

DEMYSTIFYING PURCHASING POWER PARITY

A Guide to Adjusting Revenue for BRSR Core

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WHAT IS PURCHASING POWER PARITY (PPP)?

Purchasing power parity (PPP) is a concept in economics that aims to measure the relative value of different currencies. It does this by comparing the cost of acquiring a specific basket of goods and services in various countries. In simpler terms, PPP tells you how much currency you'd need in another country to buy the same amount of stuff you could buy with a set amount of currency in your home country.

This concept can be particularly beneficial for understanding living standards across countries. By considering the relative cost of living, PPP provides a more accurate comparison of economic well-being, even if the countries involved have different exchange rates. Additionally, PPP can be a valuable tool for businesses operating internationally, allowing them to understand the purchasing power of their revenue in different markets and make informed decisions regarding resource allocation and pricing strategies.

FORMULA:

The PPP exchange rate is calculated as the ratio of the price of the basket of goods in one country to the price of the same basket in another country. Here's the formula:

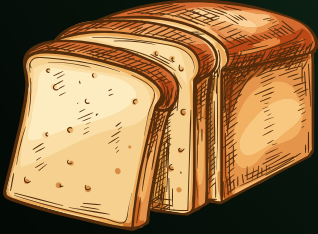
$$\text{PPP} = \frac{\text{Price of basket of goods in Country A}}{\text{Price of basket of goods in Country B}}$$

This formula gives you an exchange rate that reflects the purchasing power of the currencies involved. It's not necessarily the actual exchange rate you'd see on the foreign exchange market, but it helps compare living standards across countries.

EXAMPLE:

Let's use a basket of goods to understand the PPP (purchasing power parity) between the USA and India, considering a PPP value of 23.37

Imagine a basket containing these everyday items:



Price in India: ₹40

Price in USA: \$4.38



Price in India: ₹100

Price in USA: \$9



Price in India: ₹500

Price in USA: \$14

While the individual prices seem different between the two countries, PPP considers the relative value of the currencies. Based on the information provided, the PPP between India and the USA is 23.37. This means, in theory, ₹23.37 has the same purchasing power as \$1 in the USA.

Therefore, if you were to calculate the total cost of this basket in India and convert it to USD using the PPP, it should be roughly equal to the actual cost of the same basket in the USA. This highlights how PPP helps us compare the cost of living between different countries despite fluctuations in exchange rates and individual item prices.

Total basket cost in India: ₹40 (bread) + ₹100 (vegetables) + ₹500 (polo shirt)
= ₹640

Theoretical basket cost in India using USD (considering PPP): ₹640 / 23.37
≈ \$27.40

ADJUSTING REVENUE:

To adjust revenue with PPP, you divide your revenue in the local currency by the PPP exchange rate for the target currency. This gives you the equivalent revenue in the foreign currency, considering the difference in purchasing power between the two countries.

Unit of PPP

The unit of PPP is the same unit as the currency used in the basket of goods. For instance, if the basket is priced in US dollars, the PPP unit would also be in US dollars.

