




SMART CURRENCY FINTECH

MANAGING CURRENCY RISK

A guide to hedging in the travel industry



 +44 (0)20 3918 7255

 info@smartcurrencyfintech.com

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INTRODUCTION

This guide will cover:

- 1 Unlocking financial stability:** Discover how to safeguard your travel business against currency movements, ensuring stable profits and competitive pricing.
- 2 Managing your risk:** Learn about bespoke hedging solutions designed specifically for the travel industry, from tour operators to luxury villa rentals, providing you with the tools to navigate currency volatility.
- 3 Step-by-step guidance:** Gain access to clear, actionable steps and expert insights that demystify the process of currency hedging, empowering you to make informed decisions that protect your business and allow it to grow.

The travel sector is highly exposed to currency movements. For any business — whether that’s an airline, hotel, tour operator, or a travel agency — currency fluctuations can significantly impact profitability and efficiency. The difference of just a few pence in exchange rates can translate to an impact of millions of pounds when multiplied across thousands of transactions.

It’s hard enough to plan for the future, let alone when Black Swan events materialise. In the period of crisis surrounding the 2022 mini-budget, for example, UK-based travel firms grappled with rocketing exposures as the value of sterling changed, with many losing millions as a result.

Margins and cashflow — the lifeblood of any healthy business — are therefore at risk of currency movements. What’s more, many travel businesses spend vast amount of money employing the staff and developing the infrastructure to monitor their books. Travel firms stare down currency volatility every day, often armed with ineffective tools and risk baked into their approach. It’s a highwire act that could come back to bite you.

“This brochure highlights key strategies to protect your business from exchange rate volatility. Gain insights to safeguard profits across tours, flights and accommodations and put your business on the pathway to financial stability.”

CURRENCY RISK IN THE TRAVEL INDUSTRY

So, what are the risks of failing to manage currency exposures? As the last few years have shown, currency markets have the power (and the unpredictability) to change things in an instant.

IMPACT ON THE TRAVEL INDUSTRY:

Costs and pricing

Volatile currency rates can make it challenging to set stable prices or to manage operational costs effectively. For example, an airline may face increased fuel costs if the currency in which fuel is purchased strengthens against its own, while a hotel chain might struggle with the costs of importing goods for an overseas location.

Profit margins

Currency fluctuations can erode profit margins. A travel agency that has quoted a package in a customer's local currency may find that the cost in supplier payments has risen due to adverse currency movements. This can then eat away at margins and make planning for the future more difficult.

Competitiveness

Exchange rates often influence travel patterns. Destinations become more or less attractive as the exchange rate moves, affecting demand for travel services. Businesses that can effectively manage currency risks can offer more stable and competitive pricing and therefore attract more customers.

Strategic planning

Currency volatility can reduce a company's ability to make informed decisions. Businesses may make different decisions about entering new markets or developing new services based on assumptions that may not always be true. There's also a question of staffing. A better hedging strategy will more than often than not reduce workload and the need for hundreds of support staff.



Understanding these risks is crucial for any travel firm. By identifying the specific currency risks that your business faces, you can begin to explore hedging strategies that will protect your margins from adverse currency movements, ensuring financial stability and competitive pricing.





WHAT IS CURRENCY HEDGING?

Hedging is a financial strategy used to mitigate risk, in this case from currency markets. By locking in exchange rates or using different strategies to protect against fluctuations, businesses can ensure more predictable costs and revenues and insulate themselves against market risk. Effective currency hedging is about more than just protecting profits. When done correctly, hedging allows businesses to maintain competitive pricing, ensure budget stability for planning and expansion and ultimately secure and safeguard their financial health. Think of hedging as like an insurance policy — it protects businesses from volatility, while ensuring you get something back if things awry.

With every booking or service offered across borders, travel businesses are exposed to currency risk. Whether it's paying for accommodation in a foreign currency, pricing airline tickets for international routes, or managing overseas operational costs, the need for a strategic approach to currency risk is critical. This guide will explain travel hedging in plain terms, offering practical insights into identifying currency risks, choosing the right way to hedge and implementing strategies that align with business objectives. By understanding and applying the principles of currency hedging, travel professionals can ensure their businesses thrive in a competitive and unpredictable market.

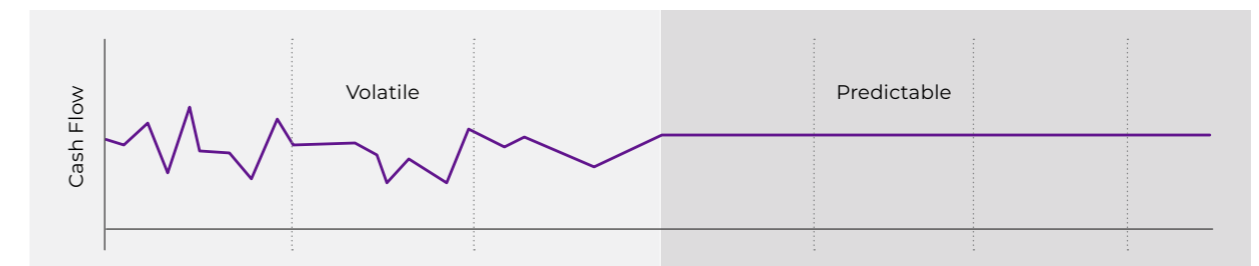
FX Hedging: Mitigate your risk from fluctuating currency

No strategy

- Difficult to price contracts properly
- Unpredictable profit margins
- Difficult to budget costs and revenues in CAD

FX hedging strategy

- Be confident in pricing your contracts
- Know your profit margins
- Accurately budget costs and revenues in CAD



TYPES OF HEDGING APPROACHES

Travel companies have a number of solutions available to hedge their exposures. Each one offers its own set of advantages, so it's worth taking the time to familiarise yourself with the available options.

