

Currency Exchange Gotcha?

by *Bonnie D. Huval*

Even a very small firm can do business across geopolitical boundaries--and that means variations in currency exchange rates can catch you flat-footed.

How to protect yourself depends upon how you do business.

When Materials and Production Stay Close to Home

For most small businesses, especially if production is done in the home country, the solution is simply to make customers pay right away in your country's currency. When customers use credit or debit cards, the card issuer handles the currency exchange and you need not fret with it.

Alter just one detail in that scenario. What if you have an online store in a venue that only accepts one currency? Etsy is a popular example. All Etsy shops are required to take payment in US dollars. But what if you are in Europe? Worse, what if you are in the UK or Turkey, for example, where the currency has fallen dramatically against the dollar?

In this situation, you have only two defenses. First, you can set prices high enough to allow for any rapid change in the exchange rate. Unfortunately, when currencies are as volatile as they have been in the past couple of years, pricing for enough of a cushion makes your prices too high to sell.

That leaves only one other option: check the exchange rate frequently and reprice everything in your store as the exchange rate moves. Notice that the exchange rate, not the calendar, tells you when to update prices. I know a shop owner who had to ship some product at a loss last year because repricing once a week allowed a large currency fall to sneak through.

Moving up the ladder, perhaps your business is bigger and sells Whatzit machines. (In this example, any resemblance to any real product is purely accidental.) You manufacture the world's finest Whatzit machines, custom made for each of your clients. Your orders come from all over the globe. But the customization you perform takes an average of two months, so delivery takes time.

What happens if you accept purchase orders priced in and payable in the customer's currency at the time of delivery? An exchange rate move in the wrong direction will cut into your profit and could turn profit into loss.

When You Buy, Make and Sell Across Borders

So far, we have only looked at businesses that use in-country materials and production, and sell internationally. Chances are that if you sell internationally, you also get some materials or production work outside your home country. Then you can have currency exchange risks on both sides, not just in making sales.

When you understand both sides, you can see how each party in each transaction would prefer to handle the exchange rate risk. The example below is from real life.

Last year, a multinational based in the UK ordered custom software at a fixed price from a company on the European mainland. The mainland company submitted its proposal and price quote in euros. The British firm accepted it that way.

Before the software was delivered and payment became due, the British pound sterling fell dramatically against the euro. The supplier got the amount of money it expected because it set the pricing in its own currency. Because the UK firm did not protect itself, paying that much in euros took over 20% more than expected in British pounds. Naturally, that extra cost takes a bite out of any profit the UK firm makes by using the software.

The outcome would have been different if the UK firm had taken either of two options:

- insisted on pricing in pounds sterling, or
- set the exchange rate to be applied

With the first of those options, all the pain of the exchange rate movement would have hit the supplier instead of the UK firm. With the second, the pain could have been divided between the two companies, depending upon exactly how the exchange rate was stipulated.

Be Creative

These are not the only solutions that could have been used. Creative use of tools that were created for other purposes can serve you just as well.

Here is one way you can adapt a tool for currency exchange protection. Some services that broker freelance professionals offer an option where the buyer pays up front into an escrow account held by the broker. Escrow is released to the seller upon completion of the job.

Escrow is intended to assure the seller that payment will indeed be made. That eases doubts at the start of a new business relationship. It also locks in the price of an international transaction as of the date when the work starts. For a small business, this is an especially accessible and non-confrontational way to protect against currency fluctuations.

When you start dealing with suppliers and customers in other countries, it literally opens a world of opportunity. But it also means there are even more details to pay attention to so you will get paid appropriately. Currency exchange is one of the first to nail down.

About the author: Bonnie D. Huval has been a consultant since 1992, helping companies make more money, especially with their automation and transaction systems. Her USA and UK business interests also include real estate, property management and a restaurant. Go to <http://www.makesureyougetpaid.com> for her materials help small businesses be more successful. If you want more, go to <http://www.seneschal.biz> for consulting services. Copyright 2009. This article may be reprinted only in its entirety, with full attribution.

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