exchange rate movements are more likely to affect a firm through direct effects on short-term cash flows, which in turn depend on the firm's sensitivity to short-term cash flow volatility. For example, if a firm's liquidity is already low, then a large fluctuation in its cash flows due to an exchange rate movement can push the firm into financial distress, and as a result, lead to changes in its fundamental value [32, 33, 34]. Similarly, when a firm has substantial growth opportunities, exchange rate movements can have greater effects on firm value due to the firm's larger underinvestment costs [33, 34, 35].

Apart from US, several scholars have made studies on the effects of foreign exchange rate movements on the domestic prices; one of such study for the Turkish manufacturing industry is made by Guncavdi and Orbay [36]. In their research, they found that sensitivity of domestic prices to movements in exchange rates is closely related to the share of imported inputs in domestic production. However, their results were inconclusive, regarding the effects of market structure on the responsiveness of domestic prices to changes in exchange rate [36].

Some of recent work in the literature, both theoretical and empirical, have recognized the role of variations in exchange rates in the price formation process from the structural point of view, and have focused on models of industrial organization to explain the link between exchange rates and prices in terms of nature of oligopolistic competition [31, 35, 36]. Given the high dependence of domestic production of imported inputs in Turkey [36], some portions of changes in domestic prices might be caused by movements in exchange rates, and the extent of these changes might be affected by some industry-specific factors, such as the nature of competition, the degree of dependence of domestic production on imported inputs and the degree of product differentiation. Studies in international economics have noted that movements in international prices are transferred into domestic prices via changes in exchange rates according to "the law of one price" [36].

There have been many theoretical and empirical studies exploring pricing to market and exchange rate pass through. On the theoretical side, Dornbusch's [37] seminal paper is the leading study in the literature. He investigates the determinants and extents of exchange rate pass through under different market structures. The methodology used in this paper is based on a Salop's type circular city differentiated product model, which indicates that relative prices of imported goods decrease with the appreciation of domestic currency, and the extent of this decrease is influenced by the degree of competition and the relative number of domestic and foreign firms. However, his model postulates nothing about the likely consequences of the use of import inputs in production.

In one of the study conducted by Henry and Longmore [38] for Jamaican industry, the results broadly suggest that the real exchange rate does not play a significant role in determining the major elements of the Jamaican current account. The overriding policy issue that arises from these observations is the usefulness of the real exchange rate as a tool for correcting Jamaica's external imbalance, as well as a metric that signals losses or gains in competitiveness.

In India very few studies in this directions has been made, one of such study made by Madhava and Dash and Madhava [39] in which they have studied the impact of currency (US dollar) fluctuations on Indian IT sector. Dash and Madhava [39] found that FOREX exposure was especially alarming for a small fraction of small – cap IT companies, the mid-cap and large-cap IT companies had relatively low/moderate exposure levels. They found that majority of the large-cap companies had already hedged their FOREX risk and were not significantly affected by their respective FOREX exposures [39]. They also found that IT companies had used different hedging tools to manage the exchange risk. Several companies had taken steps to shift their major exports interests to markets other that the US, especially in Asia and Europe, also some of the IT companies have used financial hedging tools such as forwards and options for short period where as an option of currency swaps was used for longer period of hedging [39].

In another study Goel et al. [40] have carried out the detailed analysis of FOREX exposure management strategies of MNC operating in India. They portray a thumbnail sketch of foreign exchange exposure management as practiced by various multinational companies in India. Due to the international dependence of its economy, India is extremely well suited as subject for this kind of study. The purpose of their study is to make a comparative analysis of management of foreign exchange exposure by banking and non banking as well as foreign and Indian MNCs operating in India. This study deals with various other questions such as what is their attitude towards exposure management and their policy for management of foreign exchange exposure.

Whether or not there is a separate management system for management of their foreign exchange exposure? The results of the study evidence that majority of firms face all of three foreign exchange exposures; transaction exposure, translation exposure and economic exposure. More over majority of the companies under study have proper exposure management system. There is not so significant difference between attitude of foreign and Indian MNCs towards development of separate management system to hedge their foreign exchange exposure [40]. They found that most of the companies under the present study are managing only their transaction exposure. Few of them are managing both transaction as well as economic exposure. There is no significant difference between attitude of Indian and Foreign companies towards review of their exposure and hedging policy regularly [40].

In another study pertaining to India, Agrawal [41] has studied the effect of devaluation of Indian currency in Indian economy and postulate that major reason for the same is US economy and rate of interest. He has given an emphasis on generation of more exports from India and maximum utilization of indigenous raw-materials and technology.

