Managing currency risk

A guide for SMEs

Bank of Ireland

Introduction

There is no doubt that currency volatility has had a significant impact on businesses across the country in recent times. Brexit has impacted the currency markets since the UK's June 2016 referendum. This, coupled with the tentative emergence of the global economy from the ongoing pandemic, has led to heightened uncertainty for many Irish businesses.

At Bank of Ireland Markets and Treasury, we recognise that amplified currency volatility is a significant risk consideration for those engaged in international trade and overseas investment.

We are committed to supporting you, our customers, during these challenging times. Our dedicated, experienced and highly skilled relationship teams are always on hand to assist you in managing your currency risk exposures and to help you make your international transactions as efficiently as possible.

We have put together this currency risk guide as a management aid for our customers and we hope you find it useful.

Conor Haugh,
Head of Retail Customer Business,
Markets & Treasury

Managing currency risk – a step by step guide

In this guide we have outlined a number of key areas which your business may wish to consider when managing currency risk. To begin with, there are a number of factors which may have a direct result on your currency risk exposure.

Key questions to consider are:

1. Has your supply chain been disrupted?
2. Can you still receive or deliver your product/service?
3. Is customer demand reduced?
4. Will lost sales/services be made up over time?
5. Are your forecasts related to sales, costs and operating expenses still accurate?
6. Have payment terms changed impacting the timing of when you make and receive payments?
7. How does this impact your longer term strategic and operational plans?

This guide will cover the following topics:

1. Examining your currency risk exposure
2. What level of risk can you tolerate?
3. Dual Invoicing
4. Forward Contracts
5. Foreign Currency Accounts
6. Ways Bank of Ireland can help your business

We hope this guide is a useful tool for your business, and should you require more information our team of dedicated dealers are on hand to provide support.

Our team can be contacted on 01 6094300 from 8am-6pm Monday to Friday.

01 What's your exposure?

The first step towards managing currency risk is to understand and quantify the exposure your business is open to. You need to review your costs and revenues to understand how exposed profit margins are to any changes in foreign currency rates.

For example, your business routinely imports raw material from the UK, and you are invoiced in Sterling. If the Euro weakens against Sterling – each Euro buys you less Sterling – and you will end up paying more in Euro terms for that raw material.

This might seem like bad news, but you need to consider your full supply chain to understand the full picture. Let's imagine you used those raw materials to create finished goods that you then export to the UK market, for which you receive Sterling in return. By doing that, you have a natural offset or "hedge" against deterioration in the Euro v Sterling exchange rate, as your UK costs can be matched against your Sterling receipts.

However, if you received payment for your UK sales in Euro, and paid for raw materials in Sterling, you run the risk that a change in exchange rates could substantially reduce, or indeed, wipe out your profit from sales.

Let's take the following example:

Example

1. You are a manufacturer selling goods to the UK. The currency exchange rate is: €1 =£0.90 (one Euro will purchase 90 pence Sterling).
2. You purchase £10,000 worth of raw material from the UK at this exchange rate, and thus will have to pay €11,111.11 for the materials.
3. You sell the finished goods in the UK for €20,000, receiving payment in Euro.
4. Your profit in Euro is €8,888.89. In Sterling your profit is €8,888.89 * (0.90) = £8,000.

If the Euro falls in value against Sterling by 15%, which means that a Euro is now worth only £0.7650, what is the impact on your business profitability?

1. Your costs increase to €13,071.90 in Euro terms (i.e. £10,000/£0.7650) from €11,111.11, an increase of €1,960.79.
2. Your Euro profit falls from €8,888.89 to €6,928.10 a reduction of around 22%.

02 What level of risk can you tolerate?

You are under no legal or regulatory requirement to protect your business against currency risk. However, every business will have a different risk appetite, so it is wise to set up a robust risk management policy that means you can manage currency risk within the levels you can comfortably tolerate. Once your business has decided on how it is going to manage the risk, the policy should be:

- Formally documented
- Clear and understood by all relevant employees
- Not to be deviated from without a formal process
- Reviewed regularly

Below is a useful reference for how you might create a treasury policy for your business:

Identify, understand & document risks

- What level of currency risk can your business safely tolerate?
- Should you 'fix' or 'float'?
- Is exchange rate risk priced into your products/services?

Define roles and responsibilities

- Who needs to be involved?
- What needs to be done?
- Who needs to know about the policy?

Agree the strategy

Document the policy and agree with stakeholders, so it becomes the policy of the company, not one person.

Execute, monitor, review

This is when the work really begins!

Your risk management strategy and policy should be reviewed and discussed with the relevant decision makers in your company:

- Document what's agreed including roles and responsibilities
- Execute, monitor and review frequently.

