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International Business: Currency Fluctuations

How Fluctuations in Currency Value Impact Businesses

In a recent article, CNBC highlighted the fact that the U.S. dollar has recorded gains of 7% against the Euro, Canadian Dollar, and the New Zealand Dollar. Further policy changes in Switzerland, Singapore, and India have created uneasiness for those who follow these things closely. Media outlets devote significant amounts of airtime discussing currency and the positive or negative impact fluctuations have on markets.

However, most business people hear these "macro" issues as passing noise and continue working on the day-to-day operation of their business. Should I listen closely to currency news? Do fluctuations really impact my business? If so, what should I do to address the concern? This article examines those questions and provides actionable recommendations.

Currency Overview

Currency fluctuations are changing relative values between currency issued by one country and that of another. The economic and political issues of a country impact these relative values. The 2015 general rise in the value of the United States dollar relative to other currencies, such as the Euro, Canadian Dollar, and British Pound Sterling, have both a cause and effect. The cause can be traced to the relative strength of one economy against other worldwide economies. Indicators of economic strength have a positive correlation to currency. During the latter part of 2014 and early 2015, the United States stock market broke value records. Furthermore, worldwide markets showed volatility. Similarly, the U.S. Dollar rose compared to other currencies.

So what does an increase in U.S. Dollar value mean? Let's use the Euro as an example. The value of the Euro to the Dollar on July 1, 2014 was 1.336 Euro to a Dollar. The same Euro at January 30, 2015 is 1.134 to a Dollar. The dollar gained 15.12% in value over the time period. In other words, if a person were purchasing European goods in July for $1,000; the same purchase today would be equivalent to $1,015 in value.

Date	Value of Euro to Dollar	Cost to Purchase the Same Amount of Goods
7/1/2014	1.336 to 1	$1,000
1/30/2015	1.134 to 1 **(15% increase in value of the Dollar)**	$1,015

The impact of rising currency means that a person using U.S. Dollars has increased purchasing power over other currencies. However, the downside is that foreign purchasers in Europe are now paying 15% more to purchase the same item from a United States vendor than just six months ago.

Currency Impacts

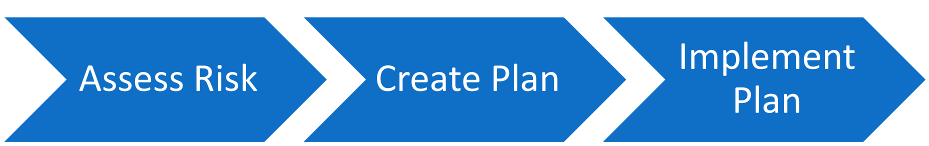
Often, currency considerations appear to be large company issues likely addressed by a headquarters minion with a green eye-shade. Many owner-managed businesses that conduct business through distribution or other export means overlook the impact these fluctuations have on the day-to-day business. Aside from monitoring markets closely and anticipating changes, many businesses first see changes in sales. In the example above, it would be likely that a buyer on the other end of United States exports would notice the increasing cost of U.S. goods. If substitution is available, the customer would likely move to the substitute quickly.

Economic theory instructs that the increased value at the sale end of the transaction should be offset by a similar decrease in cost when inputs are imported. However, experience proves the theory to be less than perfect. In reality, system friction or other business factors often defer or fail to allow the exporter to recognize the anticipated savings of stronger currency.

Erosion of profit, reductions in sales, and flattening of growth are all indicators that require close monitoring by a business. However, since today tends to move into tomorrow and then into the next day, many businesses do not notice the impact of currency during the most opportune window.

How to Play in the Game

Entrepreneurs and owner-managed businesses often feel like they are at the end of the currency whip and are being thrown about without the tools to address the issue. Below are three steps that will help you play in the currency game.



Step 1: Assess Risk

As an owner doing business internationally, it is critical to understand where you are exposed and to manage that exposure. Common risk areas to evaluate include:

- Sales Cycle (Accounts Receivable). The selling cycle can increase risk. For example, if the amount of time from contract-signing to delivery and billing to collection is 120 days. The seller could be at risk for devaluation if the invoice is in Euro and the value of the U.S. Dollar falls in value.
- Inventory and Long-Term Contracts. Property or contracts created or maintained for sales in another currency are subject to currency gain or loss.
- Financing Arrangements. An agreement denominated or subject to repayment in foreign currency can create a favorable or unfavorable financial result.

Experienced assistance can guide a business through analysis of the opportunities and pitfalls associated with foreign currency inside the business. Expertise can help you reveal your specific currency-related opportunities and vulnerabilities.

Step 2: Create a Plan

Critical plan elements include:

- Comprehensive Approaches. Understand and address all areas of the business impacted by currency fluctuations.
- Flexibility. Any currency plan needs to allow the business to function at its best without overlooking the desired results of the plan.
- Simplicity in Perception. Currency tools can be intimidating and intricate. Save the details for behind the scenes and focus on concepts, education, and understanding by those required to make the plan work in practice.

We suggest putting together a team of experts, including bankers/financers, accountants, attorneys, etc. to help you create a plan.

Step 3: Implement and Adhere to the Plan

Those who implement and adhere to the plan get on top of changes early and apply best practices to their businesses.

For more information and guidance on doing business internationally, contact us.

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