3. RESEARCH METHODOLOGY

The present research is exploratory in nature and there is no attempt to establish relationship against different factors. Formulation of Hypotheses may not be necessary since the study is exploratory in nature & in the light the objectives of the study, certain questions which are specific in nature will be investigated to understand the current problem in more detail.

However, in view of pondering further details, a hypothesis of *"movements in FOREX (mainly US $) and global factors and their impact on the local Indian industries"* has been evaluated. Also in due course of research work, some of the questions were framed to test the sector and problem specific hypothesis. Hence, a comparative approach is proposed to be adopted. In this study, secondary data from various newspapers, magazines & journals have been collected. Primary data has been collected through questionnaire, personal interview & discussion. The gathered data has been processed to develop information through various research tools.

3.1 Aim of research study :

To understand the impact of movements in FOREX and global factors, such as economic recession on Indian industries and suggest suitable strategies to improve global trade.

3.2 Main Objectives :

1. To examine the impact of movements in FOREX (mainly appreciation of US $) and global factors, mainly the economic recession in EU and USA on local Indian industries
2. To suggest a suitable measurement strategies to minimize the impact of such global environmental forces.

4. DISCUSSION ON THE IMPACT ON MSME INDUSTRIES OF INDIA

From above literature and discussion, it can be said that foreign exchange are having a profound impact on the business of the companies and has pose a need to manage the risk of FOREX in this global era. The local companies of India, mainly the unorganized industries are dealing in international business and are having similar risk as faced by other companies across the globe.

The nervous system of any business relies on four basic elements, such as social, economical, environmental and political. Out of these elements, economical aspects are vital for the success of the business in the era of globalization. In this era of globalization, the economical aspects of business are influenced by foreign trade, volatility of currency and business opportunities across the globe. Micro, Small and Medium Enterprises (MSME) industries provides valuable contribution in nation's GDP and provide valuable employment to larger part of the society. Majority of the MSME units are unorganized in nature and some of the industries of this segment produces products for the global market. Due to these linkages, these MSME sector is under an impact of global factors and FOREX movement.

The above discussions and literature portrays the "impact of movement of Forex and other global factors such as, economic recession in EU, USA and other part of the world on the performance of export – import business of local industries of India

The collected literature indicates that the awareness of foreign trade business and its legal regime among local industrialist of India is lower than the industrialist of other parts of the world. Based on the available data of literature, it has been found that due to the specific nature of local unorganized industries of India which are mainly exports oriented are having higher awareness for managing the foreign trade business than the non-exports based industries.

Because of the availability of large market in India, local industrialist of India are little reluctant to push their business in global business; also the incentives given by the government for exports business are less. Also the level of awareness and education for exports and participation in trade fair is low among local industrialists of India.

Quality of finished goods played a major role in international trade business and in case of any legal disputes for quality of finished goods supplied by the suppliers, it proves very much useful. Here the quality of Indian goods is not at par with the other international goods, which is one of the important areas where improvements are to be made to combat against the global factors in international market.

Before the appreciation of US $ value (movement in Forex), the price differentiation between other Asian nations and Indian suppliers was a valid reason to have a trade (Ricardian, Heckscher-Ohlin) and was beneficial to local industrial units to produce the products at lower cost. Here the labor and capital were not the prime factors but the demographic conditions are the main reasons of producing product at lower cost. Before the appreciation of US $ value, other Asian nations were holding the greatest relative advantage in total factor productivity (TFP).

During the survey, the importers of local industries had revealed that after the appreciation of US $ value (Forex movements), the cost of import of some of the specific materials, such as dyes and intermediates was almost equal to the price of the same materials available in local market. Hence to avoid the complexity of international trade, such as payments in US $, filing of bill of entry, and clearance through customs house agent (CHA), the local industrialist have switched to the local market for the purchase of the needed raw-materials for their industries.

Here in this context of the appreciation of US $ (Forex) value, the case of supply of chemicals and pharmaceuticals materials from China can not be overlooked. The base price of China made materials increases in India and the Chinese suppliers had lost the advantage of TFP and the trade of consuming such materials in the manufacturing process of local industries of India has followed the Heckscher-Ohlin model and established that both the countries possess the same production function in a given industry of dyes manufacturing.

Some of the local manufacturers of India are importing chemicals, mainly PTA and MEG from overseas markets of south – east to produce POY, polyester chips etc. have also faced the problems similar to the case of chemicals and pharmaceuticals. Due to these movement in Forex (mainly US $), PTA and MEG produced from Indian manufacturer is available at competitive rates. After this appreciation of US $ value, the yarn manufacturer have stopped the import and start the usage of local alternatives. Hence the cost of production of yarn increases. The price of yarn is a major factor for ultimate textile production in Indian market.

