Moving money globally

OFXpert Handbook

Managing FX for your business

Jake, OFXpert since 2012
and Alex, OFXpert since 2007

Business moves fast. So do we.

OFX was created from the idea that there had to be a better, fairer way to move money globally.

But we deliver more than just a money transfer. We have OFXperts, currency experts who can help businesses like yours develop strategies to take advantage of market opportunities and manage cash flow, even in times of market volatility.

We'll cover a lot in this guide, but if you have any questions or would like help building a plan for your business, our OFXperts are available day or night, 24/7. So you can always get real help, from a real person.

Let's get into it!

Contents

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Understanding currency

Business owners with an understanding of foreign exchange (FX) market fundamentals will be in a much better position to manage their FX risk exposure. Let's look at some of the basic concepts of the global currency market.

OFXpert Tip

Click here to view our glossary of frequently used currency terminology on page 12.

Major vs exotic currencies

Currencies can be broadly categorised as being **major** or **exotic**. These categories reflect the volume and geographic diversity in which a currency is traded.

The US dollar and euro are major currencies because of the high volume and large number of international markets in which they are traded. Exotic currencies are illiquid – meaning that little foreign trade activity takes place in these currencies, resulting in a low volume being traded.

We can help you do business in 50+ currencies.

Click here to see the full list of the **major** and **exotic currencies** we specialise in

Exchange rates explained

An exchange rate is the rate at which one currency is "exchanged" for another.

In the UK, the practice is for all exchange rates to be quoted with the GBP as the base rate. For example, when the UK media reports that the GBP is currently 1.300 US cents, this means that for every one GBP paid, 1.300 US cents will be exchanged.

Market convention is to quote EUR/GBP, however UK consumers tend to prefer GBP/EUR.

The table on the right provides examples of foreign currency market rates quoted against the GBP. Customer rates charged by OFX include a margin and are not market rates.

GBP exchange rates

Currency	Jan 3	Apr 3	Jul 3
USD	1.3083	1.2269	1.2483
CAD	1.7006	1.7420	1.6921
AUD	1.8837	2.0454	1.7982
EUR	1.1718	1.1371	1.1095
NZD	1.9625	2.0916	1.9116
SGD	1.7672	1.7657	1.7405
HKD	10.1754	9.5087	9.6746

Source: Bloomberg 2020
Bloomberg market rates daily average
Rates not offered by OFX

Click to view a larger version of this table

Some common rate terminologies that you may come across when undertaking a foreign exchange transaction include:

The market rate

Also known as the “interbank rate” or the “mid-market rate,” this is essentially a ‘wholesale’ rate that is available only to large financial institutions or those who purchase large volumes of currency. Generally, people wishing to exchange currency will not be offered the market rate, but instead will be provided with a ‘retail’ rate. Similar to the sale of goods and services, the retail rate typically is the market rate plus a mark-up added by the provider.

Spot rate

The exchange rate that is quoted for the sale of currency with a value date (the date that settlement is due for a foreign exchange contract) of two business days from the date of the quote.

Forward rates

Where the foreign currency rate is fixed at the time of the deal with a value date beyond two business days.

Silvana, OFXpert since 2017

Bryan, OFXpert since 2018

> **Need currency confidence?**
> We can help you navigate exchange rates with advanced currency tools.

What **factors influence exchange** rates?

World events

Global instability, such as political and military conflict, natural disasters and pandemics, also impact current demand and supply. During times of global instability investors tend to buy “safe haven” currencies such as the US dollar (USD), Japanese yen and Swiss franc, selling off other currencies which subsequently see a fall in their value.

This was illustrated during the COVID-19 pandemic which stalled the global economy as international borders closed and normal free trade conventions came to a halt. During the period of 9 – 19 March 2020, the GBP lost over 12.4% against the USD. In that environment, traditional fundamental factors such as GDP were no longer driving currency direction.

Global economics

The UK gets its main sources of income from service industries such as finance and banking and the demand and price is more consistent. GBP is therefore less reliant on trading demand.

The euro takes its value from the economic health of lots of different countries, which are driven by different industries. For example, Germany makes up a large proportion of European GDP due to its significant manufacturing output. Whereas countries like Spain and Greece are more dependent on tourism.

