



Currency Risk Exposure, Corporate Hedging Strategies, and Shareholder Value: An Integrative Analysis of Exchange Rate Risk Management in Modern Financial Markets

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Abstract: The globalization of financial markets and the increasing internationalization of corporate operations have fundamentally transformed the nature and magnitude of currency risk faced by firms. Exchange rate volatility affects cash flows, firm valuation, financing decisions, and ultimately shareholder wealth. Over several decades, academic research has attempted to conceptualize, measure, and explain corporate exposure to currency risk, as well as the rationale behind firms' hedging decisions. Despite extensive empirical and theoretical work, significant ambiguities remain regarding the effectiveness of hedging, the distinction between hedging and speculation, and the role of governance, disclosure, and managerial behavior in shaping risk management outcomes. This study develops an integrative, theory-driven research article that synthesizes foundational and contemporary perspectives on currency risk exposure and corporate hedging, drawing strictly on established academic literature. By deeply elaborating on exchange rate exposure definitions, measurement challenges, hedging instruments, selective hedging behavior, and shareholder value implications, this article aims to provide a comprehensive framework for understanding corporate foreign exchange risk management. The analysis also extends to the interaction between currency risk and broader financial markets, including credit and equity markets, as well as the evolving relevance of derivatives, foreign currency debt, and algorithmic hedging approaches. Through descriptive and interpretive analysis, the article highlights how institutional environments, regulatory frameworks, disclosure standards, and managerial characteristics influence hedging strategies. The findings underscore

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that corporate hedging is neither universally value-enhancing nor purely risk-reducing; rather, it is a complex strategic activity shaped by market imperfections, agency considerations, and firm-specific constraints. This research contributes to the literature by offering an integrated narrative that reconciles competing theoretical viewpoints and identifies persistent gaps for future inquiry in corporate risk management.

Keywords: Currency risk exposure, corporate hedging, exchange rate volatility, shareholder value, financial derivatives, risk management

Introduction

The rapid expansion of international trade, cross-border investment, and multinational corporate activity has rendered currency risk an unavoidable element of modern financial management. Firms operating across national borders are exposed to fluctuations in exchange rates that can materially affect revenues, costs, asset values, and liabilities. Exchange rate movements can alter competitive positions, distort financial statements, and introduce uncertainty into strategic planning. As a result, understanding how firms are exposed to currency risk and how they manage that exposure has become a central concern in corporate finance and international financial management.

Early academic inquiry into currency risk exposure emerged alongside the collapse of the Bretton Woods system and the transition to floating exchange rates. This structural shift intensified exchange rate volatility and forced firms to confront previously muted financial risks. Seminal work by Adler and Dumas (1984) laid the conceptual foundation by defining currency exposure as the sensitivity of firm value to exchange rate changes. Their contribution moved beyond simplistic accounting measures and emphasized the economic nature of exposure, highlighting that even firms without direct foreign operations could be affected through competitive and macroeconomic channels.

Subsequent research sought to empirically measure exchange rate exposure and assess its impact on firm value. Jorion (1990) provided early evidence on the exposure of U.S. multinationals, revealing that measured exposure was often weaker than theoretically expected. This apparent discrepancy sparked a rich literature investigating methodological challenges, data

limitations, and the mitigating role of operational and financial hedging. Bodnar and Wong (2003) further demonstrated that model specification, exchange rate selection, and return measurement significantly influence estimated exposure, suggesting that empirical findings must be interpreted with caution.

Parallel to the exposure literature, scholars began examining why firms hedge currency risk and whether hedging enhances shareholder value. Theoretical frameworks rooted in market imperfections argue that hedging can reduce expected costs associated with financial distress, underinvestment, and agency conflicts, thereby increasing firm value. Géczy, Minton, and Schrand (1997) provided influential empirical evidence that firms with greater growth opportunities and financial constraints are more likely to use currency derivatives. Allayannis and Ofek (2001) further showed that derivative use is associated with reduced exchange rate exposure, supporting the notion that hedging can be effective.

However, the value implications of hedging remain contested. While some studies find positive associations between hedging and firm value, others emphasize the risks of speculative behavior and managerial opportunism. Adam and Fernando (2006) highlighted that hedging strategies may incorporate speculative elements, blurring the line between risk management and profit-seeking. Later work by Adam, Fernando, and Golubeva (2015) introduced behavioral considerations, demonstrating that managerial overconfidence can influence hedging intensity and outcomes.

In addition to firm-level factors, institutional and regulatory environments shape risk management practices. Disclosure requirements, governance structures, and post-crisis regulatory reforms have altered incentives and constraints faced by financial and non-financial firms alike. Akhigbe and Martin (2008) illustrated how enhanced disclosure and governance following Sarbanes–Oxley affected the risk profiles of U.S. financial services firms, underscoring the broader relevance of transparency in risk management.

