



Simply Treasury

WHITE PAPER

FOCUS

**DYNAMIC FX MANAGEMENT
IN A FAST-MOVING ENVIRONMENT**

SPOTLIGHT

VOICES OF THE INDUSTRY

COMPLEXITY

"Foreign Exchange exposures management remains essential in an extremely volatile economic context to preserve our business margins."

Marc Pescarolo, FERRERO

MANUAL PROCESSING

"We notice that among our community, a lot of peers have still heavy manual processes around FX management."

Benoît Hamar, EUROFOIL

VOLATILITY

"Although we have always faced market fluctuations, the current health crisis has exacerbated the volatility, which can have deep P&L impacts if not properly hedged or monitored."

Fabrizio Dicembre, 3Ppark

REPORTING

"Effective reporting on FX management (i.e. financial and accounting/IFRS) requires ad hoc IT tools and often more than what TMS's are proposing."

François Masquelier, EACT

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Chairman of Luxembourg Treasury Association (ATEL)
and Chairman of EACT



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INTRODUCTION



It is interesting to remember that FX risk has been identified by PwC in its previous Global Surveys as the third most prioritised risk in 2017 & 2019, and the fourth in 2021. It demonstrates that this risk remains high on treasurer's top priority list.

As rightly said by a former CFO of Microsoft, "FX is the hardest job in finance". For corporate treasurers it is obviously also essential. Foreign Exchange (i.e. FX) is, above all, an operational risk.

FX calculation, accounting and management will depend on three main factors: (1) people, (2) processes and (3) IT systems and solutions. These three important elements are often weak or even missing in treasury teams. All Heads of Treasury complain about a lack of human resources. FX processes remain highly manual (mainly the pre-trade part) and too often EXCEL-based. Even if they used sophisticated Treasury Management Systems or FX platforms, they do not have appropriate functionalities for automating processes and producing reports. Treasurers very seldom cover the whole FX hedging process from the pre-trade phase and execution to the post-trade phase.

FX management is also complex because of the lack of visibility in identifying and reporting risks at subsidiary level (i.e., pre-trade phase). Treasurers still face difficulties in automating the reporting of

such risks, allocating hedges to underlying exposures, tracking net exposures, getting revaluation mark-to-market of portfolios and reliable cash-flow forecasting in foreign currencies. In a post-COVID period and with a war in Eastern Europe, it's even more complicated to ensure the accuracy of FX forecasts, given the number of uncertainties around solvability of customers, delays in deliveries caused by lockdowns, shortage of raw materials, etc. Time is becoming a real issue in FX management. With current volatility and high intraday volatility, any delay can cause huge P&L impacts. The strategic role of the treasury function has been reinforced by the health crisis. It was the perfect example to illustrate the "raison d'être" of treasury. Treasurer's roles have been repositioned within the finance department. FX management is clearly an area where treasurers can demonstrate added-value to their company. For example, by invoicing all customers in their local currencies and accepting invoices in their supplier's local currency, treasury gives a competitive advantage to the operating businesses. The current volatile environment also gives the opportunity to revisit and revamp FX management strategies to mitigate potential P&L impacts. By automating pre-trade processes, the treasurer can hedge exposures one-by-one 24/7 and automatically hedge underlying exposures when identified.

IN SHORT

FOREIGN EXCHANGE

Forex markets daily turnover

6,6
TRILLION USD

FX market is the only financial market in the world to operate

24
HOURS A DAY

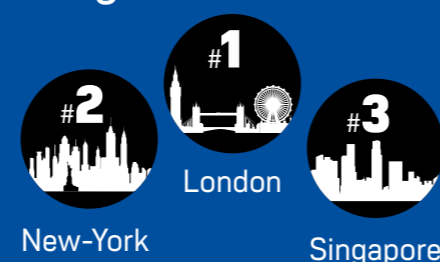
It comprises of

170
different
currencies

USD is on one side of
88%
of all forex trades

7 currencies pairs make up
68%
of the forex markets trading volume

Largest centres are



One pip worth roughly
70\$
PER MILLION



“**Adopting a more dynamic and automated solution for FX management generates value.**”

(Source: CompareForexBrokers - Justin Grossbard)

Antonio Rami, Founder & Chief Growth Officer at KANTOX
Adopting a more dynamic and automated solution for FX management generates value



INTERVIEW

Do you think that there are opportunities for partnership between banks and Fintech's, for example on improving FX management?

Yes. We are a living example of that with our BNP Paribas and SVB partnerships. Many banks understand the needs of the corporates they serve, by providing upgraded technology to support those corporates as well as themselves in the digitalization journey. This is particularly relevant in the area of FX management since the only automation that occurs here is

“**The benefits here lie in three dimensions: Cost, risk reduction and growth.**”

the possibility of serving customers through an SDP or MDP, thus only supporting the strict trade execution part of the workflow.. By having a different perspective, some banks have realized that the real need of the corporate is to streamline the entire end-to-end process. Banks have a massive client portfolio and are perceived as trustworthy enterprises with whom to do business with. How-

ever, it is these factors which act as the main challenge to overcome for many fintech solutions. These partnerships make it much easier for the client to make decisions and embark on the digitalisation journey.

