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by BNP PARIBAS

The UK CFO's guide to currency management

A guide and checklist to help British CFOs handle FX risk in a world of predictable unpredictability

00 UK CFOs and currency management: a strategic opportunity

As the British pound goes from worst to top-performing currency and vice-versa, it's **time to focus on a robust currency management framework**. Many CFOs reported lower earnings in 2022 and 2023 due to unhedged FX risk, both at large firms and SMEs.

In this handy guide and checklist, we walk you through why **currency management represents a strategic opportunity** to protect and enhance your businesses' capacity to generate long-term cash flows.

API-based tools are providing new answers to questions regarding the role of CFOs as they manage currencies. We explore how and where you need to implement digitalisation to **protect your business and increase its value.**

Contents

01 Why manage currencies? New elements in an old debate

According to a recent NEO survey, a resounding 72% of UK-based SMEs say that FX is becoming a critical matter. As the authors of the survey write: "It's clear FX has become a strategic priority". This raises the question: **what are the benefits of currency management**?

Let us start with **four specific contributions of effective FX management.** They are applicable for British businesses of all sizes seeking to protect and expand their profit margins:

Growth opportunities

Buying and selling in more currencies enhances profit margins by **capturing markups on the selling side while avoiding them on the contracting side**.

Reduced earnings variability

To the extent that investors and analysts place a high value in **reducing net income variability**, balance sheet hedging enhances firm valuation.

Lower cost of funding

Reduced cash flow variability makes it possible for companies to execute their business plans and meet all cash commitments.

Improved asset turnover

Data-driven FX pricing solutions help companies generate more sales from their assets, a key metric in assessing the efficiency with which assets are used.

While these benefits have been known for years, a new factor is at play. Automation is putting to rest the notion that currency management is a resource-intensive task. For UK-based businesses, the playing field is being levelled like never before.

02 Should British CFOs hedge cash flows or balance sheet items?

The debate about whether to hedge cash flows or balance sheet items is as old as currency hedging itself. **CFOs have a key role in ensuring enough clarity exists** so that the dangers of 'ad hoc' or unsystematic currency hedging are avoided.

Technology now allows UK-based CFOs to use **a single set of software solutions to implement various precise cash-flow and balance-sheet hedging programs.** With an added bonus: a wide range of low value-adding tasks can be easily automated.

Advantages of balance sheet hedging	Advantages of cash flow hedging
Reduced net income variability is often seen as way to boost firm valuation	Cash flow is universally recognised as the key yardstick in terms of firm valuation
Satisfies the public's thirst for performance-related information	Reduced cash flow variability is especially relevant in situations of strained capital markets
Creates a sense of discipline in the eyes of investors and analysts	Reduced cash flow variability translates into a lower cost of capital
Helps to optimise taxation when higher levels of net income are taxed at higher rates	Puts the spotlight on recognisable KPIs such as operating profit margins

02 Should CFOs hedge cash flows or balance sheet items?

Although there are solid arguments for both cash flow and balance sheet hedging (see table on the previous page), surveys show a slight preference for protecting the company’s future cash flow-generating ability.

To the extent that CFOs instruct their treasury teams to prioritise cash flow hedging, they need to carefully **define the goals of their hedging strategy.** For that purpose, the following questions provide a solid starting point:

Do you face dynamic prices?

In this case, your firm’s exposure to currency risk is in the shape of firm sales/purchase orders. You need to protect the dynamic pricing rate for all transactions.

Do you keep stable prices during a single campaign/budget period?

Here, your firm’s exposure to FX risk consists of the forecasted revenues and expenditures for that period. You need to protect that particular budget rate.

Do you keep steady prices across a set of budget periods?

Your firm’s exposure to FX risk is a rolling forecast for a set of campaign/budget periods linked together. You need to smooth out the hedged rate over time.