03 Consider Dual Invoicing

Dual Invoicing is one of a number of ways you can manage currency risk.

Simply put, this is getting two prices for anything purchased from abroad – one in Euro and one in the supplier's local currency - and paying the cheaper. By getting two prices you can clearly see the effect of exchange rate differences.

There may be times when it would be favourable for a business to pay in Euro (usually for once-off small amounts), but in summary, the benefits of Dual Invoicing are:

- Potential to reduce currency conversion costs, offering potential savings
- You have more information to choose the best payment option
- By knowing the true value of your payment, it can strengthen your buying power when dealing with suppliers.

04 Look at Forward Contracts

A Forward Contract is an agreement with a bank to exchange a specified amount of foreign currency at a specified date in the future, with the exchange rate fixed at the time the contract is entered into. It is, in effect, “today’s rate, in the future”.

- You know your cashflow in Euro terms, making budgeting and forecasting easier
- Foreign exchange risk is eliminated
- There is an opportunity to avail of attractive foreign exchange rates prevailing in the market for delivery at a future date

NOTE: As the name suggests this is a contract and therefore it isn’t possible to change the agreed rate and time period once it is established. Therefore, it is important to talk to your bank’s treasury specialist to understand fully the benefits and risks associated with a Forward Contract. A credit line is also required to transact Forward Contract.

05 Trade smartly with Foreign Currency Accounts

If you have receipts and payments in the same (non-Euro) currency, then Foreign Currency Accounts may be an option. Bank of Ireland has a range of deposit and current accounts in all major currencies.
The benefits of currency accounts include:

- The ability to “net off” foreign currency payments in and payments out – i.e. pay your suppliers from the money that you have received for sales in that currency
- They can help minimise and manage exchange risk and maximise cash flows efficiently

NOTE: If used incorrectly, you may still be exposed to foreign currency “translation” risk. This can happen when, at the end of the year, the foreign currency in your account may be worth a lot less in Euro terms than it was worth during the year, depending on exchange rate movements. Therefore, you should talk to your bank’s treasury specialists to understand fully the benefits and risks associated with currency accounts and the various ways in which this may be managed sensibly.

06 Supports from Bank of Ireland

At Bank of Ireland, we support companies from every sector and scale, from small business to multinational. The Markets & Treasury team have a wealth of expertise across areas such as market rates, funding, treasury & economic trends. In today's market, it's important that companies consider how global events may impact their business, and have a plan in place to protect their finances.

Our treasury team can explain the benefits of having a risk management policy in place for your business, and how our FX solutions might work for you.

Find out how our team could help find ways to save you time, money, and manage currency risk.

Our Markets & Treasury team are on hand for any queries from 8am-6pm Monday to Friday- call **01 609 4300**

You can also visit bankofireland.com/tradingabroad, where you can find information on:

- Market rates & news
- Trading abroad
- Our FX product range, including educational videos on FX Foundations and FX Solutions
- FXPay customer testimonials

Ways to make International payments online

Bank of Ireland offers a number of ways for your business to make easy, secure international currency transfers online, giving you peace of mind. Whether your business makes regular international payments throughout the year, or you're just beginning to deal with new suppliers and customers abroad, find the channel that is right for you.

365 Online

Benefits of using 365 Online for currency payments:

- No payment fees on transfers to the UK, EU member states and EEA countries. For example, customers can send Sterling to the UK or Zloty to Poland with no payment fees[1]
- Suitable for currency transfers up to €20,000 (payee transaction limits may vary)[2]

Business On Line

Benefits of using Business On Line for currency payments:

- No limit on transaction amounts for currency transfers
- Urgent same day international payments available[3]

FXPay

Benefits of using FXPay for currency payments:

- Allows customers to book FX deals, make payments, track rates
- No payment fee for standard payments until January 2021[4]

Bank of Ireland is here to support your business and foreign currency needs.

For more information on our range of currency supports, please contact our Markets & Treasury dealing team who are available from 8am–6pm Monday–Friday on

01 6094300

1. Terms and Conditions apply to 365 Online.

2. A security code is required to complete the addition of a new payee to your online profile. There are two options available to deliver the security code – by post or mobile phone. You must be registered to receive security codes by mobile phone. The transaction limits differ depending on the delivery method chosen. There is a total daily transaction limit of €/£20,000 including international fees and charges. This amount is included in the €/£20,000 daily transaction limit for 365 online. Payee security codes sent to your mobile phone are subject to a working day limit of €/£10,000.

3. Business On Line Monthly fee is €10. Same Day Urgent Payment fee is €37.50. Terms and Conditions apply.

4. FXPay Special Terms and Conditions apply.