

**The Effects of Currency Risk on Company Value and Earnings Quality:  
An Assessment of US-Based MNCs Operating in Emerging Markets**

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**Abstract:**

Finance theory argues that corporate decisions should be examined from the shareholders' point of view with value maximization as the goal of the firm. From the shareholders' point of view, exchange rate risk is relevant to the extent that it impacts the value of the firm. A key concern for investors assessing the impact of exchange rate risk on the value of the firm is how exchange rate risk impacts cash flows and net income. In addition, shareholders need relevant (useful) accounting information to make well-informed decisions.

Using a sample of US-based MNCs operating in emerging markets, where unique challenges such as limited derivatives markets are encountered, it is argued that firm value and earnings quality are likely to be impacted by exchange rate risk. We find that the values of firms are affected by their exposure to emerging market currency risk and, for firms with negative exchange rate exposure, the exposure is shown to be significantly influenced by the degree of

emerging market involvement, the degree of imbalance in emerging market revenues and costs, and the degree of incremental earnings that result strictly due to translation. Of particular importance, it is shown that the availability of earnings information that distinguishes between emerging market and non-emerging market earnings results enables the researcher to discern differences in earnings quality. Specifically, the earnings quality of emerging market earnings is found to be lower than that of non-emerging market earnings.

This study provides further evidence that geographic segment data, and financial statement data in general, are useful since these data characterize exchange rate exposure, explain residual stock returns, and help to discern differences in earnings quality. Taken together, these analyses highlight benefits of geographic disclosure for shareholders.