# Always strive for innovation.

# And unlock cash flow in your supply chain.

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# Not just a cost of doing business

International business provides both opportunities and challenges for an organization. Importing and exporting allow a business to enhance its revenue stream and this can present several challenges including supply chains, expenses and resources.

Most businesses will concentrate on production effectiveness to ensure they profitably deliver on commitments. They will focus on activities such as production scheduling, product pricing, management of overtime, and ensuring prompt payment from clients.

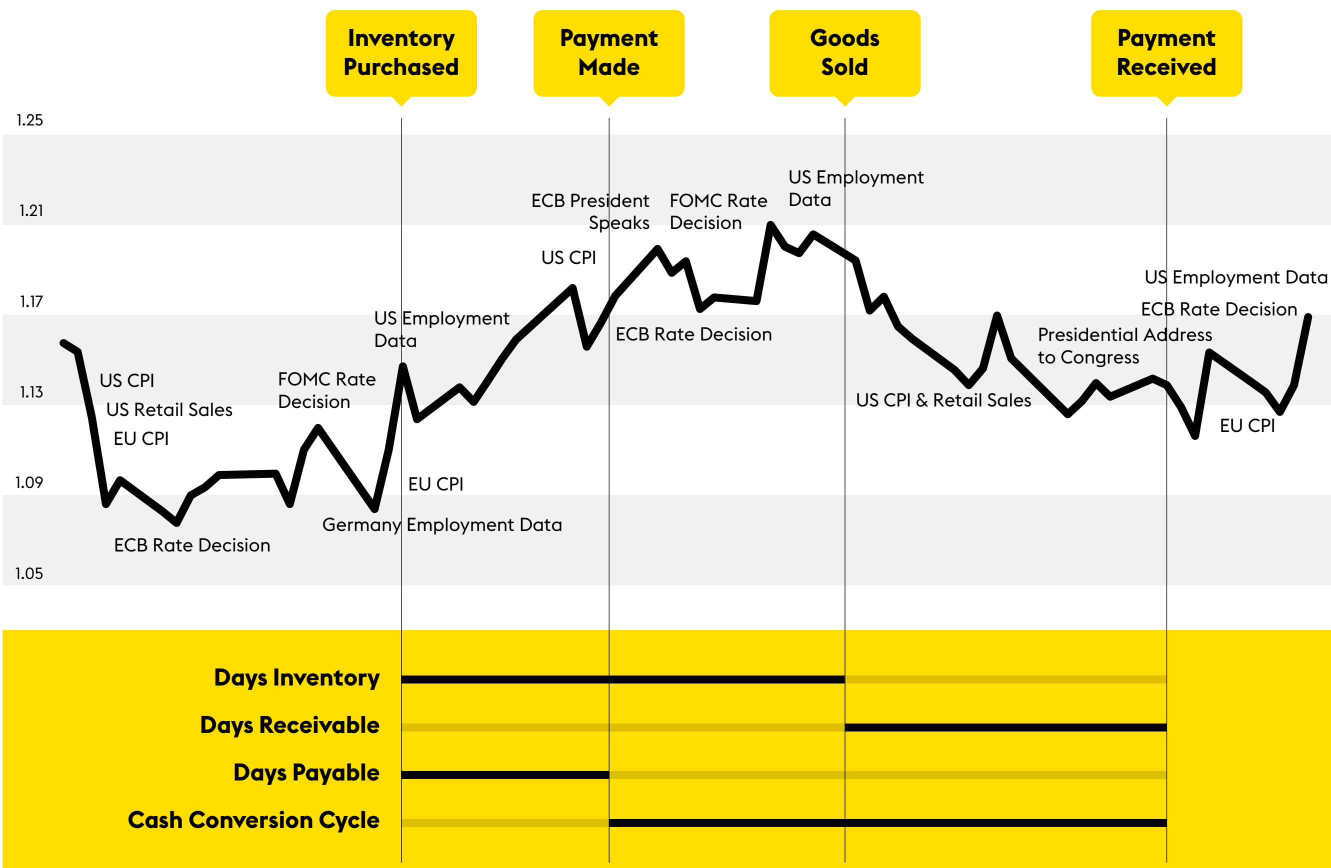
Many companies overlook the impact of currency fluctuation on profitability and cash flow, or simply accept it as a cost of doing business.

During a typical 90-day fulfillment cycle numerous economic, social and political factors can influence currency markets. You may find that despite effective delivery on your order and prompt payment from clients, your profits are eroded by market movements.

Examining the payment elements of your international supply chain can help you find ways to protect profits and take advantage of pricing opportunities. Let’s examine how balancing cash inflows and outflows can help you create a strategy to help lower your inventory costs and unlock your cash flow.

# Are there foreign exchange variables in your business cycle?

Based on some potential market events, the chart scenario below outlines the fluctuation in the US dollar against the Euro over a typical 90-day fulfilment cycle. The key question to ask yourself is whether there are FX variables in your business cycle?