In global markets, Australia is typically considered to be a resource-rich country. This means that commodity prices will often impact demand for the AUD. When commodity prices rise, demand for the AUD can increase as international resource investors seek to purchase AUD.

Other factors that typically influence the demand for a foreign currency include economic indicators such as; interest rates, GDP, inflation, currency speculation and employment rates.

What is FX risk?

Exchange rates are constantly changing, can be volatile and represent one of the major risks for businesses making international payments.

A sharp rise or fall in a particular currency can have a significant impact on costs and profits.

If your business exports goods or services, currency movements could mean that you receive less of your local currency than originally intended on the date you issued an invoice to your customer.

FX risk can also be a factor for importers who have post-paid arrangements with their suppliers. Changes to currency rates could mean paying more for goods than you planned to sell them for.

OFXpert Tip

Currency fluctuations can affect your bottom line. But, if you put a risk management strategy in place, you won't be distracted by volatility.

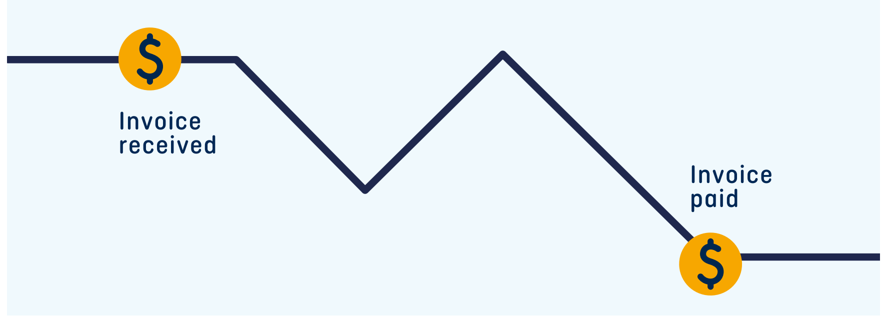
Why managing currency risk matters

As an example, let's say the customer exchange rate for 1 pound is equal to 1.3 US dollars. A business in the UK agrees to buy $500,000 in products from the US with payment due in the future. Let's say this is a retailer. That is equivalent to £384,615.

By the time the products are delivered, the pound has weakened so now the rate of exchange is 1 pound to 1.2 US dollars. While the price is still $500,000, the equivalent amount in pounds is now £416,666, so it would cost the business more.

The pound could also strengthen which would mean the US dollar amount that the business needs to pay is less.

Rate of exchange over 30 days



Customer rates charged by OFX include a margin and are not market rates. This example is purely fictitious and for illustrative purposes only.

Harry, OFXpert since 2019

Managing FX risk

There are many ways to manage foreign exchange risk. The examples opposite are some common methods, and often companies will use a combination of them to their advantage.

OFXpert Tip

If you have any questions when determining the strategy that is best for your organisation, contact an OFXpert 24/7.

Spot Transfer

When you agree on an exchange rate on the day you want to buy or sell your foreign currency. This approach offers flexibility by allowing participation in daily market fluctuations. However, it can be a high risk strategy, as the currency market is volatile and when rates fluctuate a business may experience additional costs.

Forward Contract

An agreement that allows you to fix an exchange rate now for a future transfer (between two days to 12 months) so that you know what the exchange rate will be at the time the transfer takes place. This type of transaction allows you to protect against adverse movements in exchange rates between the date an order is placed and the time when payment is required.

A Forward Contract means you may miss out on some benefits if the currency pair you need to trade in changes in your favour.

To avoid missing out on further beneficial movements, some businesses use a Forward Contract for a portion of their total payment as a way to hedge against volatility while allowing some flexibility to take advantage of moves in their favour. Speak to an OFXpert about the right strategy for your business.

Target Rate Transfer

Also known as a Limit Order, for when you can be flexible on the date of delivery of your funds. The day you receive your funds may not be the best day to transfer your money, so a Limit Order lets you target a rate that works best for your business. If the rate is reached, a transfer will be processed automatically, so you don't have to worry about missing out because you weren't monitoring the market.

Keep in mind that the market could move above your target rate, but your transfer will be completed at the target rate. The market may also move down, rather than in your favour, meaning it could have been better to transfer earlier.