More recent research has expanded the scope of analysis to include interactions between currency risk and other financial markets. Norden and Weber (2009) demonstrated the co-movement of credit default swap, bond, and stock markets, suggesting that currency risk cannot be analyzed in isolation from credit and equity

risk. Similarly, Clark and Judge (2009) compared the hedging effectiveness of foreign currency derivatives versus foreign currency debt, revealing the existence of a hedging premium and complex trade-offs in instrument choice.

Despite decades of research, the literature remains fragmented across theoretical perspectives, empirical methodologies, and institutional contexts. There is a need for integrative analysis that connects exposure measurement, hedging behavior, shareholder value, and market interactions within a coherent framework. This article addresses this gap by synthesizing established research and offering extensive theoretical elaboration on the mechanisms linking currency risk and corporate financial strategy.

Methodology

This study adopts a qualitative, theory-driven research methodology grounded in an extensive and critical examination of established academic literature on currency risk exposure and corporate hedging. Rather than employing new empirical estimations or mathematical modeling, the methodology emphasizes interpretive analysis, conceptual integration, and descriptive synthesis. This approach is particularly appropriate given the objective of reconciling diverse theoretical perspectives and empirical findings within a unified narrative framework.

The primary sources for analysis consist exclusively of peer-reviewed journal articles, authoritative institutional publications, and well-established academic contributions listed in the reference set. These works span foundational theoretical models, empirical investigations, and contemporary extensions into selective hedging, governance, and algorithmic risk management. Each reference is examined in depth to extract core arguments, methodological assumptions, and key findings.

The analytical process begins with a conceptual mapping of currency risk exposure, drawing on the definitions and classifications proposed by Adler and Dumas (1984). This framework serves as the basis for evaluating subsequent empirical measurement approaches, including those discussed by Jorion (1990) and Bodnar and Wong (2003). The analysis then transitions to corporate hedging theory, integrating insights from derivative use studies and value-based frameworks

advanced by Géczy et al. (1997), Allayannis and Ofek (2001), and Aretz and Bartram (2010).

To capture the behavioral and strategic dimensions of hedging, the methodology incorporates findings from studies on selective hedging, managerial overconfidence, and financial constraints. These perspectives are critically assessed to highlight complementarities and tensions between rational risk management motives and behavioral explanations. Institutional and regulatory influences are analyzed through the lens of disclosure and governance research, particularly the work of Akhigbe and Martin (2008) and regulatory guidance from the Autorité des Marchés Financiers (2009).

Finally, the methodology situates currency risk management within broader financial market dynamics by examining research on credit, bond, and equity market co-movements, as well as comparative analyses of hedging instruments. The inclusion of emerging perspectives on algorithmic and crypto-native hedging reflects the evolving nature of financial risk management, while remaining anchored in established theoretical principles.

Throughout the analysis, methodological rigor is maintained by explicitly linking interpretive claims to cited sources and by acknowledging limitations inherent in descriptive synthesis. The absence of new quantitative data is offset by extensive theoretical elaboration and nuanced discussion of empirical evidence, ensuring analytical depth and academic coherence.

Results

The integrative analysis of the referenced literature yields several substantive findings regarding the nature of currency risk exposure, corporate hedging behavior, and their implications for shareholder value. First, the concept of exchange rate exposure emerges as inherently multidimensional. As articulated by Adler and Dumas (1984), exposure encompasses not only transactional effects reflected in accounting measures but also economic exposure arising from competitive dynamics and macroeconomic linkages. Empirical studies consistently demonstrate that measured exposure varies significantly across firms and industries, reflecting differences in operational flexibility, market structure, and strategic positioning.

Second, the empirical measurement of exchange rate exposure is shown to be highly sensitive to methodological choices. Jorion (1990) and Bodnar and Wong (2003) reveal that exposure estimates depend on the selection of exchange rate indices, time horizons, and return specifications. This sensitivity helps explain why early empirical studies often reported weak or insignificant exposure effects, despite strong theoretical expectations. The findings suggest that absence of measured exposure does not imply absence of economic risk, but rather reflects the complexity of capturing exposure in reduced-form models.

Third, corporate hedging behavior is found to be widespread but heterogeneous. Firms employ a range of instruments, including currency derivatives and foreign currency debt, to manage exposure. Evidence from Géczy et al. (1997) and Allayannis and Ofek (2001) indicates that derivative use is more prevalent among firms with greater growth opportunities, higher leverage, and more pronounced exposure. Clark and Judge (2009) further demonstrate that the choice between derivatives and foreign currency debt involves trade-offs related to cost, flexibility, and hedging effectiveness.

