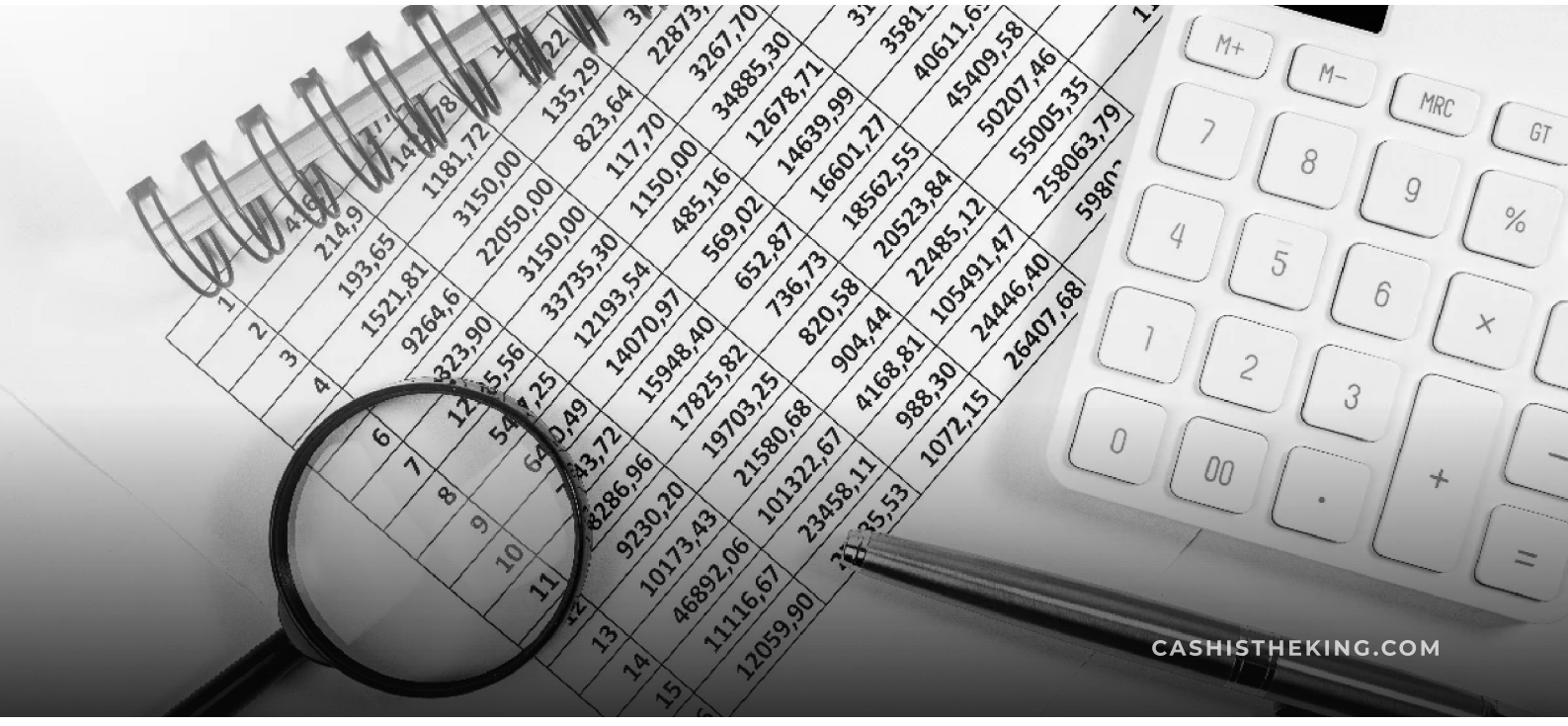
WHITE PAPER

Taking the Guesswork Out of Currency Risk

A practical guide to understanding, measuring and managing foreign exchange risk in your business.



INTRODUCTION

What you'll learn

If your business buys, sells, borrows or invests in a currency other than sterling, exchange rate movements are quietly, inevitably shaping your margins. This guide is written for business owners and finance managers, and explains in plain language how businesses can take back control of their cashflow.

You'll read:

01 Why exchange rates are a structural cashflow risk across the entire business.

02 The three ways currency risk shows up, and which one is most likely to hurt you.

03 How to put a number on your exposure, including what Value at Risk means and how to use it.

04 The main tools for managing FX risk (spot, forwards, market orders and options).

05 How to build a simple currency policy, as well as the common mistakes that businesses make.

Exchange rates are a cashflow issue

Most businesses think of currency as a technicality that need only concern the finance team. In reality, the exchange rate you achieve is one of the few variables that can move your margin by several percentage points overnight.