03 Tackling the challenges of today's predictable unpredictability

British CFOs work in a world of 'predictable unpredictability', as *The Economist* puts it. Developments in FX, money, credit, equity and commodities markets are creating scenarios that seem to grow every day in **complexity.**

But relief is at hand. With the right FX risk management tools, CFOs can simultaneously tackle three related challenges that have been particularly acute in the UK context: **exchange rate volatility, shifting interest rate differentials**, and **impaired forecasting accuracy.**

This is **a new development** made possible by the use of digital technology. To understand why this is so, consider how the main types of automated hedging programs address these problems:

	How to deal with increasing FX volatility?	How to deal with interest rate differentials?	How to deal with impaired forecast accuracy?
Firms with dynamic prices	Sales/purchase orders or balance sheet items can be **hedged with great precision**	Depending on forward points, hedging can be **anticipated or delayed**	Not a concern here, because the exposure has close to **100% occurrence probability**
Firms with fixed prices for individual campaigns	The budget rate is systematically protected thanks to a **safety net** of stop-loss orders	Depending on forward points, hedging can be **anticipated or delayed**	Conditional orders provide managers with time to **update their forecasts**
Firms with steady prices during several campaigns	The smooth hedge rate **reduces cash flow variability** period after period	Depending on forward points, hedging can be **anticipated or delayed**	Instead of protecting an FX rate, **the hedge rate is built in advance**, layer by layer

04 The UK CFO’s checklist: actionable steps for currency managers

CFOs can leverage **Currency Management Automation** solutions to systematically achieve their goals, period after period. The following checklist breaks down the major elements of your FX strategy into a series of actionable steps.

A. Start by taking currency risk out of the equation

- [ ] Set your firm’s FX goals
  Defend a budget rate, smooth out the hedge rate, hedge transactions, remove FX gains & losses
- [ ] Define the best hedging program
  Define the best hedging program by giving priority to the pricing parameters of your business
- [ ] Eliminate the element of surprise
  Use dashboards with real-time data to communicate the firm’s FX risk management processes

B. While you hedge, recognise the power of delay

- [ ] Fine-tune cash flow forecasts
  Delay hedge execution, if possible, to give the treasury team time to update cash flow forecasts
- [ ] Optimise interest rate differentials
  Delay hedge execution to reduce unfavourable interest rate differentials or forward points
- [ ] Improve cash management
  Postpone collateral disbursements by delaying, whenever possible, the execution of hedges

04 The UK CFO’s checklist: actionable steps for currency managers

C. Once FX risk is under control, confidently embrace currencies

- [ ] **Buy and sell in more currencies**
  Sell in the currency of your clients and buy in the currency of your suppliers to enhance margins

- [ ] **Price more competitively**
  Use data-driven processes to price more competitively without hurting budgeted profit margins

- [ ] **Reduce credit risk**
  Reduce the risk in accounts receivables by letting customers pay in their own currency

D. Ease cross-border payment pain

- [ ] **Remove unfair pricing**
  Connect to corporate FX platforms and ensure best-price execution

- [ ] **Speed up execution**
  Use embedded cash management to automatically align payments and exposures

- [ ] **Get real-time reporting**
  Visualise forthcoming settlements per bank and per day

E. Finally, reap the benefits of automation

- [ ] **Do more with less**
  Be API-ready and achieve all your FX goals while removing risks and costs

04 The UK CFO’s checklist: actionable steps for currency managers

Technology is changing currency management in ways that were impossible to imagine just a few years ago. The advent of multi-dealer trading platforms, for one, means that **more currencies will be used in trade**.

British CFOs can take advantage of this opportunity—but only with the help of automated software solutions. According to consultants McKinsey, adopters of automation can expect a sustained 10% annual increase in revenue.

This growth-oriented view depends on managers being early adopters and their capacity to drive cross-functional teamwork. This is exactly what can be expected from Currency Management Automation solutions.

To allay concerns expressed by treasury teams, UK-based CFOs need to explain that **automation does not mean absence of intervention**. In fact, it calls for more strategic intervention, as low-value tasks are removed.

This is the kind of leadership that is required to turn CFOs, as Bloomberg aptly puts it, into **Chief *Future* Officers**.

About Kantox
Kantox at a glance

Kantox is a **leader in Currency Management Automation software** that enables businesses to automate their end-to-end corporate FX workflow, eliminate risk and leverage foreign currencies to increase competitiveness.

With offices in **London and Barcelona**, we have grown into an international team of **over 170 professionals from across 44 nationalities.**

As of July 2023, **Kantox is a BNP Paribas company**. Kantox will continue to operate as an independent company, now with the experience and market power of BNP Paribas behind it.

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Certifications

Applus ISO/IEC 27001 Systems Certification

What's the best hedging strategy for your business?

Take our quiz and find out which hedging program can consistently handle your business's FX risk management needs and achieve your goals.

Discover now

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