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**From Macroeconomic Risks to
Firm-level Exposure
and Back:
Currency and Politics**

2018 CARE Conference:
Firm-Level Information and the Macroeconomy

Currency

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US\$ --- £

Currency

3

US\$

£

Meghan

Prince

Markle

Harry

Currency

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US\$ --- £

Meghan Markle --- Prince Harry

- $£/US\$ = 0.74$ $US\$/£ = 1.35$
- Fluctuate over time

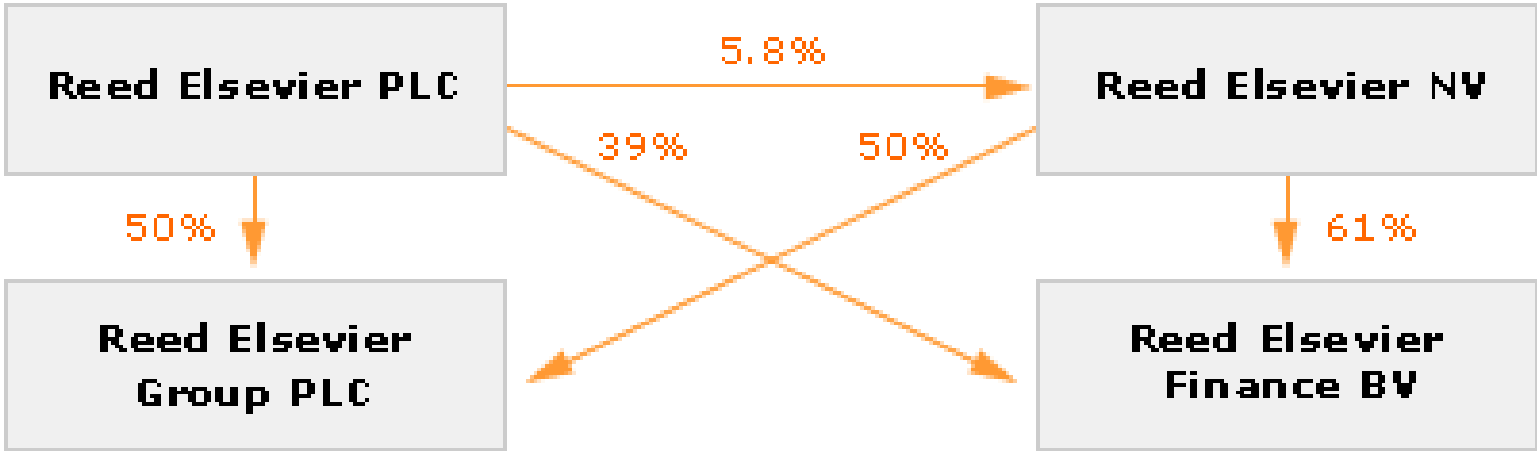
Reporting Currency

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- Reporting Currency
a.k.a. **Presentation Currency**
- Limit scope: We are *not* interested in
Functional Currency

Reed Elsevier Corporate Structure

Summarised Group Structure



Froot and Dabora (1999): 'Siamese twin' companies



- Reed Elsevier formed in January 1993, when **Reed Elsevier PLC** and **Reed Elsevier NV** contributed their businesses to two jointly owned companies, **Reed Elsevier Group plc**, a UK registered company which owns the publishing and information businesses, and **Elsevier Reed Finance BV**, a Dutch registered company which owns the financing activities.
- Separate legal and national identities.

Statoil 2017 annual report

“Change of presentation currency On 1 January 2016 Statoil changed its presentation currency **from Norwegian kroner (NOK) to US dollars (USD)**. The change was made mainly in order to **better reflect the underlying USD exposure** of Statoil’s business activities and to align with industry practice. The change in presentation currency has been accounted for as a policy change, and comparative figures have been re-presented to USD, to reflect the change in presentation currency. There are no policy changes other than the change in presentation currency.”

Novartis

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- The Swiss pharmaceutical company **Novartis** reported its financial statements in Swiss Francs (CHF) for the fiscal years ending before and on 12/31/2002, but in US dollars (US\$) for the fiscal years on and after 12/31/2003.

Novartis (12/31/2002) - US Dollar Reporting

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- We intend to change the reporting currency of our consolidated financial statements from Swiss Francs (**CHF**) to US dollars (**US\$**) beginning on January 1, 2003. The 2002 consolidated financial information will be *restated* into US dollars with this restatement being available prior to the release of the first quarter 2003 financial data. ... The move to presenting the consolidated financial data in US dollars reflects the *increasing importance of our sales in US dollars* and will make the financial information *more easily comparable* with peer companies in the pharmaceutical industry.

