



Risky business

While exporting may present new and different challenges for many businesses, strategic planning and watchful management can remove most of the financial gamble, explains Domini Stuart

However successful your business in Australia, you're selling to a market of just 20 million people. Compare this with populations of 325 million in the US, 127 million in Japan and 376 million in Europe and it's easy to understand why exporting is such a seductive prospect.

Exporting can certainly open the door to a leap in sales and profits. You don't even need to be hugely successful at home to start reaping the rewards - according to Austrade, global brands can be built from small local companies, and around 25 per cent of new exporters have no established business in Australia.

But what of the downside? Selling overseas introduces a raft of risks which simply don't apply in a domestic market. Political instability, differences in law and unfamiliar quarantine regulations are just some new threats to a smooth transaction. There are also additional risks associated with getting paid.

If a customer on another continent should default, any attempts to recover your money might prove too expensive to justify. And, as soon as you begin to deal in foreign currency, you're also exposed to the dangers of adverse currency movements and inappropriate hedging strategies.

For many would-be exporters, these are major concerns – and we only have to look to the havoc wreaked on companies like Pasminco and Sons of Gwalia by foreign exchange and commodity hedging exposures to see that such fears are not entirely unfounded. However, thousands of Australian businesses exporting successfully every day are proof that the risk is manageable

Developing a plan

Ian Rogers, Manager of Trade Development and Operations at HSBC, believes that managing financial risks begins the moment you consider doing business overseas. “Planning is the crucial first step, backed up by serious research,” he says. “You need to know everything about your potential market. You need to be sure that the currency is tradable and, of course, that your buyer has the capacity to pay. Your bank can run a credit check to help with that one.

“In fact, your bank can help with a lot at this stage,” he continues. “Banks are generally very under-utilised, yet a close working relationship is good for both sides. Remember that, from a selfish point of view, it’s in the bank’s interest to ensure that customers get paid.”

“The earlier you get your bank involved the better,” agrees Mark Evans, HSBC’s Senior Trade Services Manager, Australasia. “Ask for their help in structuring your transaction – there’s no point in waiting till you land a contract before you talk to them. When you’ve already agreed your terms of trade and method of payment, there’s no room to manoeuvre.”

“Different banks have different criteria,” adds Rogers. “Be prepared to shop around.”

Are you sure you’ll get paid?

Totally risk-free, upfront payment is every exporter’s dream. Incredibly, it can sometimes be a reality. The Purist Company Pty Ltd has been exporting a range of safe, pure skincare and hair care for over two years, and it’s still the only form of payment they consider.

“We’re lucky in that we’re being chased for the product,” says Managing Director Catherine O’Keefe. “Rather than having to push into new markets we’re being pulled by demand, and that means we can trade on our own terms. At the moment, we insist on payment upfront in Australian dollars.”

Naturally, the company is keen to continue in this enviable state for long as possible. However, O’Keefe is aware that the US market may not be as accommodating as New Zealand, Hong Kong, the UK and even Brunei. “We’re just moving into the US now, and we know it will be our toughest test so far. We accept that we’ll inevitably have to start trading in US dollars before too long.”

For the majority of exporters, where upfront payment isn’t an option, Letters of Credit offer the required security.

“Here the bank takes on the buyer’s risk,” explains Evans. “As long as you comply with the terms of the agreement, you have an unconditional guarantee that bank will pay if your purchaser doesn’t.

“Because the bank pays as soon as the agreement is finalised, a Letter of Credit can also smooth out your cash flow,” he continues. “If your shipment terms are, say, 30 or 60 days, you won’t have to wait for your money.”

The cost of a Letter of Credit may be reduced if you and your buyer use different branches of the same bank – when you’re deciding on a bank, it could be worth choosing one with branches in the countries where you plan to trade. However, the costs involved may still make it more difficult for you to compete with local suppliers working with an open account.

HSBC’s Debtor Finance was developed to help exporters compete on the same terms. “You simply complete the contract then present the invoice to us,” says Evans. “We pay you in anticipation of receiving funds 30-60 days later. Just as with a Letter of Credit, we underwrite your credit risk. If the buyer doesn’t pay, we wear the loss.

“Debtor Finance can also be used to provide security for a trade loan to cover pre-shipment costs,” he adds. “This is a big issue for many exporters – we’ve known people to keep on investing in property just to provide security for the expansion of their export business. With Export Debtor Finance you simply use your receivables as security instead.”

Hedging for protection

When your contract is in place, your terms of trade are agreed and you’re confident you’re going to be paid, it’s time to think about hedging.

“Hedging is simply a way of protecting yourself against currency fluctuations,” says Peter Mace, General Manager NSW of the Australian Institute of Export Ltd. “When you have to wait for money to come in from overseas, you want to be sure you receive at least the same amount in Australian dollars as you would have done on the day the contract was agreed.”

“As with any insurance, it’s all about weighing up the probabilities,” says Matt Gilmour, Managing Director of www.ozforex.com.au, “and the first step is to establish exactly when exposure occurs.

“Say you’ve had an order for 10,000 widgets at \$1 each and you’re to be paid in US dollars. Your exposure is crystallised as soon as you strike the deal. From that point on you’re subject to changing dollar values. If the Australian dollar should strengthen before you receive payment, you’ll lose out. If you’re dealing in multiple currencies, you need to analyse all of your exposures.”

Your next step is to quantify the risk in relation to its impact on your business. “If 95% of your business is in Australia, the risk is relatively small. If your business is 100% export, the relative risk is very high, and you need to take that into account.

“Essentially, you have three tools at your disposal – Forward Exchange Contracts, Optional Exchange Contracts and Foreign Currency Accounts,” continues Gilmour. “There are other alternatives – derivatives, for instance – but these are generally too complex and expensive to be worth considering by a small to medium business.”

