WHITE PAPER

TREASURY MANAGEMENT

Understanding and overcoming volatile currency markets

smart CURRENCY BUSINESS

"The **proactive management** that we enjoy from Smart is refreshing when you are used to FX companies who are all about getting your business but who have no interest in dealing with you in the **professional, efficient and accessible** way that the Smart team do".

Running a business can be extremely difficult. First you have to find the customers, then win them over, then fund and grow the company, then effectively manage the process from beginning to end. So, given all of the hard work involved, imagine the frustration of seeing forecast profit margins - both gross and net - eroded by exchange rate volatility, especially if the currency risk is manageable. That frustration only deepens if it turns a profit into a loss.

Recent volatility in sterling markets has had a significant impact on the sales margins of many UK businesses. It is therefore quite surprising that many of them do not actively manage their currency risk.

Indeed, many corporates we speak with consider their foreign exchange (FX) risk at the end of the process as opposed to the beginning. Considering how important managing FX risk is to those doing international business, the exchange rate risk should be thought about from the start

MAKING INFORMED DECISIONS

When approaching treasury management, many companies struggle with a lack of understanding or access to the right kind of information. The current political and economic climate is more uncertain than it has been for some time, which has brought the potential ramifications of currency movements to the fore.

One only has to look at the disparities between what the major banks are forecasting over the next 12 months to appreciate that nobody really knows what is going to happen in the short term. Geopolitical uncertainty and the return of Donald Trump has caused great volatility for global currencies.

This white paper is designed to explain the importance of effective currency risk management and how it can mitigate the potential losses to your margins and, subsequently, your bottom line. Ultimately, such losses can impact on your cash flows and impede business growth.

MITIGATING CURRENCY RISK

What, then, is currency risk? In essence, the term refers to macroeconomic conditions, such as fiscal policy and economic data, along with political and economic uncertainty, that affect currency movements. If a business only ever made and received payments in a single currency, then those movements would not result in currency risk.

However, an increasing amount of UK businesses have foreign currency exposure, so the constant fluctuations between one currency and another have real impacts on the cost of business. Obviously, if the markets move in your favour, then this presents a potential profit opportunity but, on the other hand, if they don't, your business stands to be negatively affected.

For instance, the pound's weakening against the euro since the Brexit vote has made many exports from the UK cheaper because the pound is less valuable than it was. Equally, goods imported from Europe and the rest of the world are now more expensive. Any UK companies importing and exporting are therefore at the mercy of the gods.

"Our business is extremely varied. We have had many different challenges with the fluctuating nature of currency over the last few years. I think we have come out about even which is pretty amazing given we haven't put much effort into it. Now we have decided to take the risk out completely by using Smart."

Let's say that your business has agreed to pay €1,000,000 for the purchase of goods imported from Europe in the next six months. At the date of contract, the exchange rate is £1/€1.14, meaning you will have to pay almost £880,000 to purchase €1,000,000. Then, six months from now, you find that the euro has strengthened against the pound and the exchange rate is now £1/€1.08. Now you will have to pay just over £925,000 to fulfil the terms of the contract. That's an additional cost of £45,000 which must either be passed on to your clients, or has a direct impact on your profits.

Of course, if the euro weakens against sterling then you stand to pay less for the purchase of the goods, but therein lies the risk.

100+ employees **71,000** private clients **2,000** corporate clients

ACHIEVING SECURE CASHFLOW

Currency risk management should not be thought of as a means to improve your existing cash flow. FX should never be seen as a revenue stream. Instead, we recommend a strategic approach to achieving a definite cash flow. So, irrespective of which way the currency markets move, you can be assured that you have enough to meet the obligations of your business and, in turn, help grow your business.

Many of the people we speak to think of hedging tools as a convenience, whereas they should be thought of as a tactical approach to locking in future exchange rates. All too often the focus is on rates, which is why we try to work with our clients to strategically manage their FX exposure.

We have seen countless incidences when a market has moved in a client's favour only for them to say they believe the positive movement will continue. Equally, there are times when the currency markets move against a client but they believe that the trend will be bucked before long and they will recoup their potential losses.

We never tell our clients what to do. Instead, we work closely with them to better understand their unique situation. Only then are we able to offer guidance on the nuances of currency risk management, so they can make informed decisions in the context of their business's situation and how that relates to that of the markets.

BESPOKE TREASURY SOLUTIONS

Each and every business is unique, their situation is unique and their requirements are unique - strategies that work for one would not necessarily work for another. But there will always be a solution, something your business can do to mitigate its currency risk

Ultimately, doing nothing is a mistake. What you must do is entirely dependent on your business's situation. Having foreign currency exposure is not about gambling, it is about managing risk..

If you want to learn more about how Smart Currency Business can help your business remove uncertainty and mitigate the risks of foreign currency exposure, please email us at info@smartcurrencybusiness.com or give us a call on 020 7838 0500.

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Managing Director

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