Due to the Forex movement, the credit period for the goods exported has been increased from its specific period mainly due to US $ value appreciation and recession in international market. The units which are facing a problem of higher credit period are integrated units where entire manufacturing chain or all process under one roof carried out. Also the payment cycle has been affected to a great extent due to the global factors and movement in Forex, as majority of the exports oriented industries have to make payment in US $, due to the appreciation of value of US $, they have to pay more Indian rupees. In short run they are facing this payment of higher rupees due to no hedging made by them to safeguard their payables.

It has been found that some of the manufacturing units are having a system to hedge their payments against the volatility in currency. Even though the units have adopted a strategy to hedge their payments against the US $ but they fail to exercise proper rates due to the lack of knowledge of international trade. Because of this improper hedging, the cost of their payments has been increased and their over all return on investment is reduced.

The manufacturing units have changed their product mix due to the appreciation of US $. This is mainly due to the reduction in return on investment on capital employed. They switched over to other products and started exploring new customers in international markets. In view of maintaining the production cycle and over all profitability of the units, the manufacturers have altered their product mix. From the collected data, it has been found that in view of the recession in the global markets, the owners of the units have reduced their manpower. This step has been taken in view of managing the cost of production with an aim to supply the products at competitive rates in the market. Apart from recession, another reason for reduction of manpower in these units are implementation of modern machinery in units, these machinery are procured from local and international market for the meeting the process requirements. Implementation and using of modern machinery in manufacturing process is one of the step initiated by the owners to reduce the cost of production and improving the quality of finished products in long run.

During the survey, it has been found that management of the units have convinced their staff through a series of meeting for reduction in wage rates in view of the recession and appreciation of US $ rate (Forex). Also they have informed to their staff about the exploration of new markets by them and once those markets will be fully utilized, they will restore their wage rages and difference of deduction will be given.

It has been found that the units which are of MSME nature (in terms of no. of employees and capital investments) but are able to produce more due to usage of latest technology machines. Higher level of production derived from computer based machines is one of the reasons for higher level of productivity. The variation in maintenance expenses is mainly due to the type of advance machinery involvement in higher quality production.

From the collected data, it has been found that the units of local industries are getting the support from the bank officials for hedging of their payments and receivables. Also they have informed that due to the uncertainty prevailing in the FOREX market, they some times failed to get the actual benefit of hedging. Also they have informed that bank officials are providing guidance through seminars and conferences for the FORX market on periodic basis. Also the banks and financial institutions have reduced the cash credit facilities of the local industrial units. The bank officials have revealed that cash credit facilities reduced due to the appreciation in US $ and recession in global market. The main reason behind reduction of this cash credit is foreign exchange; the cash credit limit sanction by banks are in Indian rupees and payments made by them is in US $ terms. Because of the appreciation of US $, buying capacity of the units reduced, which has ultimately reduced the flow of raw-materials for production. Also due to the appreciation, credit period, i.e. period for receivable increased. Because of this, the financial institutions have reduced the credit facilities to units.

5. CONCLUSION :

Based on the data collection, analysis and inferences drawn, the findings of the preliminary survey are summarized as follows :

- Awareness of foreign trade business and its legal regime among unorganized industries lower than the organized industries, is mainly due to the nature of business.
- In global trade, local unorganized industries of India are facing the stronger competition from other nations such as Taiwan, Vietnam, Bangladesh and China.
- As there is a large market for the consumption of local products in India and few incentives by the Indian government for exports business, the traders are not willing to explore international trade.
- There is a need to develop awareness and educate the local industrials if MSME sector for exports and along with a motivation to participate international trade fair.
- The government has to develop specific policies for MSME sectors, such as the recent move of ‘Atmanirbhar Bharat’ and ‘Make in India’ for providing the global access to local industries of India.
- Indian government has to initiate positive steps, such as revision in EXIM policies, to provide incentives to the local industry to boost up exports.
- Due to the recession in EU, USA and other nations, the local industries who were in exports business have switched the focus from existing clienteles and explore new markets.
- In view of the recession and appreciation of US $ rate (forex), the entrepreneurs of the local industrial units have adopted innovative HR practices carried out series of interactions and convinced their workforce for reduction in wage rates; no strike has been observed from labor staff.
- Due to the appreciation of US $ and recession in international market, majority of the units of the local industries have reported that, banks / financial institutions have reduced the cash credit facilities.

- Now, after the Covid-19 pandemic, the move of anti-globalization with start and every government will focus on local production for their need, which will generate more employment in India and have a long term socio-economic impact.

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