4 steps to protecting profits

Guard your business against currency risk.

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Guard your business against currency risk

With the world getting smaller every day and as technology makes it easier to forge relationships in far flung places, you've decided to venture into foreign markets. There is a whole world of partners, products and new markets out there that could take your business to the next level.

But international opportunity comes with its own set of challenges, especially currency market volatility.

Cash flow is the biggest reason why small businesses go under, and this risk increases in an environment where currency fluctuation can shrink profit margins and detract from your bottom line.

Currency risk management helps to minimize the effects of foreign exchange on cash flow by developing a strategy based on the unique needs of an individual business. If you can work across borders while avoiding currency related losses, you're positioned to expand your reach and grow your business.

4 steps to protecting profits

How to prepare a simple currency risk management strategy for your business.

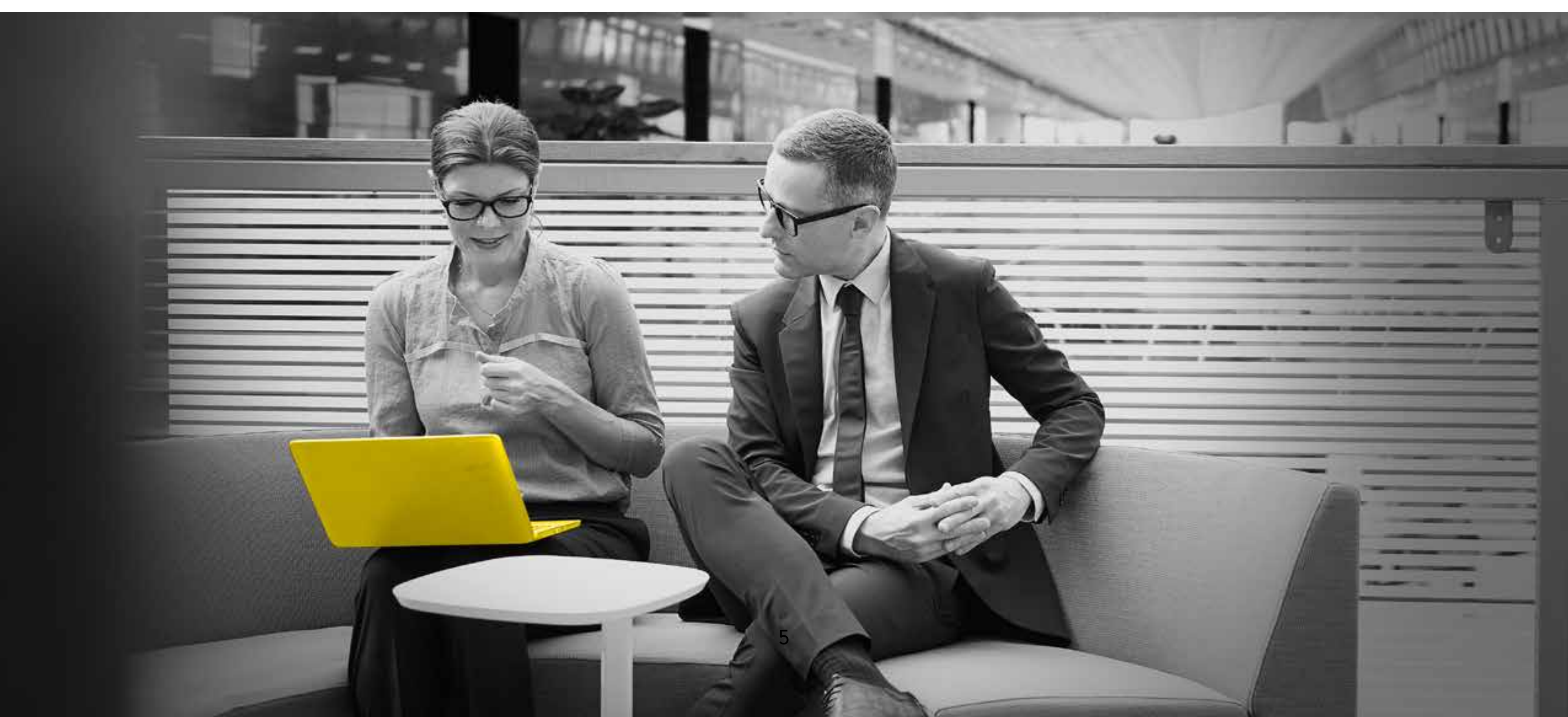
- Understand your exposures
- Create a strategy
- Choose the right tactic, and execute
- Evaluate and adapt your strategy

1 Understand your exposures

No business can manage currency risk without understanding where currency exposures exist, and what it currently does to protect itself from volatility (if anything).

- Start by assessing your business goals, and how they are impacted by exposures. Speak to a range of people in your business to get different perspectives on what is and isn't working.

- At this stage it can be beneficial to use a monitoring and analysis tool that evaluates your upcoming invoices against real-time exchange rates, to highlight where profits are exposed. Such a tool will also show the cost of these invoices in your local currency.



2 Create a strategy

With an understanding of your business objectives and a handle on the local currency cost of your foreign invoices, you have the power to start making informed decisions.

Define some goals specific to managing currency risk. This could include defining a target exchange rate to help achieve your set margins, or determine what percentage of a payment to protect from currency fluctuation.

Consider establishing a formal risk management policy to define processes and ensure personnel are accountable. This might sound time-consuming, but a strong, short document can be created easily – particularly with the assistance of a foreign exchange specialist.

Select the right hedging tools for your business. One size does not fit all, and the strongest strategies are driven by specific business requirements associated with shifting currency exposures. Many businesses use a combination of tools to form their strategy.

What hedging tools are available?

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.

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.

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.

Structured Options

Book an exchange rate to protect your bottom line while maintaining the ability to participate in favourable market moves up to a certain point. No upfront premium required.

3 Choose the right tactic, and execute

Once the most effective hedging instruments have been selected, applying the right trading tactics can mean the difference between success and failure.

Few businesses are prepared to completely ignore the opportunities that can be captured when currencies move in their favour, and often put themselves at risk as a result. The strongest strategies recognize a framework for executing trades at favourable levels while protecting against material risks.

It's also important to review the market and identify recent trading patterns to understand the risks and opportunities available.

For many small businesses, following the markets is complicated and time consuming. Speaking to a specialist can help determine market direction and where this consensus is vulnerable to adjustment. Market adjustments lead to currency volatility, which creates both risk and opportunity.

4 Evaluate and adapt your strategy

Currency fluctuation operates independently of business fundamentals such as profit projection. To keep plans on track you must monitor your strategy, and adapt to new circumstances and market conditions. Identifying shortfalls and building on successes is vital.

You might want to formalize this refinement process by aligning reviews with financial reporting periods.

Producing a brief "performance profile" document at these junctures can help communicate important information to internal and external stakeholders, and ensure the strategy remains relevant and effective as the business evolves over time.

> **"A goal without a plan is just a wish."**
>
> Antoine de Saint-Exupéry

Manage risk, don’t create it

The foreign exchange market and its management aren’t easily summed up in a few hundred words. These four steps are the nuts and bolts that can help you build a successful risk management strategy. The take away is that currency fluctuation does not have to be a cross to bear.

Many small companies are prepared to accept currency fluctuation as a cost of doing international business, or that only large companies have the strength to engage in currency risk management.

The reality is that with some pro-active planning, and specialist advice, a business of any size can ride the ebbs and flows of volatility into international growth.

Gain further insight on protecting your profits from currency risk.

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