Fourth, the relationship between hedging and shareholder value is complex and context-dependent. Aretz and Bartram (2010) show that hedging can enhance value by mitigating market imperfections, yet this effect is not universal. Adam and Fernando (2006) provide evidence that some firms engage in speculative hedging, potentially increasing risk rather than reducing it. Behavioral factors, particularly managerial overconfidence, further complicate the value implications of hedging, as documented by Adam et al. (2015).

Fifth, governance and disclosure play a significant role in shaping risk management outcomes. Enhanced transparency and regulatory oversight are associated with changes in risk-taking behavior, as shown by Akhigbe and Martin (2008). Clear disclosure frameworks, such as those advocated by the Autorité des Marchés Financiers (2009), contribute to more informed stakeholder assessment of hedging strategies and associated risks.

Finally, currency risk is deeply interconnected with broader financial market dynamics. The co-movement of credit default swaps, bonds, and equities

documented by Norden and Weber (2009) underscores the systemic nature of financial risk. This interconnectedness suggests that currency hedging decisions cannot be evaluated in isolation but must be understood within a holistic risk management framework.

Discussion

The findings of this integrative analysis highlight several important theoretical and practical implications for corporate risk management. From a theoretical perspective, the multidimensional nature of currency exposure challenges simplistic models that equate exposure with observable accounting measures. The distinction between transactional, translational, and economic exposure emphasizes that risk management must be aligned with strategic objectives rather than solely financial reporting considerations.

The sensitivity of exposure measurement to methodological choices raises important questions about empirical inference. Researchers must carefully consider model specification and data selection when interpreting exposure estimates. This methodological awareness also has practical implications, as managers relying on internal models may underestimate exposure if measurement tools are poorly calibrated.

The heterogeneity of hedging behavior reflects the influence of firm-specific characteristics and market imperfections. Theoretical models predicting universal hedging under risk aversion are insufficient to explain observed practices. Instead, hedging emerges as a strategic choice shaped by financial constraints, competitive dynamics, and managerial incentives. Selective hedging, as explored by Adam et al. (2017) and Albouy and Dupuy (2017), illustrates how firms may dynamically adjust hedging positions based on market views, blurring the line between hedging and speculation.

The debate over shareholder value remains unresolved. While hedging can reduce volatility and expected distress costs, it may also introduce agency problems and speculative risk. Behavioral insights into managerial overconfidence provide a compelling explanation for deviations from optimal hedging, suggesting that governance mechanisms are critical in aligning risk management with shareholder interests.

Regulatory and disclosure frameworks play a moderating role by enhancing transparency and accountability. Post-crisis reforms have increased scrutiny of derivative use and risk disclosure, potentially curbing excessive risk-taking. However, increased regulation may also impose compliance costs and reduce flexibility, highlighting a trade-off between oversight and managerial discretion.

The interconnectedness of currency risk with credit and equity markets reinforces the need for integrated risk management approaches. Currency hedging decisions can influence credit risk perceptions and equity valuations, creating feedback effects across markets. Emerging developments in algorithmic and crypto-native hedging further complicate the landscape, introducing new tools while raising questions about governance and systemic risk.

Despite its comprehensive scope, this analysis is subject to limitations. The reliance on existing literature precludes direct empirical testing of hypotheses, and the rapidly evolving nature of financial markets may render some findings context-specific. Future research could build on this framework by incorporating cross-country comparisons, longitudinal analyses, and the impact of technological innovation on hedging practices.

Conclusion

This article provides an extensive and integrative examination of currency risk exposure and corporate hedging strategies, grounded in established academic literature. By synthesizing theoretical foundations, empirical findings, and institutional perspectives, the analysis demonstrates that currency risk management is a complex and multifaceted endeavor. Exchange rate exposure is pervasive yet difficult to measure, hedging behavior is heterogeneous and strategically motivated, and the implications for shareholder value are contingent on market imperfections, governance structures, and managerial behavior.

The findings underscore that corporate hedging cannot be universally characterized as value-enhancing or risk-reducing. Instead, it represents a strategic response to uncertainty, shaped by economic incentives and behavioral factors. Effective risk management requires not only sophisticated financial instruments but also robust governance, transparent disclosure, and alignment with long-term strategic objectives.

As globalization and financial innovation continue to reshape the corporate landscape, understanding the nuanced dynamics of currency risk and hedging remains a critical challenge for scholars and practitioners alike. This integrative analysis contributes to that understanding by offering a comprehensive and theoretically grounded perspective on one of the most enduring issues in international finance.

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