

Foreign-Exchange Strategies to Boost Manufacturing Profits

Understanding the implications of currency fluctuations may mean the difference in succeeding or failing in international business.

By Guido Schulz

Business is picking up again for manufacturers, and executives involved in international trade need to understand the implications of currency fluctuations. By implementing a few simple strategies, such as the use of risk-management tools and market-monitoring services, executives can safeguard against currency fluctuations.

On an average business day, nearly \$2 trillion trade in the foreign-exchange market, where currency volatility has become the norm. Due to this inherent volatility, value of the U.S. dollar fluctuates constantly against other currencies. From May 1, 2002, to May 1, 2005, the U.S. dollar weakened by 36 percent against a basket of currencies comprised from America's major trading partners: the Eurozone, Canada, Britain, Japan, Australia and Mexico. Numerous factors contributed to the dollar's decline and market participants are debating whether the dollar has bottomed. As a result, short-term fluctuation has increased significantly.

Whether your company imports or exports tooling, machinery or other products, you can improve your bottom line with a few simple actions, such as formulating a foreign-exchange risk-management plan, monitoring the market for short-term opportunities, executing orders when favorable market opportunities arise, and making and accepting payment in foreign currency.

Additionally, consider the timely use of forward contracts. Not only will these tools empower you to control costs, but they may also build goodwill with suppliers and clients, leading to increased business.

In the past, U.S. companies conducted business abroad in U.S. dollars. The advantage was clear: It placed the burden of foreign-exchange risk on the shoulders of the foreign customer. Today, savvy overseas partners and domestic brokers are less willing to accept the added cost of converting funds.

Be a Savvy Buyer

If your machinery supplier allows you to lock in a rate of exchange when making a payment in foreign currency, take advantage of it. Consequently, you immediately know the exact U.S. dollar amount and foreign-currency equivalent required, and eliminate the risk of sending too much or too little, or of being re-billed. In addition to saving money, you build a better relationship with suppliers, as they receive immediate payment without an expensive conversion fee.

Often, suppliers send an invoice with the U.S. dollar equivalent calculated for the customer.

Customers who remit this amount can be sure that the supplier has included an added cushion to guard against dramatic rate fluctuations and high conversion fees in order to ensure a certain profit margin.

By paying in U.S. dollars, a buyer most likely spends more than the equivalent cost of the foreign currency. The solution: Ask your supplier to quote a price in foreign currency and in U.S. dollars. You can compare the two and pay the lower amount.

To compete in today's international marketplace, in-the-know exporters price goods and receive payment in foreign currency. For those exporting manufacturing equipment and products directly abroad, accepting foreign funds facilitates payment procedures for clients and may boost the manufacturer's competitive edge in overseas markets. Consider, also, that when the U.S. dollar is weak, exporters may be missing an opportunity to earn higher profits in the buyer's currency. The key is to remember that the impact of the foreign-exchange risk you assume can be managed effectively.

Many manufacturers look for convenience and low fees and rates when selecting their foreign-exchange supplier. They usually buy when a payment is due, aggregating various liabilities into one large transaction.

Whether you are paying for tools and machinery, for imports or exports; for the raw materials to manufacture products, tools and machinery; for equipment purchases from overseas; or a parent

company or international subsidiary, it is critical to plan how you will hedge against currency risk exposure. Most tooling and machinery businesses have regular foreign payments, deliverable between 30-90 days. Thus tooling and machinery businesses are prime candidates for forward contracts and short forwards.

The Forward Contract

Once your manufacturing company has committed to conducting a transaction in a foreign currency, you are exposed to market fluctuations. There are simple ways to manage risk without undue stress.

One of the most basic means of protecting against currency exposure for a pending financial transaction is buying or selling funds “forward,” using a forward contract. With a forward contract, you lock in a current rate of exchange for a payment for goods you have contracted to buy in the future. As a result, you know what the funds will cost when you convert the currency at a future date. With the exchange rate established, the U.S. dollar amount is set, regardless of subsequent market movements, which can amount to five percent during a single month. A fixed rate allows manufacturers to budget effectively without currency fluctuations eroding profit margins.

