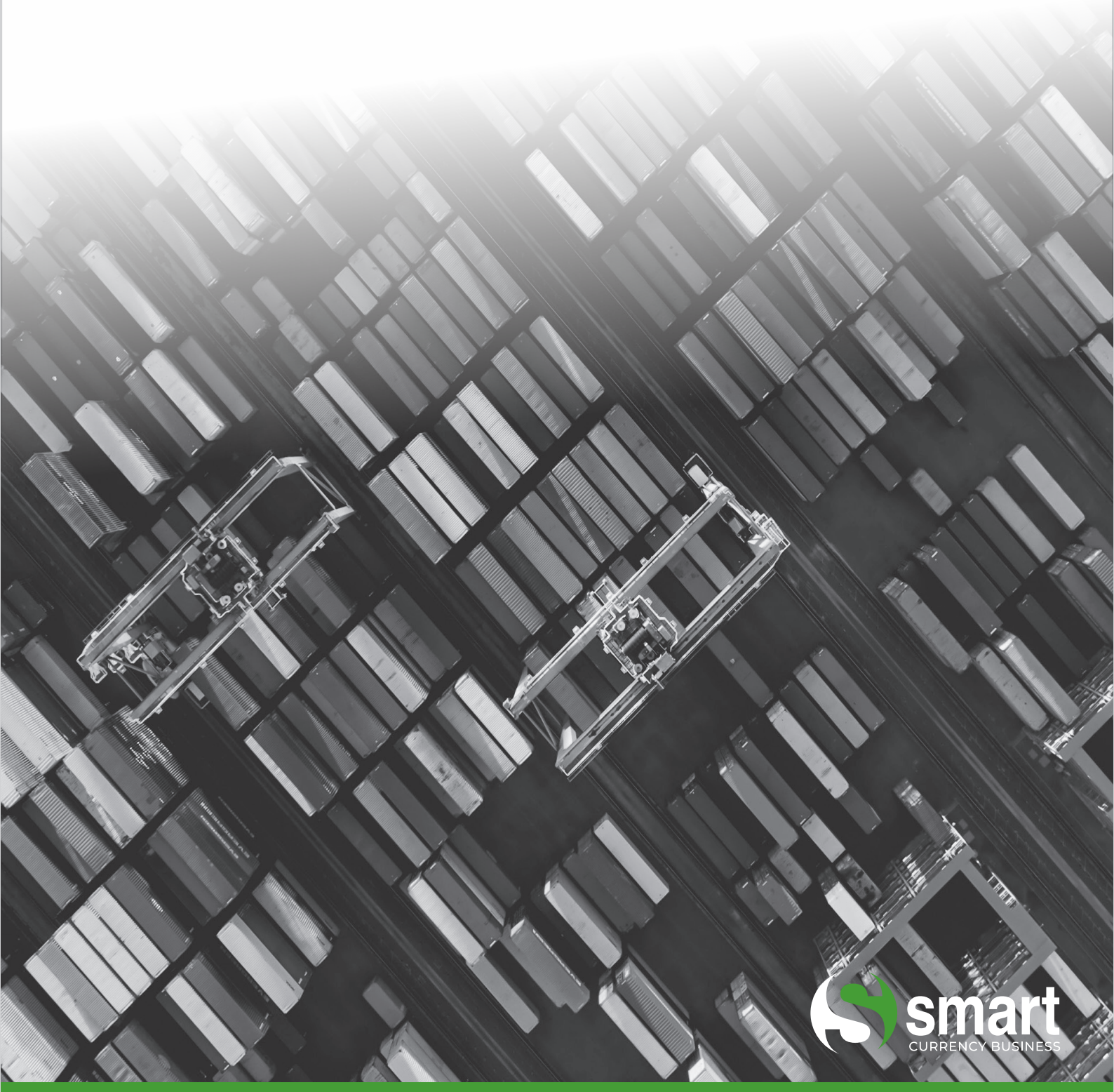
UNDERSTANDING CURRENCY RISK: A GUIDE FOR BUSINESSES



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CURRENCY MANAGEMENT FOR CEOS, CFOS AND TREASURY MANAGEMENT TEAMS

Unaddressed currency exposures puts millions of pounds of corporate profits at risk each year. With market volatility high, failing to implement a structured risk management strategy risks impacting corporate balance sheets and underlying profits.

WHAT IS CURRENCY RISK?

Currency risk in its simplest form refers to the potential losses a business faces when making or receiving an overseas payment. Due to rapid and unpredictable fluctuations in relative value, a company can . If the transactions are large enough, that variance can amount to millions on the balance sheet.

Global currency markets are inherently unpredictable. That's because the day-to-day value of currency pairings is influenced by so many competing factors. Some of these are rational and quantitative – economic reports, interest rates, government budgets – while others are altogether less predictable – snowballing market narratives, country-specifics shocks and even the threat of war.

