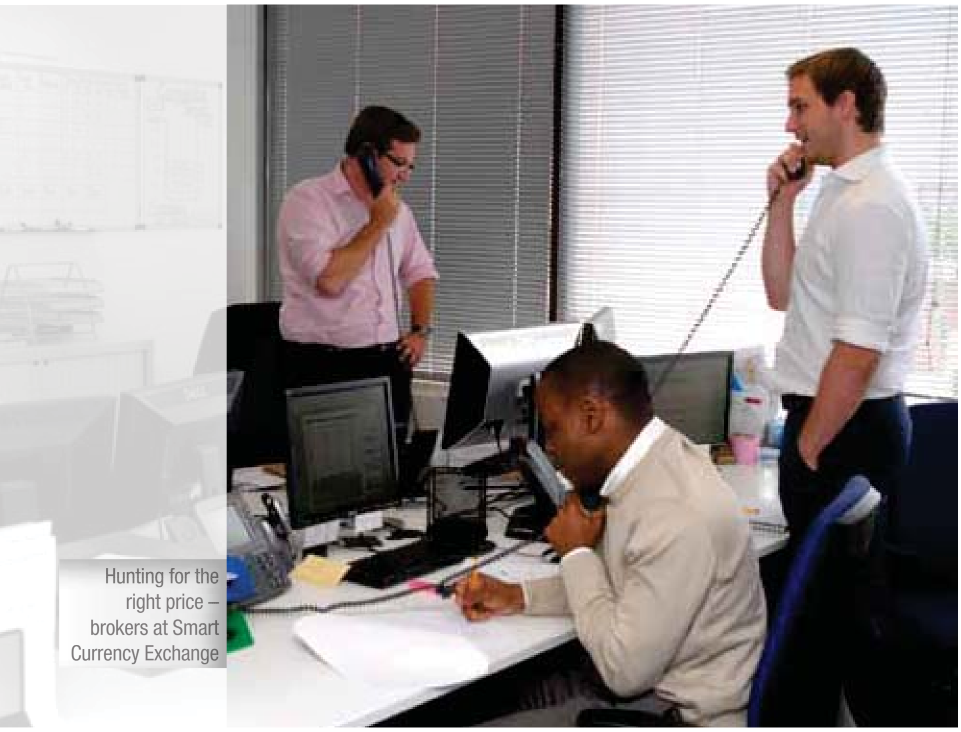
Be safe, not sorry
with foreign exchange

Dealing in foreign currencies can be fraught with danger if you play the markets by chance. But you can reduce your risk and save money by using specialist currency brokers.



Hunting for the right price – brokers at Smart Currency Exchange

THE manufacturing industry is at the forefront of globalisation. Exports are now more important than ever, with the most recent Purchasing Managers' Index findings leading analysts like Lee Hopley at EEF to venture that manufacturers' success in the immediate future could soon be largely dependant on their strategies for sending goods abroad.

Coupled with this, manufacturers now need to buy in stock and components from all corners of the globe, for cost, quality and availability reasons. And, with the pound weak – against the euro in particular but other global currencies too – many businesses who might previously have been able to pay their suppliers in sterling will have found they are no longer afforded this luxury.

This can cause major headaches. A company might line up a deal to buy several thousand of a certain component from the same overseas company for a year, which it will pay for in monthly instalments in the home currency of the supplying business. The price will be agreed when the deal is made, but if the currency goes up in value over the year the business will ultimately end up paying more in real terms.

One way to mitigate this risk is to agree with overseas customers and suppliers that any losses that arise because of exchange rate fluctuations should be shared between the two parties. However, currencies don't just go up in value: sometimes they go down. If you've agreed a deal to share the losses – and the finance director of the company is worth his salt – you'll also have to share the spoils in the event that the exchange rate works out favourably for you.

Banks and currency specialists offer services that can also reduce the risk. Most of the high street banks offer bank accounts set to a specific foreign currency. In operation, they are the same as a normal bank account, with all of the same features, but everything is displayed in the designated currency. Customers with these accounts can generally hope to enjoy favourable exchange rates with the issuing bank when they convert foreign currencies to sterling and vice versa.

The banks also offer spot deals, whereby you can arrange to buy a set amount of foreign currency, either immediately or on a set date in the future for whatever the market rate is on that day. Similarly, forward contracts are available; these fix the rate for the future purchase at whatever the rate is on the day that you sign the deal. With these types of deal, you could be quids-in (or dollars-in) if you can accurately predict the way that the value of the currency in question will change. Of course, there's also a risk that you could lose money. Also, the banks don't give much away lightly; to profit to any real extent you'll need to know something they don't. This in itself could be quite a feat.

One guaranteed benefit of spot deals and forward contracts though is that you usually don't have to pay straight away. You arrange the deal and pay a small percentage of the total value of the order as a deposit. You then pay the balance when the time comes to buying the currency. This means that your money isn't tied up between the time that you sign a deal and the time that you have to pay, which can be months.