Understanding how these variables impact your business can go a long way towards helping you plan ahead and improve your cash flow.

# 3 factors to unlock your cash flow

Imagine if you knew what all your future payables were, and you had confidence that your receivables would come in on time. How much freedom would that knowledge afford your business?

There are many elements that can help you maximize your working capital efficiency however, three key areas include:

- Understanding the **timing of payables and receivables** to help maximize all available discounts or opportunities.
- **Minimizing the amount of cash tied up in idle inventory.**
- **Maximizing payables and receivables** to help you manage your profitability.

# Timing of payables and receivables

Many businesses extend their ‘days payable outstanding’ (DPO) to help maximize their free cash position. This strategy also often reflects that there are times when paying sooner is beneficial. For example, you may be offered a discount for early payment, or, there may be an opportunity to leverage a favorable foreign exchange rate.

Cash flow forecasting is still more art than science. A sound business decision to ‘pay today’ may no longer make sense if an anticipated receivable fails to materialize when expected and you’re forced to cover overhead.

One of the keys to a successful payables strategy is visibility of all your outstanding cashflows, so you can respond to opportunities when presented. A current view of cash on hand, and all payables and receivables due, helps you understand potential costs and which opportunities you might be able to take advantage of.

A shift in foreign exchange rates is one opportunity that you may be able to take advantage of, by enabling you to acquire inventory at a discounted price. If a situation such as this arises you may want to consider the following:

- Do I have the cash on hand to take advantage of this lower price?
- If I use pending receivables to cover the cost of additional inventory will I have sufficient funds when needed?
- What percentage of those pending receivables are typically paid early for discount, on-time, late?
- If I had to borrow to cover the cost of the cheaper inventory at what point do the lending costs nullify the foreign exchange cost advantage?
- Can I lock in the current exchange rate to use for future inventory purchases?
- Can I simulate scenarios that help me make informed decisions about what strategy to take?

# Reduce the amount of cash tied up in inventory

Inventory optimization is typically viewed as a function of right-sizing inventory level and supply-chain responsiveness. This includes balancing inventory on-hand with near-term demand to keep as little cash tied up in idle inventory as possible.

Instead of describing right-sizing in terms of inventory units alone, it is critical to consider the cost of acquiring the inventory and the corresponding payment terms. If you can acquire the same amount of inventory for less money, and hold the funds for longer, then you may be able to reduce the cash trapped in inventory and improve your free cash position.

The variables are similar when using either domestic or international suppliers; quality of the product, cost of the product and time to deliver.

When engaging with international suppliers, the cost variable may be impacted by currency fluctuation, and the time-to-deliver variable may impact cash-flow at a specific point in time.

To illustrate this point, let's assume you are forecasting sales and will need 100,000 units of inventory 90 days from now. You have two suppliers, with different unit costs and payment terms to choose from:

## You need to source a supplier for 100,000 units in 90 days

| Domestic supplier | | German supplier |
|---|---|---|
| $15.50 USD/unit | **Base unit cost** | €14.00 EUR/unit<br>1.0700 exchange rate |
| $15.50 USD/unit | **USD unit cost** | $14.98 USD/unit |
| **$1,550,000 USD** | **100K units cost** | **$1,498,000 USD** |
| $52,000 USD<br>additional cost | **Cost difference** | **$52,000 USD**<br>savings |
| 60 days | **Payment terms** | **90 days**<br>Hold funds for an extra 30 days |

This is for illustrative purposes only. Your results may vary.

In this example, the German supplier is the lower cost option and the payment terms would enable you to hold your cash for a longer period.

To help protect the cost savings offered by the German supplier, you may want to consider hedging the invoice amount so that you know the true cost of your inventory prior to payment.

### Preferred option: **German supplier**

| | |
|---|---|
| **Base unit cost** | €14.00 EUR/unit |
| | 1.0700 exchange rate |
| **USD unit cost** | $14.98 USD/unit |
| **100K units cost** | **$1,498,000 USD** |
| **Cost difference** | **$52,000 USD** savings |
| **Payment terms** | **90 days** Hold funds for an extra 30 days |

This is for illustrative purposes only. Your results may vary.

It is possible that market movements could favor you and further lower your inventory cost. Alternatively, negative market movements may erode your profitability.

You will need to consider your risk tolerance level when determining the size of your exposure. There are multiple strategies that you can deploy from a simple bid order to a comprehensive strategy.