The only typical requirement to enter into a forward contract is a deposit of 10 to 15 percent of the dollar cost of the funds. However, there are also forwards that require no deposit that can be executed within 45 days.

Ruesch International, for example, has a product called short forwards, which are forwards ranging from three days to two weeks in length plus a delivery window of one to 30 days.

Because clients usually have as long as 60 days to pay their invoices, a short forward is a perfect risk-management tool to capture the rate of a good trading day and enables manufacturers to fix their margin costs at any time. A company with low cash flow can use a short forward with no impact on its liquid assets.

Tools to Minimize Risk

In addition to forward contracts, manufacturers also can leverage standing orders as a risk-management tool. Standing orders require a foreign-exchange specialist to monitor the market and act upon the client's request to buy foreign currency at a target rate. Manufacturers can capitalize on standing orders either through intraday or overnight (\$100,000 minimum) agreements to secure their profit margin ahead of a due payment. Manufacturers sometimes hold balances for incoming funds, enabling them to make payments in foreign currency without having to maintain and pay for overseas accounts or lose money in the exchange process.

A Foreign-Payment Success Story

Tritec Associates Inc. is a private company that imports and distributes woodworking machinery for cabinet manufacturers in the panel-processing industry. Though not related to metalforming and fabricating in its business, the company provides a case study on how you can work the foreign-exchange market to your advantage.

Since 1984, Tritec Associates has sold a line of multiple spindle drills, case clamps and dowel-insertion equipment. It has eight employees at locations in Sterling, VA, and Sacramento, CA. The effective management of currency-market volatility presents a major challenge for Tritec. "Ruesch International allows us to purchase forward contracts as a part of our euro cost averaging strategy," says Linda Wells, Tritec controller. "This helps mitigate the highs and lows of the dollar, ensuring that we don't lose to currency fluctuations. More importantly, forward contracts help to stabilize our list price of products."

Tritec's import volume changes on a monthly basis, depending on sales and demand for various products in the United States. Prior to using forwards, Tritec utilized spot purchases and wired the money for all international payments. By contacting a payment provider, the company secured the current exchange rate in the spot market. Then its payment provider executed the transaction.

The spot exchange rate is the current value of one currency compared to another currency.

Generally, spot purchases are used for immediate payment needs.

By using forwards as risk-management tools, Tritec protects its profit margin, and reduces anxiety because by locking in the rate during favorable market conditions, the company effectively protects its assets.

In September 2004, Tritec purchased five short-forward contracts totaling 220,000 euros at a specific rate. Tritec was able to secure a profit of more than \$11,000 by leveraging short forwards and implementing a euro cost-averaging strategy versus buying in the spot market.

From this scenario, you can observe the impact that currency fluctuations can have on a company's bottom line. By locking in a rate, your cost or profit margin is protected and there is no worry that market fluctuations will affect the company's bottom line.

Select an Expert

Because exchange rates fluctuate from minute to minute, staying informed about the foreign-currency market is a fundamental prerequisite for effectively managing international payments. Numerous variables such as economic indicators and social events impact the foreign-exchange market and account for currency volatility.

A foreign-exchange provider should offer comprehensive monitoring services, which greatly reduce the effort of otherwise painstaking data collection. By staying abreast of pertinent news, managers can time transactions to coincide with favorable market conditions and potentially increase savings. Seek a monitoring service that tailors its program to provide as much or as little information as you deem necessary.

The key, as with any client-supplier relationship, is to select a foreign-exchange expert that will work with you to improve your company's bottom line. Consider simplicity and convenience when selecting a supplier. The international-payment and risk-management specialist you select may mean the difference between a savings of several hundred dollars in the short term and

potentially thousands of dollars in the long term. Most importantly, seek the advice of a foreign-exchange supplier that will design a tailored program to meet your specific demands.

Understanding the market will keep you ahead.

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