Novartis (12/31/2002) in CHF

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	2002	2001	%Change
Cash flow from operating activities	8,162	7,342	+11%
Net effect of currency translation			
on cash and cash equivalents	(99)	31	
Change in cash and cash equivalents	(3,009)	2,344	

Novartis (12/31/2003) – in USD

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	2002	2001	%Change
Cash flow from operating activities	5,229	4,358	+20%
Net effect of currency translation			
on cash and cash equivalents	836	(156)	
Change in cash and cash equivalents	(841)	1,268	

Novartis (12/31/2003) – in USD

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- Since January 1, 2003, we have prepared our consolidated financial statements in US dollars and have also restated consolidated financial information for prior years into US dollars. In either case, a significant portion of our earnings and expenditures are in currencies other than our reporting currency..

Novartis (12/31/2003) – in USD

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- In 2003, 43% of our sales were made in US dollars, 26% in Euro, 8% in Japanese yen, 4% in Swiss francs and 19% in other currencies. In 2003, 41% of our costs were generated in US dollars, 23% in Euro, 17% in Swiss francs, 4% in Japanese yen and 15% in other currencies.

Novartis (12/31/2003) – in USD

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- Changes in exchange rates between the US dollar and other currencies can result in increases or decreases in our costs and earnings. Fluctuations in exchange rates between the US dollar and other currencies may also affect the reported value of our assets measured and the components of shareholders' equity. We seek to minimize our currency exposure by engaging in hedging transactions where we deem it appropriate. To mitigate some of these risks, we have hedged certain foreign currency positions for 2004.

Novartis (12/31/2002) - US Dollar Reporting

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- We intend to change the reporting currency of our consolidated financial statements from Swiss Francs (**CHF**) to US dollars (**US\$**) beginning on January 1, 2003. The 2002 consolidated financial information will be *restated* into US dollars with this restatement being available prior to the release of the first quarter 2003 financial data. ... The move to presenting the consolidated financial data in US dollars reflects the *increasing importance of our sales in US dollars* and will make the financial information *more easily comparable* with peer companies in the pharmaceutical industry.



CANADA:

**AMERICAS
HAT**

Map of Canada



Setting with two currencies

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- Canadian Dollars (CAD) and U.S. Dollars (USD)



- Reporting currency:
 - Almost all US firms use US\$ (but 1%).
 - Most Canadian firms use CAD (but 10%).
- Some firms switch between CAD and USD

Prior Literature

- Benchmark:
- Beaver and Wolfson. 1982. Foreign Currency Translation and Changing Prices in Perfect and Complete Markets. *Journal of Accounting Research*
- Accounting-based valuation with FX uncertainty
- Hughes, Liu and Zhang. 2004. Valuation and Accounting for Inflation and Foreign Exchange. *Journal of Accounting Research*.
- Liu. 2006. On international accounting valuation. *The Journal of International Accounting Research*.

Reporting Currency - EU

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- Euro-adopting countries
- Denmark (Danish Kroner)
 - *Vestas Wind Systems A/S* reports in Euro
 - *Simcorp A/S* reports in Euro
 - *Dampskibsselskabet Torm A/S* reports in USD
- Sweden (Swedish Kroner)
 - *Nordea Bank* reports in Euro
- United Kingdom (British Pound)
 - *BHP Billiton PLC* reports in Euro
 - *Rio Tinto PLC* reports in Euro

Reporting Currency - Europe

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- Switzerland (Swiss Francs)
 - *ABB LTD* reports in USD
 - *Adecco SA* reports in EUR
 - *Syngenta AG* reports in USD
- Iceland (Icelandic Krona)
 - *Marel HF* reports in EUR
- Norway (Norwegian Kroner)
 - *Eitzen Chemical ASA* reports in USD
 - *Ocean Rig ASA* reports in USD

From Micro to Macro

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<u>Company</u>	<u>Country</u>
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Nokia	Finland
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Erickson	Sweden
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From Micro to Macro

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<u>Company</u>	<u>Country</u>
BHP Billiton Ltd.	Australia
AP Moller-Maersk	Denmark
Statoil	Norway

From Micro to Macro

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Aggregate earnings or bellwether
firms affect:

stock markets

Bond markets

FX markets!

From Micro to Macro

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Aggregate earnings or bellwether
firms affect:

stock markets

Bond markets

FX markets!

From Macro to Micro

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José Manuel Campa and Kevin Chang. 1996.

Arbitrage-based tests of **target-zone**
credibility: Evidence from **ERM cross-rate**
options.

The American Economic Review.

Economic consequences of SOX

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Negative **stock** market reaction

Ivy Zhang

Peter Iliev

Appreciation in **US\$/£** and other currencies.

Politics

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- Douglas Hibbs
- Political science applies to the relation between accounting information and macro-variables.
 - ✦ State-level aggregate data
- State-level earnings dispersion is negatively related to current and future state GDP growth up to two quarters

The World



Takeaways

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- Reporting Currency affects perceived volatility
- Earnings and aggregate earnings can affect exchange rates
- Politics affect aggregate earnings dispersion