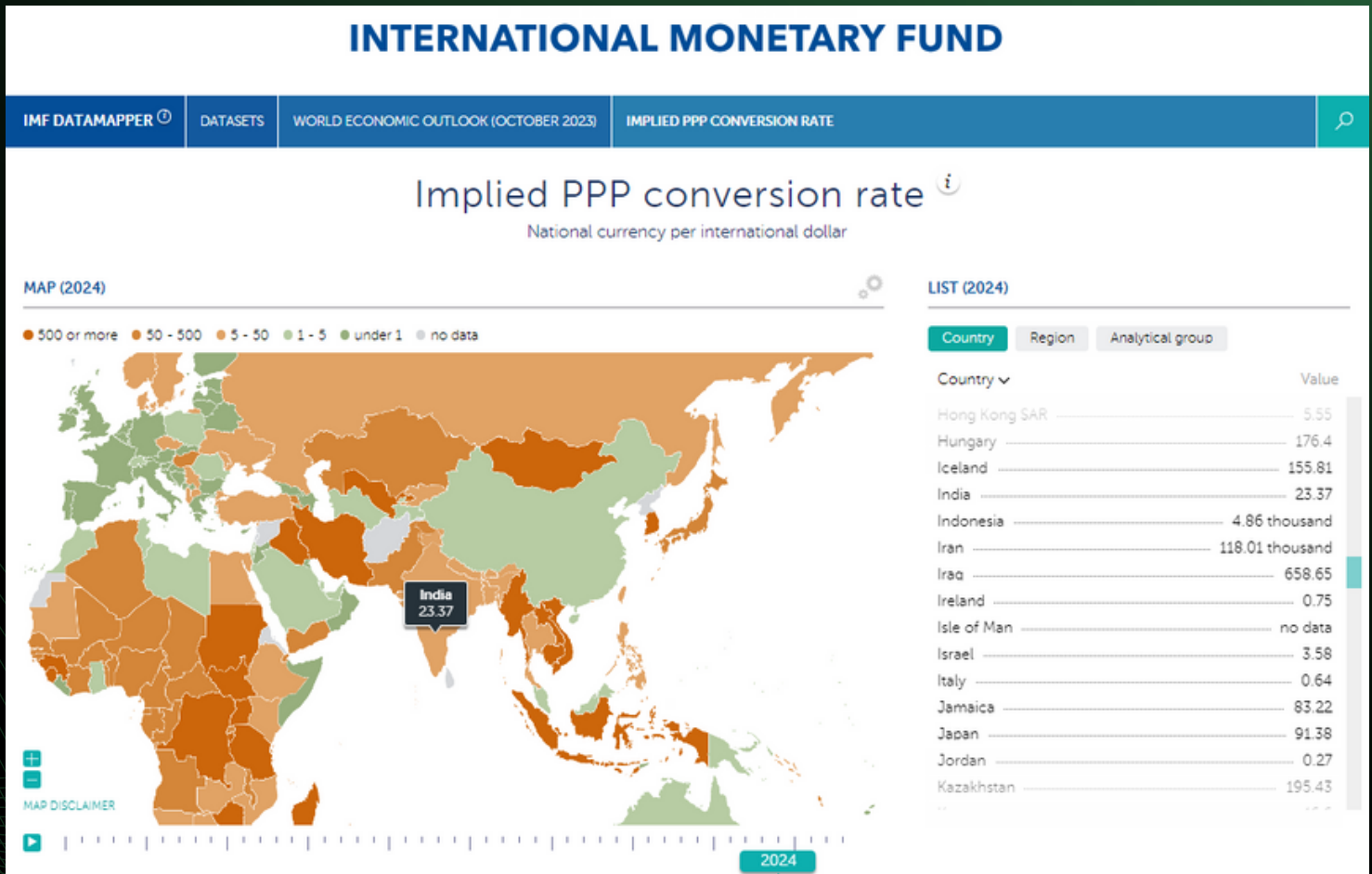
Adjusting Your Company's Revenue:

Let's say your company has a revenue of ₹1,00,000 and you want to adjust it to USD using the PPP of 23.37 (India to USA). Here's the calculation:

$$\text{ADJUSTED REVENUE IN USD} = ₹100,000 / 23.37 \\ \approx \$4,282.35$$

This implies that your company's revenue of ₹1,00,000 has the same purchasing power as approximately \$4,282.35 in the United States.

SOURCE:



The International Monetary Fund (IMF) is a reliable source for data on Purchasing Power Parity (PPP), which reflects the relative cost of living between different countries. The IMF's World Economic Outlook (WEO) database provides PPP data through their PPP conversion rates, allowing for comparisons of economic output and living standards across nations after adjusting for price level differences. To explore PPP values for specific countries, like India, you can visit the IMF Data

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POINTS TO CONSIDER:

- PPP is a theoretical concept, and real-world exchange rates can deviate from PPP due to various factors like trade barriers and transportation costs.
- The basket of goods chosen for PPP calculation can influence the outcome.
- Quality of the goods may also be region specific
- PPP is a valuable tool for comparing relative living standards and economic productivity between countries, but it shouldn't be solely relied upon for financial decisions.

This article is intended to provide general information about adjustment of PPP in BRSR report. It is not intended to provide specific advice. The author does not claim copyright of the data used in the report. This article is purely for knowledge-sharing purposes.

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Readers are advised to consult with a qualified professional for specific advice.