For businesses with overseas exposures, failing to address this risk can be disastrous. Volatility doesn't just influence the price of goods or the value of receivables, it can also lead to a host of other issues, such as straining cashflow and making it much harder to plan ahead for the future.

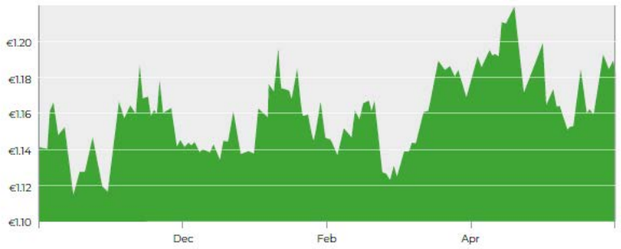
EXAMPLES OF VOLATILITY

Over the course of August 2024 alone, GBP/EUR ranged by almost 3%. In the same month, GBP/USD swung by 5 cents – the largest monthly variance in two years. All this in August, usually a relatively benign and quiet month. In 2022, Liz Truss's ill-fated 'mini' budget led to the pound falling by almost 5% against the US dollar and the euro. Thousands of British companies were left with massive bills as they picked up the pieces.

Perhaps the most famous example of risk in recent times was the Brexit referendum in 2016. In the weeks after the vote, GBP/EUR sank by almost ten cents, as market predictions of a remain victory turned out to be wrong.

Currency risk has been around as long as the global economy itself. Whether it's the 1970s or the 1500s, history is full of shocks, panics and market movements, all of which had a tangible impact on the currencies of the day.

GBP/EUR over a typical six month period:



CURRENCY RISK IS AN NATURAL FEATURE OF MARKETS AND REQUIRES CAREFUL, STRATGIC MANAGEMENT



When a company agrees a transaction with a foreign partner, it can take weeks or even months until that payment is due. With currencies moving significantly on a daily basis, the cost or revenue generated by that transaction can be vastly different from when the contract was signed.

Not being able to accurately quantify currency risk makes strategic planning challenging. Businesses looking to expand may be unlikely to pursue investment if their bottom line is at risk, while those operating with smaller margins can find themselves crippled by the risk of losses and a lack of certainty over future cashflows.

A - Contract signed in April, when £1 = €1.20, so a €2,000,000 purchase costs £1,665,000.
B - Payment due in August, but now £1 = €1.10, so the €2,000,000 purchase costs £1,820,000.
In just four months the price of a €2,000,000 purchase has leapt by nearly £155,000. This can affect cashflow and erode profit margins.

HOW ARE FINANCES AFFECTED?

As this example shows, he difference of just a few decimal points in the relative value of currencies can disrupt any corporate balance sheet. That's because changes to the cost of goods or services you buy or the price of those you sell has a knock-on effect on cashflow. Businesses are of course aware of currency risk, but often the biggest risk is not being able to quantify the extent of those exposures.

Currency pairings routinely move by more than 5% in just a few months. Companies unprepared for volatility often find this puts their profit margins at risk.

HOW WE CAN HELP

Smart Currency Business offers a range of financial products designed to mitigate currency risk. Each of these offers specific benefits and, when used correctly, can completely transform the way your business approaches its payments. Our consultative approach means we will work to implement the right solution for your needs.

Our products include:

Forward contracts: Forward contracts allow your business to “lock in” a rate at a specified future date. Forward contracts are an effective way of ensuring future payments are portected from risk.

Spot contracts: Take advantage of favourable exchange rate movements to secure the best possible price. Good for businesses looking for adhoc arrangements, but far riskier when it takes the place of a more comprehensive risk management strategy.

Market orders: Market orders allow you to target an optimal rate and only execute a transaction when the rate is achieved. This helps minimise risk and is good for businesses with the flexibility to search for the best outcome.

Foreign currency ptions: Option deals are perhaps the most complex currency contract. Options give businesses the right to execute trades, subject to market dynamics and various other considerations.



SMART CURRENCY BUSINESS HELPS OUR CORPORATE CLIENTS MANAGE CURRENCY RISK, ALLOWING THEM TO NAVIGATE VOLA-TILE MARKETS WITH CERTAINTY.



CONTACT US

Unlike banks and brokerages, Smart Currency Business offers comprehensive treasury management solutions, from risk identification all the way to trade execution. Our dedicated team of account managers will continue to monitor market movements and sector-specific trends to ensure that your business has a bespoke strategy to help overcome currency risk.

For more information, email info@smartcurrencybusiness.com or call 020 3918 7255. Visit smartcurrencybusiness.com to read more about our fleixble products and sector expertise, plus currency news, analysis and quarterly reports.



Alex Bennett,
Managing Director



Guy Phelan,
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Adequately insulating yourself from currency risk requires a comprehensive approach. Our expert team provide guidance that works for your business.