As with any type of risk, there's an upside and a downside to consider. For businesses, currency risk could mean a few things:

Upside

If the currency you need to buy weakens against your base currency, your costs fall → Lower costs increase your company's profit margins → Higher profits boost your business capabilities → Makes your business more competitive → Helps accelerate key investment decisions

Downside

If the currency you need to buy strengthens against your base currency, your costs rise → Increasing costs compress your profit margins → Lower profits limit your business capabilities → Makes your business less competitive → Delays key investment decisions

If you leave your foreign exchange to chance, you have no control over whether you will be facing an upside or a downside. If you buy goods or services overseas every month then the risk is multiplied because of the number of transactions you make.

Measuring FX risk

It's vital to have a clear understanding of what your foreign exchange risk is. This can be done in a number of different ways.

To analyse your currency sensitivity, you can prepare a table showing how foreign exchange movements will affect the selling price of exported goods, or overall potential profits.

To give you an idea, in the first half of 2020 the GBP/EUR saw a high of 1.2074 and a low of 1.0516 which impacts the OFX customer rate. This wide range could cause a lot of unintended consequences for

OFXpert Tip

Understanding what your business break even rate is can allow you to plan ahead and manage risk.

Do you know your **break-even** rate?

Sensitivity analysis example

Let's say a UK importer needs to pay a €10,000 invoice, when they receive it, the customer exchange rate is 1.1016 (GBP £1 buys EUR €1.1016) and so they budget for that. If GBP/EUR customer rate rises to 1.2016, the importer would save €755 because GBP is worth more EUR. Conversely if GBP/EUR falls to 1.0516, the importer will suffer a loss of €432.

GBP/EUR rate (GBP £1 buys EUR)	Cost to importer in GBP	Variance
1.0516	£9509.32	-£431.61
1.0716	£9331.84	-£254.13
1.0916	£9160.86	-£83.1596
1.1016 (budgeted rate)	**£9077.71**	**£0.00**
1.2016	£8322.24	£755.47
1.3016	£7682.85	£1394.85

Customer rates charged by OFX include a margin and are not market rates. This example is purely fictitious and for illustrative purposes only.

While these swings may seem extreme, we're increasingly seeing this range of exchange rate movements. The good news is, FX risk can be managed by implementing a hedging strategy.

Your first steps to **more certainty**


Vani, OFXpert since 2013

Managing your foreign exchange risk doesn't have to be complicated. Here are seven key steps that could help you get started when looking at hedging for the first time.

1 Identify what foreign exchange risk means for your business

- What proportion of your business results in the need for foreign exchange payments? The higher this amount, the greater your likely exposure.
- What countries do you do business with? Some countries suffer much more political instability and therefore have much higher currency volatility.
- How frequently do you make payments? The more often you transact, the more you'll encounter exchange rate variations.
- How tight are your operating margins? At what exchange rate can you sell or buy goods and still remain profitable?

2 Consider ways of removing foreign exchange risk from the start

Is there a simple change in process that can help remove or minimise the foreign exchange risk, such as aligning a customer billing cycle with supplier payments?

3 Set out clear risk management objectives

- What is the ultimate attitude/culture of your business (from the top down) towards risk? Is it conservative or progressive towards risk in general?
- Are there banking covenants that need protecting?

Consider all of these issues before creating a written plan for your currency hedging. It's important to avoid making emotional decisions as markets move.

4 Do your research into foreign exchange products available

It's important to gain a good understanding of the various products available and how they can help you manage your foreign exchange risk. All businesses are different and there is no one best plan to suit everyone.

For example, a portfolio approach with 70% hedged and 30% unhedged could allow a company to protect its profit margin while still benefiting from any positive currency movements.

5 Seek professional assistance from the marketplace

Managing currency risk is a specialised area, and if you do not have the necessary skills within your business to formulate a strategy, it's wise to seek outside help. If you prefer not to outsource this function, then ensure you and/or relevant staff are properly educated about what it involves.

6 Regularly review hedging performance

Continually monitor and review any hedging against your objectives (quarterly, semiannual or annual).

Do not judge performance solely by the 'opportunity cost' of implementing an appropriate risk management framework, which is a very common mistake. Also, do not be distracted by short-term currency rate movements. Consider any changes within the framework of your business that may need to be reflected in the policy over time.