A SIMPLE EXAMPLE

A UK importer agrees to buy €500,000 of goods from a European supplier, payable in three months. At the time of the order, the rate is £1 = €1.17, so the expected cost is about **£427,000**.

By the time payment falls due, sterling has weakened to £1 = €1.11. The same €500,000 now costs roughly **£450,000,**an extra **£23,000**, or more than 5% of the purchase price, gone. Nothing about the deal changed except the rate.

For a business running on a 10% net margin, a swing of that size can wipe out half the profit on an order. The reverse is equally true for exporters, whose sterling income shrinks when the currency they invoice in weakens against the pound. The point is not that currencies are dangerous, but rather that leaving the outcome to chance is a choice, and usually the wrong one.

The three types of currency exposure

Currency risk is a complex thing, and for that reason it helps to separate it into three types. Each is managed differently, and each sits with a different part of the business.

Type of exposure	What it means	Where it shows up
Transaction	The risk between agreeing a price in a foreign currency and settling the payment. This is the one that hits cash directly.	Supplier invoices, customer receipts, one-off purchases, loan repayments in foreign currency.
Translation	The accounting effect of converting foreign assets, liabilities or overseas earnings back into sterling for your accounts.	Consolidating a foreign subsidiary; revaluing foreign-currency bank balances at year end.
Economic	The longer-term effect of sustained currency moves on your competitiveness and future cash flows.	A strong pound making your exports pricier abroad; a weak pound raising the cost of all imported inputs.

For most small and mid-sized businesses, **transaction exposure** is the one that matters most, because it turns directly into cash won or lost. It is also the easiest to manage, which is where the rest of this guide focuses. Translation exposure is largely an accounting concern; economic exposure is a strategic one that belongs in your pricing and market decisions.

Putting a number on your risk

You cannot manage what you have not measured. The first step is simply to map your exposure: over the next 3, 6 and 12 months, how much are you due to pay or receive in each foreign currency, and when? That schedule is the foundation of everything that follows.

What Value at Risk tells you

Value at Risk (VaR) answers a practical question: given how much this currency typically moves, how bad could it realistically get over a given period? It expresses the risk as a single figure, with a confidence level attached. For example:

VALUE AT RISK, IN PLAIN ENGLISH

"There is a 95% chance that the loss on my €500,000 exposure over the next three months will not exceed £18,000."

Put another way, in the worst of 20 possible outcome, you should be prepared to lose more than that. VaR sizes the risk so you can decide how much of it you are willing to carry.

You can calculate this for your own exposures using the **Value at Risk calculator** on the Cash is the King website. Enter the amount, currency and time horizon, and it estimates your potential exposure based on how volatile that currency pair has been. It is the fastest way to turn an abstract worry into a number you can act on.

Scenario and sensitivity analysis

VaR is a statistical estimate; it is worth pairing it with a couple of common-sense scenarios. Take your largest upcoming exposure and ask what happens to your cost or income if the rate moves 3%, 5% and 10% against you. If a plausible move turns a profitable order into a loss-making one, that exposure needs managing, regardless of what any model says.

The hedging toolkit

"Hedging" simply means reducing uncertainty about a future exchange rate. There are four main tools, ranging from doing nothing about the future (spot) to buying protection with flexibility (options). None is inherently right. The choice depends on how much certainty you need, your risk appetite and how much flexibility you want to keep.

Tool	What it does	Best for	Trade-off
Spot contract	Exchanges currency at today's rate, for near-immediate settlement (usually two working days).	Payments due now; no future exposure to manage.	No protection against future moves — you take whatever the rate is on the day.
Forward contract	Fixes an exchange rate now for a payment on a set future date, or across a window of dates.	Known future payments or receipts where certainty matters most.	You are committed to that rate even if the market later moves in your favour; a deposit may be required.
Market order	An automatic instruction to trade when the rate hits a target (limit) or a worst-case floor (stop-loss).	Aiming for a better rate while capping the downside.	The target rate may never be reached; needs monitoring alongside a plan.
Currency option	The right, but not the obligation, to exchange at a set rate on a future date.	Wanting protection while keeping the upside if the rate improves.	You pay a premium up front, whether or not you use it.

For most businesses managing transaction exposure, **forward contracts** are the most common solution. It lets you lock in the rate (and therefore the exact cost or income) the moment you agree a deal, so your margin is protected before it can erode. Options add flexibility at a cost, which can be worth it for larger or less certain exposures.

Building a simple currency policy

A currency policy does not need to be a thick document. Answering five questions in advance is enough, just enough to mean that decisions are made by design rather than in a panic when a rate moves.