Why pay more?

It is possible to avoid the high street banks altogether, though, and it may be beneficial to do so. Foreign currency specialists like Smart Currency Exchange and Moneycorp offer the same services as the banks in this area but they say that by using them instead you can save significantly; in time, as well as money. The general design is that they offer more favourable exchange rates by vastly cutting their margins and seek to reduce the processing fees for international money transfers – typically £20-£30 per transaction at the bank – or eradicate them entirely. Some, including Smart, also closely monitor the market in order to select the right time to buy on its customers' behalf.

Carl Hasty, head of trading at Smart and a founding member of the company at its inception six years ago, explains: "Though they don't tend to operate on fixed margins, the banks add anything form one per cent to four per cent to the price they buy foreign currency for when they sell it on. We typically add on just a half a per cent or less and then rely on sheer volume of business to make money."

The banks often just set their rates once a day, first thing in the morning, Hasty says. This means they need the high margin level to ensure they won't incur losses if the rates drop heavily throughout the course of the day. Businesses like Smart which keep a close eye on the rates all day and adapt their own rates accordingly circumvent this pressure.

Another benefit of using a currency specialist instead of a high street bank is the time that it takes money to clear in the beneficiaries account. "A bank will guarantee the money will be cleared in four working days" says Hasty. "For US dollars, for instance, if we push the send button in the morning, it'll be cleared by the afternoon." In a world where time is money, this seems to represent pretty good value.

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Carl Hasty, Smart Currency Exchange

Rubber stamped savings

One company that has benefited from utilising Smart's services is Worcestershire-based hose and tubing manufacturer Goodflex Rubber. Last September, the company lined up an agreement to import €100,000 worth of rubber from Europe, working out its margins based on the then rate of €1.2 per pound. However, the company didn't need to pay until January.

"We didn't want to tie up £84,000 for four months by buying the full amount of euros there and then," says Mark Dufty, Goodflex Rubber's managing director. "Unfortunately, when we came to place the order, the exchange rate had dropped to €1.19 per pound."

All of a sudden the deal was looking less attractive. However, the company contacted Smart who advised that the market looked like it might recover again soon. Goodflex instructed Smart to buy its currency when the rate peaked again. Sure enough, the exchange rate promptly grew to €1.2160. Goodflex placed a forward contract order fixed at that rate and immediately saved itself almost £2,000. It proved a shrewd move – when January came around and with it the time to pay, sterling had weakened considerably against the Euro to €1.13 per pound. Had the company waited until then to order its currency it would have been over £6,000 out of pocket and its margins would have been obliterated.

As well as spot deals and forward contracts, currency specialists offer stop loss orders and limit orders. It is with these facilities where the organisations' eagle eyes on the market come into their own. With a stop loss order, a company can instruct the currency firm to buy a certain amount of stock if the market rate goes down to a level which the business deems is the lowest it can afford to pay. This protects the company from suffering if the market nosedives. Conversely, a limit order is for companies that do not necessarily need foreign currency at any set point in time but are happy to buy it if the rate goes up to a level at which the company thinks it can then profit from it.

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>
> *Mark Duffy, Goodflex Rubber*

Spoilt for choice

There are many foreign currency specialists on the market and all offer similar services which they will process in much the same way. This is because the industry is regulated by the Financial Services Authority, just as the banking industry is. Smart says its niche and its advantage over its competitors is that it is the only UK company which doesn't use a commission structure for its brokers. "Our unique selling point is that none of our guys receive individual commission and this in the best interests of the trader," says Hasty, "because the broker can't look at a deal today and see exactly how much they are going to make off that deal and see what will be in their pay packet at the end of the month. This means that although they want you to do the transaction with us they're not inclined to push you into making a deal there and then – it's better for all parties concerned if we watch the market for you and make sure we buy at a better rate." END

Smart Currency Exchange has put together a list of check points which it says you should consider when looking for a foreign currency specialist

Ask yourself the following:

- Do they charge some kind of set-up (upfront) fee? There are a few that do this, but the majority do not. The only thing you should pay for is:

1. The money (at the agreed rate)
2. The transfer fee imposed by your bank
3. The fee the overseas bank might charge to accept transfers
4. Some exchange specialists charge a fee for transfers under £10,000

- Does the company specialise in currency exchange only or are they a 'jack of all trades', trying to sell insurance and other products to dilute their offering?
- When calling the company, do you deal with anyone that picks up the phone or do you have a dedicated account manager and/or trader?
- Does the company offer helpful resources such as daily currency updates or educational reports?
- Do the currency traders make commission on selling you currency? If the trader makes commission on your currency purchase it's possible that it's in their best interests to make the most on the transaction and get you to trade even if the currency is at a poor rate.
- When asking the specialist about rates or the market do they come across as knowledgeable & talk in terms that anyone can understand rather than financial jargon?