

YOU NEED SENSE

E=MC2: EVEN A GENIUS WILL FIND IT DIFFICULT TO

MARTIN Chesno is slap bang in the middle of currency fluctuations. His business, the Mulberry Silk Company, buys pure silk duvets from Zhenze, China, and sells them on his website. About 80% of his sales are in SA, but because his website advertises prices in euros, Martin has been able to sell his duvets as far afield as New Zealand — with regular shipments to Canada.

Every time the rand weakens, Martin gets more money for the duvets he sells abroad. In October this year, the rand fell nearly 20% against the dollar. Martin earned about 20% more — in rands — for every one of his duvets he sold in Europe or North America. The flipside is that he also had to pay 20% more for each duvet he bought from China.

HINDSIGHT IS 20/20

Had he been able to predict the future, Martin could have secured the rand price at the beginning of October. He could've done this by taking out insurance against the increase in the price of dollars. But then, hindsight is always perfect.

"If I knew two months ago that this was going to happen, I would have locked in the stronger rand rate," Martin said. "Then I'd be rolling in profit."

When Martin has a big local contract he typically opens a forward exchange contract with his bank in order to lock in the value of the dollar (in which he does business with his Chinese supplier) against the rand. This equates to putting in an early order — before a scheduled annual price increase, but only paying once the goods are delivered. Martin only pays for his dollars when he needs them to pay his supplier, but his bank can tell him upfront how much he'd need to pay for each of those dollars. And that can be crucial to his business.

Knowing exactly how much his products will cost in rands — takes the risk out of the equation. So while he can't predict currency movements, he can at least protect himself against their worst effects.

WHEN INSURANCE DOESN'T KEEP UP

But that is not always the case. When the rand fell 20% against the dollar in October it had nothing at all to do with small business owners or with SA; the change was mostly thanks to stupid decisions at large American banks. But it affected every local business imaginable, often in ways that are difficult to guard against. Importers had to pay more and exporters made more, but as the value of the imported goods increased, a new risk was uncovered.

A lot of businesses, and the replacement value of their imported stock or their imported equipment suddenly shot up, but their insurers didn't," says Neil Goodall, a manager at Lion of Africa Insurance.



WIN SOME, LOSE SOME: Martin Chesno's business has gone global, and so has the cost of buying his products abroad whenever the rand takes a dip, as he pays for his product in dollars. Picture: DAVID HARRISON

When the dollar sneezes, your business can catch a severe cold. **Phillip de Wet** speaks to a silk duvet marketer who needs to protect himself against currency fluctuations

Even if things go wrong months from now those businesses might still be in trouble. Many business insurance policies will include an annual automatic increase, but it is rare for those increases to be more than 10%.

Which means that if your warehouse burned down you'd still need to find R10 000 extra to replace what was R100 000 worth of stock in October, and for which your insurer will now pay R110 000, even though it costs R120 000.

HIDDEN COSTS

Insurance is a good illustration of the hidden costs of currency fluctuations, but the impact goes much deeper.

A change in the value of the rand will almost immediately reflect on the local prices of goods like computers or commodities like steel. The price of petrol and diesel isn't far behind.

But in a globalised economy, all goods are eventually affected; agricultural output, because food

stuffs can be exported if local prices don't stay on track with those elsewhere; manufactured goods, because raw materials become more expensive and, eventually, labour costs follow thanks to general inflation.

But while it is hard to protect your business against an increase in petrol prices or labour costs, it is easy to fend off exchange rate fluctuations directly — which is why banks are so frustrated when customers don't.

RUSSIAN ROULETTE

"Exporters see that the rand weakens sometimes, so they decide to take the risk themselves because they can make money that way," says Stephen Meintjes, general manager of customised trade solutions at Nedbank.

"That is the same as putting a bullet in a [revolver] and playing Russian roulette with it."

On that, financial advisers are in total agreement: trying to time the currency markets is a fool's game. The rand is an especially volatile currency, with prices changing upwards of 10 times a second and huge — and often unexplained — swings happening every so often.

Businesses that choose not to shoulder that risk can, relatively cheaply, eliminate it almost entirely.

Banks may not be able to provide typical forward exchange cover for very small transactions, Stephen said, but there is usually a mechanism through which the current exchange rate can be locked in, for import or export.

REDUCE YOUR RISK

Exporters can also take out insurance that will cover the revenue due from a transaction in rands at an agreed rate.

"We don't become involved in the negotiation of an exchange rate, but we will cover a shipment at the forward exchange rate covered by the bank," said Theo Reddi, senior manager for export at Credit Guarantee, which underwrites debtors.

"If the buyer defaults, we'll cover the claim at the value of that exchange contract."

When it comes to insuring stock or machines there is no product that will cover any eventuality, Paul says, because insurance companies cannot accept unlimited liability.

There are, however, ways of reducing the risk.

"When you insure, consider the valuation not in today's terms but on the likely value of that asset in the future."

"That is hard to do, which is why we as an industry try to provide an incentive to err on the side of caution and rather over-insure."

One such mechanism is declaration-based insurance, which takes into account varying stock levels and comes with discounted monthly premiums (usually a discount of 2%) and an end-of-year payment based on the average monthly stock declared.

Building in some extra cover in the maximum amount the insurance policy will pay out can make room for sudden currency swings.



TELL US: Are you trading abroad and has the currency fluctuations affected your business? Write to editor@itsmybusiness.co.za