IAS PARLIAMENT
Information is Empowering
A Shankar IAS Academy Initiative

Constant Currency

What is the issue?

\n\n

\n

- Indian rupees is facing hurdles due to widening current account deficit.
\n
- In this scenario the concept of constant currencies and realised exchange rates are found as alternative solutions.
\n

\n\n

What is constant currency?

\n\n

\n

- Investors and analysts debating two different sets of numbers for companies from export-driven sectors such as software, pharma, textiles.
\n
- One result based on ‘constant currency’ and the other based on the actual realised exchange rates.
\n
- Results based on ‘constant currency’ show how a company would have fared for the quarter or year, had exchange rates between the rupee and the dollar (or euro or yen) not changed at all during the periods being compared.
\n

\n\n

Why constant currency is important for business?

\n\n

\n

- Swings in the rupee’s exchange rate against a foreign currency can make a big difference to the growth numbers of export-oriented companies. They can bolster profit margins as well.

\n

- The healthy growth figures in the reported currency may have nothing to do with the underlying business.
\n
- So, companies like to strip out the effect of exchange rates on their numbers and report them on a ‘constant currency’ basis to inform investors how they really performed.
\n
- Such numbers are calculated after assuming a fixed exchange rate for the dollar, euro or pound against the rupee.
\n
- IT companies always tend to give their guidance in constant currency dollar terms.
\n

\n\n

What is the significance of constant currency?

\n\n

\n

- Constant currency growth can be a better indicator of how a company’s core business is faring than its reported numbers.
\n
- Most exporters, including IT companies, deliver their services in the US and Europe and bill clients located in different geographies in different currencies.
\n
- The major billing currencies are the US dollar, Euro and British Pound, in recent times the dollar has gained against all the major currencies of the world.
\n
- The rupee too has declined heavily against the dollar, This makes it quite important to analyse the results without currency movements in the equation.
\n

\n\n

What is the way forward?

\n\n

\n

- Most companies tend to highlight whichever numbers make them look good, investors thus need to be cautious for taking informed decisions.
\n

- If constant currency numbers exceed the actuals, the indication is that business traction is good, as is the case with the Indian IT pack currently.
\n
- Investors, however, must keep in mind that stock valuations are based on only the numbers actually realised.
\n
- Most analysts, however, tend to dwell on which numbers present the most realistic picture for a company.
\n

\n\n

\n\n

Source: Business Line

\n