Growing your business in foreign markets can offer new growth and expansion opportunities. But you should also be mindful of the impact of potential currency fluctuations on your bottom line. If you’re looking to grow your business beyond borders, you’ll need to have a foreign exchange risk management strategy in place to help mitigate negative exposures to your business.

Here are some important risk management steps you should consider if foreign exchange is a factor for your private business.

Step 1: Identify and quantify the risk elements
As you assess your risk, it’s important to have a clear picture of the amount of exposure that your business has in foreign currency on a month-to-month basis. Once you have quantified the approximate exposure, determine what your objectives are and who can assist you in meeting your goals.

Step 2: Determine what works for your business
When evaluating your foreign exchange risks, there are a number of important questions to address to determine the right course of action for your foreign exchange policy.

- Are you looking to eliminate all foreign exchange risk?
- Do you want to protect against downside risk only?
- Are there ways to minimize your foreign exchange costs?
- When should your foreign exchange exposure be hedged?
- What tools and instruments are you comfortable using and under what circumstances?
- Who should be responsible for managing foreign exchange exposure?
- What are your regular reporting requirements?
- What is the accounting policy for the hedging methodology chosen?

Once you’ve determined how your foreign exchange objectives and processes should be managed, the next step is determining the strategy to achieve those objectives.
Step 3: Develop the strategy

When developing the right foreign exchange strategy and tactics to implement it, you'll want to put in place hedges that are consistent with your company's policy.

What are some of your options?

**Forward contracts** are agreements to buy or sell a given amount of a currency at a set exchange rate on a specific future date. Forwards are obligations and are not generally flexible, should your needs change during the term of a contract.

**Futures contracts** allow you to buy or sell a currency at a set exchange rate in a given month. Futures are highly liquid, so they can be closed out before the settlement date, giving you flexibility.

**Currency options** give you the right, but not the obligation, to buy or sell a currency at a set exchange rate during a specific time period. As a result, they offer a great deal of flexibility.

In addition to your internal strategy, it's also important to evaluate how the market is behaving and the trends that are occurring. The market can be greatly impacted by current economic fundamentals including various geopolitical situations. Understanding the direction the market is going and whether or not you should be waiting or taking advantage of opportunities can help determine the right direction to pursue, and whether or not a change in plan is required.
Step 4: Execution and evaluation of your chosen strategy

Once you’ve determined the course of action for your foreign exchange exposure, it’s critical to evaluate your progress towards managing your risks. Establishing clear objectives and benchmarks will help facilitate this evaluation. It will also help those responsible for implementing the policy to make the measures in place for hedging your risk effective when compared against your goals. Staying up to date on market trends and determining if there are any changes to your objectives or risk elements can help you proactively mitigate your risk.

You should revisit your foreign exchange risk management strategy throughout the year to keep it efficient and effective toward achieving your desired goals. Market variables can quickly change and you’ll want to be prepared to manage those risks.

We can help

To learn more about how foreign exchange can impact your private business, please contact us at privatecompanyinfo@ca.ey.com.

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