Forward contracts

A forward contract is an agreement to buy or sell a currency at a set rate on a specified date. This is particularly useful for travel companies with future obligations, allowing them to lock in exchange rates and ensure cost certainty.

Currency options

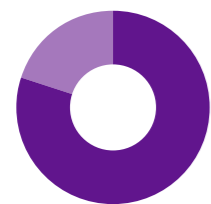
Options give the holder the right (but not the obligation) to exchange currency at a set rate before or on a specified date. Options provide greater flexibility than forwards, as they provide protection against adverse movements while allowing businesses to benefit from favourable shifts.

Currency swaps

In a swap, two parties exchange currencies for a specified period, agreeing to reverse the transaction at a later date. This can be useful for managing cash flows in different currencies, particularly for larger companies with operations across multiple countries.

Natural hedging

Also known as exposure netting, this strategy involves offsetting exposure in one currency with exposure in the same or correlated currencies. For example, a travel agency could match expenses in a foreign currency with revenues generated in that currency, thereby reducing the need for financial hedging.



Over 80% of travel industry businesses operate in more than one currency.

IMPLEMENTING CURRENCY HEDGING

Implementing an effective currency hedging strategy in the travel industry involves several steps. In order to be effective, businesses must:

- 1 Identify exposures**
Determine the extent of your currency risk by assessing foreign currency transactions, both receivables and payables, and their timings.
- 2 Select the right instrument**
Choose the hedging instrument that best matches your risk profile. Make sure to consider your specific circumstances and requirements.
- 3 Develop a policy**
Establish a formal hedging policy that defines when and how hedging activities will be conducted, including decision-making processes and risk management objectives.
- 4 Monitor and adjust**
It's important to regularly review exposures and hedging positions, adjusting strategies as market conditions and business needs change.



HEDGING IN ACTION: REAL WORLD EXAMPLES

Implementing currency hedging in the travel industry can be an unwieldy process. There's a danger that businesses think too much about hedging as a theoretical construct, rather than a proven plan to protect their margins and cashflow. With that in mind, below are a few practical examples illustrating how different segments within the industry can utilise hedging strategies to mitigate currency risk:

1. TOUR OPERATORS

Situation: A tour operator in the United Kingdom offers vacation packages to Europe for the upcoming summer season. The prices are advertised in UK pounds (GBP), but many of the expenses (hotel rooms, local transportation, guided tours) are payable in euros (EUR).

Solution: To protect against the risk of the euro appreciating against the pound, the operator can enter into forward contracts to purchase euros at a fixed rate. This guarantees the cost of European services at the time the packages are sold, ensuring that the advertised prices remain profitable regardless of currency fluctuations.

2. VILLA RENTAL COMPANY

Situation: A UK company rents luxury villas in Europe and the USA, charging in British pounds (GBP) but paying owners in euros (EUR) and US dollars (USD), exposing them to currency risk.

Solution: To manage this risk, the company uses forward contracts to lock in exchange rates for EUR and USD. This ensures predictable costs for future payments to villa owners in both regions, while allowing the company to maintain stable pricing across its rentals.

“By carefully selecting hedging instruments that match their specific exposure and financial goals, businesses can protect themselves against unpredictable currency fluctuations.”

3. HOTEL CHAINS

Situation: A hotel chain operates in multiple countries and deals with revenues and expenses in several currencies. The fluctuation in exchange rates could impact their profit margins when consolidating financial statements in their home currency.

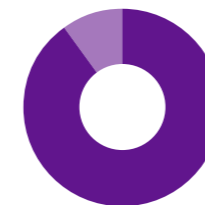
Solution: By practicing natural hedging, the hotel chain can align its revenue and expenses in the same currencies, thus reducing the need to convert currencies. For instance, it could prioritise marketing efforts in regions whose currency matches or closely correlates with the currencies of its expenses, balancing out the cash flows.

4. ONLINE TRAVEL AGENCIES (OTAS)

Situation: An OTA based in Canada earns commissions in Canadian dollars (CAD) but owes a significant portion of its operating expenses, including property rentals and marketing costs, in US dollars (USD).

Solution: The OTA can enter into a currency swap agreement with a financial institution, exchanging CAD for USD for a specified period. This swap ensures the OTA has USD available for its expenses while locking in the exchange rate, protecting against USD appreciation.

