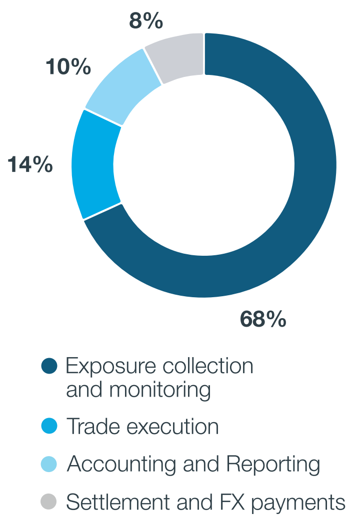
FX Hedging Strategies for 2021 and Beyond

As new processes and technologies are called upon to help businesses navigate turbulent waters post Covid-19, foreign exchange hedging strategies will need to change too. The latest survey from Kantox, in partnership with TMI, reveals the extent of what's needed now.

By **Tom Alford**, Deputy Editor

In a world where business efficiency and effectiveness suddenly became essential survival skills rather than just cost-saving measures, traditional foreign exchange (FX) management strategies must develop, and fast. As a key finding of the 2020 FX Risk Management Survey, conducted by Kantox in collaboration with TMI, it shows the depth of the impact of the pandemic on commercial activities. Indeed, says Antonio (Toni) Rami, Chief Growth Officer and Co-founder at Kantox, "it confirms that the life of the treasurer is becoming more difficult, and a lot faster than ever expected".

FIG 1: FX HEDGING CHALLENGES DURING THE COVID CRISIS



Data from 155 responses

The survey, conducted from June to July 2020, evaluated the effect of Covid-19 on FX risk management processes and policies among various industries, including manufacturing, retail, financial services, hospitality, and health care, and representing a revenue spectrum from firms in the under €20m bracket, to those over €1bn-€10bn from which most respondents were drawn.

The results indicate that even with a robust FX risk approach, the pace at which the world is changing means that no business is immune from market volatility. As such, a clear trend that can be observed among the 154 respondents is that FX strategies that were once considered sound must now be reviewed for post Covid-19 survival, and the call for more and better technology to help with optimisation is growing louder.

Pain points

Some 68% cited exposure collection and monitoring as the most pressing FX challenge surfacing in the three months prior to the survey being taken (see figure 1). The lack of systems and clearly defined processes is the chief cause here; this has been exacerbated by the pressure of operating under Covid-19. As a mark of the significance of this point, other challenges were way down, with trade execution (14%), settlement and FX payments (10%), and accounting and reporting (8%), rounding out the list of concerns.

The majority of treasury pain arising from the pandemic is caused by increased market volatility, this being cited by 64% of respondents. Even the normally reliable EUR/USD benchmark has seen wild spikes in 2020, with an initial 6.7% drop in March 2020 that was countered by a major rally that caught many treasurers off guard. More predictably, emerging market currencies are also exhibiting dramatic and potentially costly swings for businesses.

One of the main causes of disquiet emerging from all this, notes Rami, is a lack of treasury confidence in FX policy and hedging processes. This, he says, confirms that "policy is still not in alignment with the business". But where it may have been almost adequate when the markets were less volatile, current circumstances, he feels, have exposed every weakness. Indeed, 52% of those polled describe their current FX hedging programmes as either inadequate, partially adequate or non-defined in handling the Covid crisis.

Clearly, there is widespread acceptance in treasury that existing hedging policies and processes are not fit for purpose in the new era. A response is being mounted, with 43% saying the pandemic has been the catalyst for a review of their FX management objectives (see figure 2), and 56% believing that the importance of FX risk management will increase within treasury after Covid. Although 43% say policy will remain unchanged, the majority clearly understand the impact a suboptimal FX policy may have on the overall results of the company.

Of the other pain points raised, being over-hedged and having to unwind was a big issue for 34%. Most of these respondents (66%) base their hedges on forecasting. This suggests that forecast accuracy is nowhere near as effective as it should or could be. Even combining accounts payable/accounts receivable data – assuming it is easily accessible – within a forecast-based hedging programme could ease this issue.

As Rami notes, most of the challenges arise from a lack of alignment of policy with business. With just 30% of respondents having an FX hedging strategy approved by senior management outside of finance, it demonstrates that FX risk management

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Chief Growth Officer and Co-founder, Kantox

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Rami has a background in strategy and operations having worked for Inveready Technology Investment Group and Deloitte before launching Kantox. He speaks regularly at events across Europe and is considered an FX and fintech leader. Rami holds a Master's degree in Business Administration from ESADE Business and Law School, Barcelona, and also from Singapore Management University.

is yet to be viewed as an essential strategic task. "It shines a light on the need for treasury to prepare, but it also underlines the need for the different functions to work closer together, to solve FX problems for the company and for its clients and suppliers." As awareness of what needs to be done increases, so too will the level of response.

Treasury impact

As a result of new challenges arising, 56% of respondents are anticipating an increase in workload in their treasury over the coming months. Of these, 81% are expecting to be handling the increase with the same level of resources. Where manual processes are used to manage FX, and with market volatility showing little sign of weakening, the teams mitigating the risk can expect to be pushed to the limit.

Of course, treasurers know a solution exists. In response to suboptimal systems and processes in the pre-trade phase of the workflow, for example, 73% say technology – not more people – would help lighten their burden, with forecasting (40%) and exposure collection analysis (33%) the focus of their requests.

The argument for the adoption of technology is compelling. However, Rami notes that many treasurers are still wedded to spreadsheet operations. This commonly means treasurers struggle to explain to business colleagues the enterprise-wide impact of FX volatility.

With many firms still not grasping the strategic importance of a sound FX policy, and the role that investing in technology plays in mitigating risk in volatile markets, it is no wonder that most treasurers expect to be 'doing more with less,' and that seeking sources of efficiency is for them now paramount.

However, the lack of understanding of the issue beyond treasury is also a major hurdle to securing budget. When it comes to de-stressing and de-risking their FX hedging activities, 53% of respondents report insufficient technology budget, and 46% claim internal resistance to change. For Rami this is frustrating. "I just don't buy it," he states. "The return on FX-related systems is obvious."

Breaking boundaries

Nevertheless, with cash visibility and the need for greater control over liquidity a known priority for corporates the world over, Rami predicts an increase in TMS adoption. That said, he argues that these systems do not necessarily have a strong focus on areas such as FX risk management. As such, we will likely see the rise of what he calls the "multi-tech treasury", where third-party Currency Management Automation software augments core system functionality.

And when this happens, he believes that treasurers will finally be able to "break the silos" that have constrained FX risk management. It is, he states, the best opportunity to enable closer collaboration with commercial teams to create useful FX risk KPIs and robust policy. "When treasury takes the lead, it can demonstrate to the rest of the business that by aligning processes, everybody wins."

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To read the complete survey findings, please download a complementary PDF copy at

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FIG 2: REVISION OF FX RISK MANAGEMENT STRATEGIES FOR THE POST COVID ERA