1. Forward Exchange Contract

A Forward Exchange Contract locks in the Australian dollar value of your overseas payment so you know exactly how much local currency you'll receive.

In effect, you're agreeing to sell one currency amount and buy another currency amount at an agreed rate on a fixed date in the future. The simplest way of protecting yourself against unfavourable currency movements, a Forward Exchange Contract can be written in most major currencies, and can cover the exchange risk between a foreign currency and Australian dollars or between two foreign currencies.

One downside is that, if rates should move in your favour, you will miss out on additional profits. It's also important understand that this is a contract to deliver a certain amount of currency at a specific time. If for any reason you don't have it – your contract falls through for instance – you may have to purchase foreign currency in order to fulfil the contract's terms. Depending on the shortfall, this could prove very expensive.

2. Foreign Currency Option Contract

If you prefer more flexibility, a Foreign Currency Option Contract gives you the right to sell a specified amount of one currency, at a fixed rate and time, just like a Forward Exchange Contract – but you're under no *obligation* to do so.

“With an optional contract, you know your worst case scenario, but there's no limit on your profit,” says Rob Rennie, Chief Currency Strategist with Westpac “If the rates go against you, you're protected. But if the rates go your way, you can simply decline to take up the contract and just pay the premium, as you would with any insurance policy.”

3. Foreign Currency Account

If you import as well as export and your payments and receipts are in the same currency, you're in the fortunate position of having a natural hedge. In this case, a foreign currency account could simplify your transactions and reduce the associated costs. According to Gilmour, it can also help with netting your foreign currency exposures.

“Imagine you're importing and exporting in euros. If you had to pay, say, 80,000 euros for raw materials but were due to receive 100,000 euros in payment for manufactured goods, your net risk is just 20,000 euros. A foreign currency account can work well in this situation – but you need to shop around for the best rates and transaction costs.”

No rights or wrongs

Rennie is concerned by rising volatility. “The Australian dollar fluctuated by 16 per cent over ten years then, last year, the fluctuation was up to 25 per cent,” he says, “and a number of factors suggest that this volatility could continue, or even increase. Global politics, terrorism, the US economy, oil, the importance of the Asian economy – both to Australia and the world, the risks of a policy accident in China and the fact that the Australian economy is so out of synch with the global economy all mean that

hedging or not hedging could be one of the more important decisions an exporter makes in the years ahead.”

“In this uncertain environment, we recommend that everyone looks at some level of cover,” says Wayne Raven, Global Manager, Corporate Foreign Exchange Sales at Westpac. “The people who get into trouble with hedging have generally entered into Forward Exchange Contracts, so we tend to favour the flexibility of Optional Contracts in times of change. But there are no right or wrong answers when it comes to managing risk.

“The first variable is your own risk profile,” he continues. “If you’re risk averse, you’ll want to insure everything. If you’re more comfortable with risk, you may just choose to take limited cover or remain uncovered. It’s important to let your bank know what you’re looking for.”

Too much of a gamble

As Managing Director of JD’s Seafood, Joe DeBelin exports Australian seafood to Germany, France, UK, Switzerland, Denmark, Belgium, Greece, India, USA, Russia, Dubai, Tahiti, Indonesia, Hong Kong, Singapore and Japan. With a single consignment containing as many as 17 species, his strategy is to provide a one-stop shop for the top five per cent of the world market – he shipped all of the Australian seafood for the recent Danish royal wedding.

“We used to trade in US dollars, but the fluctuations became too great,” he says. “When the Australian dollar strengthened we lost a lot of business. During October, November and December 2003, the momentum of Christmas kept us going. Then, in January, everyone backed off. We dropped 80% of our business almost overnight. We were just too expensive.

“Now we trade in Aussie dollars and let customers enjoy the benefits when it’s weak,” he continues. “At the moment, dealing in foreign exchange is too much of a gamble for us. We could probably make more money, but we’re fish traders, and we need to concentrate on what we do best. If we continue to grow we’ll probably have to think again, but we’d need to pay someone to organise that side of the business for us.”

In his willingness to stay both focused and open-minded in his response to movements in foreign exchange, DeBelin is avoiding a dangerous trap.

“Some people get greedy when it comes to foreign exchange,” says Rogers. “Companies have even gone down because of it. Rather than locking in a profit margin they believe they can beat the market, then they end up with a loss. Playing the foreign exchange market is gambling - you need to remember that your strength isn’t trading, it’s selling products overseas.”

“There will always be those who see hedging as losing an opportunity to make a fortune,” agrees Gilmour, “but we counsel them to think in terms of stabilising cash flow and minimising risk. Movements in foreign exchange are extremely difficult to predict even for an investment banker – and attempts at prediction can take up time

you'd be better off spending elsewhere. While you're watching the screens for best rate, you could have made another sale.”

Your risk management check list

- Do your research. You need to know everything there is to know about your competition, the market, the country and your customer.
- Shop around for a bank whose priorities are a good fit with your own. Don't be afraid to ask questions. You need to feel you're working in partnership with your bank, and that you can talk to your contacts there whenever you need help or advice. If they don't seem particularly interested when you make your initial inquiries, look elsewhere.
- When you've decided on a bank, use it. Get advice. Bring them in at the planning stage, and have them run credit checks on anyone who's likely to owe you money. Remember, they want you to get paid almost as much as you do.
- Establish your preferred method of payment and terms of trade.
- Define the risk associated with the transaction. You need to be clear about when the exposure occurs, its relative significance in terms of your overall business, and whether the risk is balanced by any form of natural hedge.
- Put your hedging strategy into action as soon as you're exposed.
- Focus on your core strengths – selling products or services overseas. Leave gambling with foreign exchange to the experts.