These examples highlight the importance of approaching currency markets strategically. By carefully selecting hedging instruments that match their specific exposure and financial goals, businesses can protect themselves against unpredictable currency fluctuations. Responding to changing market conditions and business needs by regularly reviewing and adapting these strategies is crucial for ongoing protection and financial stability.



Over 90% of travel businesses believe that effective currency hedging is critical to their financial stability

USING THIS CURRENCY HEDGING GUIDE

Implementing a currency hedging strategy in the travel industry requires a lot of thought. This extends to each stage of the process, from planning to execution and ongoing management. To succeed, businesses must understand their own currency exposures and select the right hedging instruments before monitoring their effectiveness. Here's how businesses in the travel industry can put this guide into practice:

STEP 1: ASSESS CURRENCY EXPOSURE

Conduct a currency risk audit: Start by identifying all the areas of your business that are exposed to currency risk. This might be revenues from foreign clients, payments to overseas suppliers, or operational costs in foreign currencies.

Quantify exposure: Estimate the potential impact of currency fluctuations on these areas. Consider using historical data to capture the full range of potential outcomes.

STEP 2: DEFINE HEDGING OBJECTIVES

Set clear goals: Determine what you want to achieve with your hedging strategy. Common objectives include stabilising cash flow, protecting profit margins, and securing competitive pricing.

Risk Tolerance: Assess your company's risk tolerance level. This will guide how aggressive or conservative your hedging strategy should be.

STEP 3: DEVELOP A HEDGING STRATEGY

Choose appropriate hedges: Select the most appropriate hedging solutions based on the above steps. Your choices might include forward contracts for predictable cash flows, currency options for more flexibility, or natural hedging strategies to minimise costs. Remember it's always best to talk through your options with a currency specialist like Smart Currency to ensure that your risk management approach will be fully effective.

Hedging policy: Formalise your approach in a hedging policy document. This should outline how and when to hedge, who is responsible for hedging decisions and how hedging activities will be monitored.

STEP 4: EXECUTION

Engage with financial partners: Work with banks, financial institutions, or specialised currency brokers to execute your hedging transactions. Ensure that you understand the terms, costs and potential implications of each hedging instrument.

Documentation: Keep detailed records of all hedging positions and the underlying exposure they are intended to guard against.

STEP 5: MONITORING AND ADJUSTMENT

Regular reviews: Currency markets are fluid, which means that your hedging requirements may change over time. Because of this, you should always regularly review your currency exposure and the performance of hedging instruments.

Adjustments: Be prepared to adjust your hedging strategy in response to new information, changes in the market, or shifts in your business operations.

STEP 6: REPORTING AND COMPLIANCE

Internal reporting: Ensure that there is clear communication and reporting within the organisation about the hedging strategy and its outcomes. This should include financial implications and any adjustments made to the strategy.

Regulatory compliance: Make sure you are informed of (and in compliance with) regulatory requirements in your jurisdiction, along with any other relevant foreign jurisdictions.

KEY CONSIDERATIONS

Along with these steps, we'd like to offer a couple of things to bear in mind for any travel business looking to deploy a hedging strategy:

Education and expertise: Currency hedging can be complex. Consider investing in training for your team or hiring experts with experience in currency risk management.

Technology and tools: Leverage the latest technology to monitor and manage your positions. Speak to the team at Smart Currency Fintech so see how our solutions could help your business.

Stakeholder engagement: Keep stakeholders informed about your hedging strategy and its impact on the business. This includes employees, investors and key partners.



SUMMARY

Currency markets can be an overwhelming, confusing place. We hope that this guide has provided a useful blueprint towards addressing your exposures and protecting your margins from volatility. For more information about how we can help you implement a personalised set of solutions, don't hesitate to get in touch with us.

Managing currency risk is all about being considered and proactive. If you stay ahead of the curve and take the appropriate steps to hedge against adverse fluctuations, addressing those few pennies that make up currency swings might in turn save your business millions.

HOW CAN SMART CURRENCY FINTECH HELP?

Smart Currency Fintech was founded to integrate the latest technological leaps into your business. With the travel industry changing at a frantic pace, it's never been more important to stay ahead of the competition and look to use solutions to protect yourself from risk. That's where we come in.

Smart Currency Fintech is a central pillar in our vision for the future. Our expansion into fintech looks to advance corporate digitalisation, offering a pathway for businesses to excel in a rapidly changing landscape. Smart Currency Fintech blends sharp industry insights with cutting-edge technology and a keen understanding of client needs.

We offer a comprehensive suite of products – **Smart Platform**, **Smart Tech**, **Smart Hedge**, and **Smart Pay**. This suite is more than a set of tools, it's a transformative ecosystem designed to save you money, eliminate risk and improve your workflows.

Currency risk has never been so pronounced. For travel firms, this means your margins and cashflow are under threat. Smart Currency Fintech offer a smarter way to operate.

Is your business at risk of currency movements? Speak to a member of the team today to see how Smart Currency Fintech could help you.



TALK TO OUR TEAM

To speak to a member of our team, call **+44 (0) 20 7898 5000**

You can also email us at **info@smartcurrencyfintech.com**

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