# Lowering inventory costs with foreign suppliers

| Depending what currency you're invoiced in, consider the following: | How do you minimize the capital tied up in inventory? |
|---|---|
| What is your budget rate for that currency? | Source from the lowest cost supplier. |
| Is there an advantage to paying in the local currency? | Commit to advance purchases from the supplier. |
| Are you able to buy that currency? | Maximize discounts that make sense – pay in local currency, pay early. |
| Are you able to hedge that currency? | Commit to buying when less of your currency is needed to buy product or when favorable opportunities arise. |
| What delivery methods are available? | Take advantage of favorable currency rates to lock in payment of future inventory needs. |
| Will you have issues with speed, security and cost to deliver funds? | |

# Managing payables and receivables

Companies that sell their products in international markets can also optimize their working capital. Once agreements are signed with clients you will know what revenue to expect from fulfilling the contract. If you haven't paid for the inputs to your finished product prior to making a sale, your profits may be exposed to currency risk.

Time delays between when you need to pay your supplier versus when you receive funds for the product sold, are intensified by currency fluctuations and can erode your margins.

As part of your pricing strategy you may want to consider employing a suitable hedging policy to help protect profits against unfavorable market movements.

# Developing a hedge policy

To manage your payables and receivables, consider the following:

**Should I sell my currency on the spot market?**

Converting currency and initiating transactions at the time your invoices are due may provide the opportunity to participate in favorable market shifts. It also may expose your organization to negative currency fluctuations which can adversely impact your profitability, and make it difficult to understand the true cost of an invoice until it is settled.

**Do I lock in expected revenue now?**

Even though your foreign receivables are expected at some point in the future, you can lock in the rate today and can help you gain full certainty on your revenue. In addition, knowing your true costs in advance helps you understand your ability to take advantage of early payment incentives or purchase more inventory if currency movements make it advantageous to do so. It's important to note that locking in the rate today, may prevent you from participating in favorable market movements at a later date.

**Should I consider a partial hedge?**

A common approach is to hedge a portion of the receivable and transact the remaining portion when the funds arrive. This may provide some protection but still gives the opportunity for participation in favorable market moves. It's important to consider that you may be obligated to exchange a portion of the underlying funds.

# Manage your revenue

Your final sale price reflects cost of goods sold, while profit margin depends on costs of variable inputs.

To help manage your revenue, consider these important questions as part of your strategy:

- **Have you paid for the inputs yet?**
- **Have you hedged your unpaid foreign currency inputs? Or are your accounts payable exposed to market fluctuations?**
- **If you have hedged the receivable, do you have sufficient flexibility if your client elects to pay early or late?**

**Gain the security of knowing wherever the market moves, you can take strategic steps to protect profits.**

# What if currencies move in my favor?

It’s not uncommon for companies to accept currency fluctuation as a cost of doing international business. But this does not have to be the case. Currency risk management can help to minimize the effects of market volatility on cash flow.

A reality of responsible risk management is that ensuring certainly around your cost today can occasionally limit your ability to take advantage of favorable markets at a later date. Means the security of knowing that no matter where the market goes, your projected profits are protected from currency fluctuation, you’re not gambling with your bottom line, and your cash flows are more predictable.

Working with a foreign exchange specialist allows you to assess your business objectives and identify the right combination of hedging tools to help meet your goals. This includes tools that can offer protection from negative market shifts while potentially allowing you to participate in favorable currency movements.

# Hedging tools and how they work

| | |
|---|---|
| **Internal Hedging** | One approach is to net incoming against outgoing cash flows to help reduce the amount of currency exposed to fluctuation. However, this isn't always practical due to timing issues which can replace currency risk for alternative forms of uncertainty. |
| **Vanilla Options** | Lock in an exchange rate to insure your business against negative shifts in currency movements, while maintaining the flexibility to benefit from any positive market shifts. Vanilla Options require you to pay an upfront premium. |
| **Forward Contract** | A basic hedging tool that lets you lock in the current exchange rate for a set period of time (up to 12 months). This provides exchange rate certainty and insures your profits against adverse fluctuations. Forwards can be booked up to a year in advance, and can be combined and structured to establish the level of price protection your business needs. Regardless of where the spot market is at maturity, you have to pay the set price. |
| **Structured Options** | Book an exchange rate to protect your bottom line while maintaining the ability to participate in favorable market moves up to a certain point. No upfront premium required. Depending on the type of structured option, there may be some disadvantages to consider. For example, participation in favorable market movements may be limited to your participation rate. |

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# Make capital work for your supply chain

Incorporating cash and risk management strategies into your efforts to help drive production effectiveness can offer significant opportunities to expand your bottom line. Whether your client pays on time is not the only factor to consider within the standard 90-day fulfillment cycle.

Even if you can ensure that goods are delivered on time, and you receive payment promptly, fluctuating currencies can still eat into your project revenue, including your profits. Considering foreign exchange and its role in the timing of payables and receivables, appropriately managing your inventory and receivables to account for currency fluctuation can help you position your business for growth.

Currency risk management should be considered an integral part of any international supply chain strategy, as it helps position your organization for end-to-end success in the global marketplace.

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# Learn how to manage cash flow, risk and get an edge in business

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