

# Combating Currency Risk and Accessing the Best Exchange Rates

In today's volatile markets managing currency risk is even more important than ever. Dramatic currency movements of the sort we have seen in the last few months can erode or even wipe out profits unless action is taken to mitigate this ever present financial hazard. This article will outline strategies that help to eliminate these risks while minimizing the amount of time and resource you expend in keeping on top of your currency exposures.

## Currency Risk

Whenever a business enters into an agreement to trade in goods or services priced in a foreign currency, an exposure is immediately created. For example, manufacturing business IPG buys raw materials from the US every six months. The company contracts to sell finished product to a wholesaler at a set sterling price several months in advance, so it's important that production costs are known at the outset. A sharp fall in the Sterling/Dollar exchange rate would mean the cost of materials soar, wiping out profit margins. For finance director Neil Jones the solution is to "fix" the exchange rate as soon as the wholesale agreement is struck. That way he knows what the raw materials will be costing in sterling as well as knowing the price he will receive for the goods. The easiest way to do this is to book a "forward contract" with a currency broker. That simply allows you to buy currency up to two years before you actually need it. A ten percent deposit is payable, with the balance only due once you take delivery of the currency. Most importantly, the exchange rate is fixed and guaranteed whatever the market does over the life of the contract.

## Market Strategy

Neil speaks to his currency broker regularly to get a feel for what currency rates may do over the next few months. The main priority is to cover any risk on outstanding contracts, but with rates constantly fluctuating Neil also relies on his broker to monitor the market and spot potential opportunities. At the outset of each contract Neil and the broker discuss the short term market outlook and decide whether to buy now, or set a "target rate" for the currency purchase. Then it's up to the broker to keep watch and buy if the price reaches the specified

level. Depending on the outlook, they may also set a "stop order" at a lower market level that will automatically trigger a buy order if the exchange rate drops. These tools allow IPG to maximize opportunity and control risk on every currency transaction. For example, when the Sterling/Dollar rate began to deteriorate in August 2008, a stop order was triggered at a rate of 1.90 allowing IPG to buy \$100,000 at 1.90 for delivery in March 2009 (a forward contract). As that date draws closer, and the current exchange rate is now 1.38, Neil has effectively saved £20,000 on that transaction alone.

## Better Rates

Aside from the risk of unwelcome currency fluctuations, most small and medium size businesses are already losing money on currency transactions by making them through their bank. Typically the banks do not provide a pro-active currency dealing service, and exchange rates are often in excess of 3% worse than you can get with an independent currency broker. For example, if the Sterling/Euro rate is around 1.0600 (this is the "interbank rate" viewable on Ceefax or the internet), the banks may quote anything from 1.0100 to 1.0300 for a currency transfer. A currency broker should be able to offer a rate above 1.0500 for the same transaction, and will usually make your international payment free of charge. Savings of over two or three percent are common, and for many SME's this difference can represent bottom line efficiencies of many thousands of pounds per year.

Every company has different currency exposures to consider, and varying resources available to manage the risks. Using an independent broker is an effective way to "outsource" the time consuming aspects of currency management, nurturing a pro-active and risk oriented approach that saves both management time and money. Establishing a trading facility with a currency broker is quick and easy, and can usually be completed online in a few minutes. ■

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