1. **Risk appetite.** How much of a loss on an exposure can the business comfortably absorb before it hurts? This sets how much you need to hedge.

2. **Hedge ratio.** What proportion of a known exposure will you cover — 50%, 75%, 100%? Many businesses fully hedge committed costs and partially hedge forecast ones.

3. **Layering.** Rather than hedging everything at one rate on one day, cover exposures in tranches over time to average out the rate you achieve.

4. **Governance.** Who is authorised to enter a hedge, and up to what size? Even a one-line rule prevents ad-hoc decisions.

5. **Review cadence.** Set a regular point — monthly or quarterly — to review exposures against the policy and adjust.

Written down, these five points turn currency management from a source of anxiety into a routine. That is the whole goal: predictable margins, and no nasty surprises.

The most common (and costly) mistakes

- **Having no policy at all.** Reacting to each payment individually means every decision is made under pressure, usually at the worst possible moment.

- **Hedging on emotion.** Trying to guess where the rate is heading turns risk management into speculation.

- **Leaving it to the last minute.** Only ever using spot rates means you are fully exposed right up to payment day, and forfeit every tool that could have protected you.

- **Treating your bank's rate as the benchmark.** Banks often build a wide margin into their exchange rates. Comparing against the mid-market rate reveals what protection is really costing you.

- **Managing the rate but ignoring the timing.** A great rate is worth little if the funds arrive after you needed to make a payment. Align your hedging with your cashflow calendar.

A worked example

ILLUSTRATIVE SCENARIO

THE SITUATION

A UK manufacturer imports components worth €200,000 each quarter, payable 60 days after order. Its net margin on the finished product is 9%.

THE EXPOSURE

At £1 = €1.17 the quarterly cost is about £171,000. A 5% adverse move would add roughly **£8,500 per quarter**, or £34,000 a year, enough to erase a meaningful slice of profit.

THE RESPONSE

The business books a **forward contract** each time it places an order, fixing the sterling cost the moment the deal is agreed. Its margin is locked in at the point of sale.

THE OUTCOME

Whether sterling rises or falls over the following 60 days, the cost is unchanged. The business has swapped an unpredictable margin for a **certain one,** exactly what good currency management delivers.

Self-assessment: how exposed are you?

Work through the checklist below. If you answer "no" or "not sure" to more than a couple of these, currency risk is probably costing you more than you realise.

- [x] I know how much my business is due to pay or receive in foreign currency over the next 3, 6 and 12 months.
- [x] I have put a number on how much a realistic adverse move would cost me on my largest exposure.
- [x] I understand the difference between a spot and a forward contract, and when to use each.
- [x] I have a simple, written rule for how much of my exposure I hedge.
- [x] I compare the rate I am offered against the mid-market rate, not just my bank's quote.
- [x] Someone in the business owns currency decisions, and we review them on a regular schedule.

To size your own exposure in a couple of minutes, use the **Value at Risk calculator** on the Cash is the King currency-risk page.

Where to get help

Managing currency risk well does not require an in-house treasury team. A specialist currency partner can help you map your exposures, set a sensible policy, and access the right tools — usually at better rates than a high-street bank, and with guidance built around your business rather than a product.



smart CURRENCY BUSINESS
TREASURY EXPERTS SINCE 2004

Smart Currency Business works with UK businesses to manage foreign exchange and treasury risk, from forward contracts and market orders to a full currency strategy. If your business has regular or significant foreign currency payments or income, a short conversation is the fastest way to find out what you could be protecting.

If you are managing currency for personal reasons (buying a property abroad, receiving an overseas pension or transferring funds internationally) **Smart Currency Exchange** provides the same expertise for private individuals.

Next steps and further resources

CALCULATOR

Model your exposure with the **Value at Risk calculator** on the currency-risk page.

WATCH

The currency-risk webinar and other specialist sessions on the Cash is the King YouTube channel.

SUBSCRIBE

The Cash is the King newsletter, for regular, practical guidance on protecting your cash flow.

READ

Companion guides on managing inventory, debtors and creditors — the three levers of your cash conversion cycle.

About Cash is the King

Cash is the King is a practical resource for business owners and finance leaders who want to protect and improve their cash flow. It brings together clear, jargon-free guidance on the things that most affect the cash in your business , from working capital to currency risk, alongside webinars, tools and expert insight.



Charles Purdy

Charles Purdy is a qualified Chartered Account. As CEO of Smart Currency Group since 2004, he has helped thousands of UK businesses achieve sustainable growth by focusing on their cashflow.

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