7 Diversify your risk

Consider blending a number of different strategies for example, a mix of spot and forward contracts. While this may add complexity, some dynamic/fine margin business models may require such diversification.

Adam, OFXpert since 2010
and Cissy, OFXpert since 2020

Business moves fast. So do we.

We covered a lot in this guide and hope you're feeling a little more knowledgeable about managing FX for your business.

Sometimes we all need a little help – that's why our OFXperts are available 24/7, day and night.

Find out how much your business could save by working with an OFXpert.

Email **corporate@ofx.com** or call us:

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Glossary of terms

Budgeted rate

The Budget Reference or Budget Rate is the exchange rate that a company's financial management uses to draft budgets and establish business objectives.

Forex/FX

An abbreviation of foreign exchange.

Forward rate

Where the foreign currency rate is fixed at the time of the deal with a value date beyond two business days.

Forward Contract (or Forward Exchange Contract or FEC)

A Forward Contract is an agreement that allows you to fix an exchange rate for a future transfer (between two days to 12 months) so that you know what the exchange rate will be at the time the transaction takes place.

Hedging

A hedging transaction is one which protects an asset or liability against a fluctuation in the foreign exchange rate.

OFXpert(s)

OFXpert (noun): A foreign exchange specialist. The partner businesses need to save money and help reduce currency risk.

"OFXperts saved my business money."

We believe real help from real people counts, and that's why we offer our clients the best of both worlds – an easy to use digital platform, combined with 24/7 phone access to our currency experts (we call them OFXperts). Our clients are all over the globe, so we are too. We operate in offices in London, Sydney, Auckland, Hong Kong, Dublin, Singapore, Toronto and San Francisco. It's global expertise, delivered locally.

Settlement

The physical exchange of one currency for another between dealer and client.

Spot rate

Also called Spot FX. This is the exchange rate that is quoted for the sale of currency with a value date of two business days from the date of the quote.

Value date

The date that settlement is due for a foreign exchange contract.

Volatility

A measure of price fluctuations.

Appendix

We can help you move money in 50+ currencies:

Majors

Currency	Code	Currency	Code
United Arab Emirates dirham	**AED**	Mexican peso	**MXN**
Australian dollar	**AUD**	Norwegian kroner	**NOK**
Canadian dollar	**CAD**	New Zealand dollar	**NZD**
Swiss franc	**CHF**	Polish Zloty	**PLN**
Chinese Yuan Renminbi	**CNH**	Solomon Island Dollar	**SBD**
Czech Koruna	**CZK**	Swedish Kroner	**SEK**
Danish kroner	**DKK**	Singapore dollar	**SGD**
European euro	**EUR**	Thailand baht	**THB**
Fiji dollar	**FJD**	Tongan Pa anga	**TOP**
Pound Sterling	**GBP**	Turkish lira	**TRY**
Hong Kong dollar	**HKD**	US dollar	**USD**
Hungarian forint	**HUF**	Vanuatu Vatu	**VUV**
Israeli Shekel	**ILS**	Samoan Tala	**WST**
Indian Rupees (RDA)	**INR**	CFP Franc	**XPF**
Japanese yen	**JPY**	South African Rand	**ZAR**

GBP exchange rates

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Exotics

Currency	Code	Currency	Code
Azerbaijani Minat	**AZN**	Peruvian Nuevo Sol	**PEN**
Bulgarian Lev	**BGN**	Papua New Guinea Kina	**PGK**
Bahraini Dinar	**BHD**	Philippine Peso	**PHP**
Brunei Dollar	**BND**	Pakistan Rupee	**PKR**
Chinese Yuan Renminbi*	**CNY**	Russian Ruble	**RUB**
Egyptian Pound	**EGP**	Saudi Riyal	**SAR**
Indonesian Rupiah	**IDR**	Seychelles Rupee	**SCR**
Indian Rupees	**INR**	Taiwanese Dollar	**TWD**
South Korean Won	**KRW**	Tanzanian Shilling	**TZN**
Kuwaiti Dinar	**KWD**	Vietnamese Dong	**VND**
Sri Lankan Rupee	**LKR**	CFA Franc	**XOF**
Moroccan Dirham	**MAD**		
Malagasy Ariary	**MGA**		
Malaysian Ringgit	**MYR**		
Omani Rial	**OMR**		