Mitigating Currency Risk

July 2012, by Yolander Prinzel

You don't need to move overseas or speak four languages in order to manage an international business. With suppliers around the globe becoming easier to access and the Internet providing a worldwide stage for your own products and services, many small businesses have the opportunity to do business internationally. While this is exciting, it does introduce a risk you must protect your business against, and that is currency risk.

Similar to the price of precious metals, the value of a country's currency can rise or fall based on the overall health of its economy, political stability, rate of inflation and other events. The stronger and more stable a country and its economy, the more valuable its currency, (to get a sense of the movement possibilities, visit websites like Yahoo! Finance or xe.com). As you know, currency rates are constantly fluctuating, which can make conducting predictable business using foreign currencies challenging.

For example, if a vendor you use requires your business to price goods for sale in a foreign currency, and the value of that currency falls by the time your company receives payment, you will net less than expected. Additionally, if you need to exchange USD for a different currency in order to pay suppliers, you may find your outgoings increase if the supplier's currency has increased in value.

Exchange rates can hurt your bottom line if you don't plan for them in advance. Here are six ways you can reduce your currency risk when dealing with international contractors, suppliers and clients:

1. Negotiate payment terms in USD. This transfers the currency fluctuation risk to the other party.

2. When appropriate, take advantage of the current (spot) rate.
   Action: There are three easy ways to do this:
   a. Keep payment due dates close to the contract date.
   b. Require a deposit in order to secure the spot exchange rate for at least a portion of the contract.
   c. Buy a spot contract to lock in an exchange rate through a specific future date. Alternatively, for a fee, you can purchase a forward contract to lock in a future rate. Talk to your broker about the availability and practicality of these contracts for your business. If you don't have a broker, there is a foreign exchange solution offered by American Express that allows you to lock in an exchange rate for 12 months.

3. Consider the future exchange rate when bidding for projects. Your bid may look profitable today, but if the exchange rate falls in the six months it's valid, it will cut into your profits.
   Action: Unfortunately, there is no way to pinpoint what future exchange rates will be, but keeping the open period short for your bid or quote will help limit your risk exposure. Also review historical exchange rates and keep updated on the Japanese Yen, Chinese Yuan and the Euro, as these currencies tend to illustrate their respective regions' economic health.

4. Consider discounting carefully

Action: When selling products overseas, check currency exchange rates before reducing prices. If you put an item on sale and collect payment in a foreign currency with a low exchange rate, you could end up selling at a loss.

5. Diversify your currency exchange risk
   Action: Expand your marketing to other countries to diversify market fluctuations. When you do business with just one or two other countries, you are only directly affected by their currency exchange rates. By diversifying the countries with which you do business, you increase the number of currencies to which you are exposed. This will improve the chances that some currencies will be decreasing in value while others increase. The details of your expansion plan will vary depending on your business sector. Inc.com has a helpful article, "How To Build An International Brand" that covers some of the considerations to be made.

6. Spin to your benefit.
   Action: When USD exchange rates are lower than another currency's, remind your foreign-based clients they are enjoying a built-in discount. When USD rates strengthen, this gives you more buying power in other currencies, as such consider ordering more goods from foreign suppliers.

The need to reduce currency risk is becoming increasingly real. By taking the steps above, you can better protect your business and your profits.

Yolander Prinzel is a financial writer with over a decade of financial industry experience as an underwriter, insurance agent, licensed broker and agency director of marketing. She has written for a number of publications and websites such as Covestor.com, Advisor Today, Money Smart Radio and the International Travel Insurance Journal (ITIJ).