How would you explain the concept of “dynamic hedging”?

Kantox Dynamic Hedging® is the product we have built and will continue to build on so corporates can fully automate the workflow of managing currencies. We have engineered a product that will ‘vacuum’ all the FX exposures that a corporate has as soon as they arise (e.g. forecasts, firm commitments, balance sheet items). We can do this from any system where this information might be located (ERP, TMS, sales order system...) and from as many en-

ties/subsidiaries this can be generated from. Through this process, Kantox Dynamic Hedging® sets up the necessary processes to maximize data quality on which the hedging will be executed. In short, it enables exhaustive, timely, granular, and validated exposure capturing. In parallel, to have all these exposures retrieved, Kantox’s Dynamic Hedging® will enable any corporate to construct their ideal hedging program through the configuration of a few simple rules. This ranges from the simplest rolling, layered or micro-hedging program, to the most elaborate such as dynamic layering, which helps companies minimize negative carry combined with balance sheet programs. This enables companies to eliminate the risk of not adhering to the defined policy, as well as massive time savings, full traceability, and governance over the topic.

Do you think that a revisited FX management process (i.e. more automated, centralized, and dynamic) can bring added value to the operating businesses?

Of course. The benefits here lie in three dimensions: Cost, risk reduction and growth. In general, we can see by automating these processes; companies can turn something that is usually perceived as a burden to be managed by the treasury team into an advantage. This result is increased sales, higher margins, and above all, a more robust company that will not suffer from currency volatility no matter how internationalized it is.



CHALLENGES

- ⊕ The absence of technology is a classic and typical problem faced by treasurers. Even with Treasury Management Systems, treasurers must often have recourse to additional tools, applications, or spread-sheet developments. Some IT vendors have bought solutions to complement their treasury suite. FX management remains, in general, too Excel dependent, not robust enough and error-prone.
- ⊕ Uncertainties around businesses and reliability of cash-flows in currencies
- ⊕ The economic context is changing faster and faster.
- ⊕ Political risks also increased in recent years. Therefore, currency fluctuations have also increased significantly over previous months. It remains a "classic" but prime risk for corporates to manage.
- ⊕ The impact of swap points (depending on your position) with certain currency pairs may affect the price, increase costs of hedging or simply be a stop.
- ⊕ Difficulty to monitor open positions (if any) e.g. when differential of interest is too large or tenor too long.
- ⊕ Absence of perfect coordination and gaps between exposure and hedging (lack of communication may appear with home-working).

WHAT ARE THE TOP PRIORITIES OF TREASURERS TODAY?

WE CAN IDENTIFY 4 MAJOR ONES:

1. Liquidity management and funding,
2. Working capital optimization,
3. Cash-flow forecasting accuracy and eventually,
4. FX exposure management.

They are all interconnected. The crisis crystallised the demand for a more dynamic and automated management of treasury and more specifically of FX hedging. Treasurers are there to ensure liquidities, to guarantee outflows execution and protect margins against FX fluctuations. Through proactive management, treasury can become a "revenue protector", to play a more strategic role as stakeholder, to be a partner of the operations, giving, if possible, a competitive advantage to business operations.

TO HEDGE OR NOT HEDGE? THAT IS THE QUESTION.

We should accept that not hedging is not an option. Markets have become more/too volatile since the COVID crisis and the war in Ukraine (e.g., trade wars transformed into budget wars, liquidity issues, USD challenged as the world reserve currency, increasing interest rates in all major currencies, uncertainty consequences of health crisis, etc...). There are many reasons to think it will continue to accelerate in the future with daily and more extensive corridors of fluctuations. It requires a smarter approach to be successful. FX management remains so important for all multinational companies that it requires a more dynamic approach and more automation. The good news is that there are solutions, and if effectively used, treasurers can even add value to FX hedging, if done properly. New IT solutions, the so-called "Currency Management Automation" systems, offer means to enhance FX management. By revamping and automating further its FX management, treasury can play a more strategic role, closer to operating businesses.

TAKE AWAYS

HOW TO PROTECT AND ENHANCE PROFIT MARGINS WHILE IMPROVE COMPETITIVENESS?

In low profit margin businesses giving competitive advantage to operations is fantastic. Margins are sometime so low that unexpected FX movements can kill the whole operating profit. You can build on technologies and leverage them to optimise your FX management. But you need solid forecasts and a robust solution, including automation to free up the time of teams and reduce risks of errors, while reinforcing internal controls. Discipline and respect for strategy are critical. You have today an opportunity to revisit and revamp your FX management. Outsourcing is a solution to compensate the absence of resources, processes, and systems. There are many factors to optimize FX management: fluidity of data exchanged, good knowledge of processes and underlying businesses (often not understood by finance people), identification of natural hedges if any, process automation to simplify tasks and agile tools to refine hedges and to continuously adjust positions which will fluctuate. As you can see, it is a major risk (and it is bad news) but there are solutions (and that is the good news). It may be time to revamp your FX management and to implement IT solutions to automate all processes and adopt a (more) dynamic management to generate added value to operations.



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