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Currency risk management

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***Abstract*— Effective risk management is becoming a key element of running a business, as an incorrect approach can lead to financial problems. In the global economy, companies use various strategies to reduce currency risk.**

The article analyzes currency risk in order to determine the most beneficial method of reducing the occurrence of this type of risk.

The analysis was based on survey research. The study aimed to identify the most effective strategies and methods for minimizing currency risk and assess their impact on the financial result and competitiveness of economic entities.

The results provided important information on currency risk management practices, which may be useful for further analysis and practical recommendations.

The first part of the article discusses currency risk and risk management, and the next part discusses the research results.

Keywords— risk, currency risk management

I. INTRODUCTION

Ensuring stability in the financial area is possible provided that effective and efficient supervision and control are in place in this area. The basic task of the company's managers is, above all, to ensure a sense of security in relation to financial undertakings undertaken in connection with the conducted business. The issue of risk, including currency risk, covers a wide range of issues, starting from defining the functions it is to fulfill, through outlining the subject and entity covered by the risk, to issues related to currency risk management (N. Dubiel, 2024, p. 27).

The extensive and multi-threaded theory of risk indicates its inextricable connection with action. All actions concerning risk management should be actions taken in advance of the occurrence of events. Considering risk in business activities should be long-term and consistent with the enterprise management strategy. Risk management is the search for opportunities and threats located in the enterprise's environment and the strengths and weaknesses of the organization (Iwaszczuk, 2021, pp. 5-6).

One common type of risk that many businesses face is currency risk, also known as exchange rate risk. It can be described as unforeseen changes in the exchange rate of one currency against another. These fluctuations can cause a decrease or increase in the value of receivables or expenses, which can lead to a decrease in revenue. The essence of currency risk management is to prevent, minimize, or eliminate threats that appear in this area.

The aim of the article is to analyse currency risk and determine the most advantageous method of reducing the occurrence of this risk as well as to assess the impact on the financial result and competitiveness of economic entities.

The article uses a systematic literature review method. The research material is Polish and foreign literature and the research method is a survey.

The proposal is to provide a kind of support for improving procedures and principles aimed at helping to establish the most advantageous technique for hedging against currency risk. The article is an introduction to further discussion and research on the state of currency risk management in Poland.

II. LITERATURE REVIEW

A. Risk

Risk is one of the most important factors influencing the economic activity of entities and over the years it has been the subject of various analyses and interpretations aimed at characterizing this difficult phenomenon. It is a complex and ambiguous concept, therefore it is very difficult to provide one

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precise definition (Culp, 2001, p. 3).

Certain sectors of the economy are not only regulated by rigid legal regulations, but also by standards (norms) that have a strict meaning and application. In addition to those systems that were oriented towards risk reduction from the very beginning, e.g. safety management or business continuity management, one can observe an orientation towards risk management in standardized management systems, e.g. quality, where risk management gains the status of an important function. Hence, the issue of the organization's relationship with the environment is of key importance in the process of integrating management systems in the context of the organization's activities and interested parties (Jedynak, 2015, pp. 330-332).

Nowadays, increasingly stronger connections are noticeable between the real sphere (the market of goods and services) and the financial sphere (the market of financial services). The increased mobility of financial capital, moving freely between countries mainly in the form of operations on capital markets, contributes to the increase in risks related to currencies, interest rates and price risk on the market, which in turn generates problems on the market of goods and services (Iwaszczuk and Brożyna, 2022, p. 17).

A change in the assessment of economic prospects leads to an outflow of capital and a depreciation of the currency, which can be significant, especially during currency crises. A sharp decline in the value of the local currency and an outflow of foreign capital cause problems in the financial system, which spread to the stock exchanges and the banking sector. In such a situation, monetary policy is tightened, which results in an increase in interest rates, transferring problems to the goods and services market. Currency crises can cause economic difficulties even in countries with good economic conditions, and the close links between the financial market, and the real sector strengthen crisis impulses (Kaszuba-Perz and Perz, 2010, p. 59).

For many companies, domestic markets have become insufficient to ensure further development and growth in economic value, which is why they are increasingly expanding their operations beyond their own country, which is reflected in a significant increase in sales and a positive impact on the margins achieved by the entities. The free flow of goods, services and capital has led to a significant increase in trade turnover, which has contributed to the development of domestic companies. However, operating on foreign markets is associated with new risk factors. One such factor is the risk related to currency fluctuations, which may affect the profitability of the company. Awareness of this risk should encourage companies to develop appropriate risk management strategies, although this may be a challenge (Filipiak, 2017, pp. 7–9).

B. Currency Risk Management

Modern risk management emphasizes the importance of adopting a risk-neutral concept that treats risk as both a threat and an opportunity. A proactive approach to risk can benefit a company and increase its competitiveness in the long run (Riehl, 2001, p. 8).

Companies often create dedicated units to develop risk management strategies that include identifying financial threats and taking actions to limit or mitigate their effects. In this context, derivatives play an important role as risk protection tools. A key element is the appropriate development of contract clauses related to the subject of delivery, quality parameters and possible guarantees. Risk management therefore requires the development of consistent procedures and remedies, becoming a key element of importers' and exporters' analyses (Ksendzuk, 2017, p. 61).

Insufficient commitment of the company in using the currency risk mitigation strategy may be caused by various factors. The complicated process of currency risk management requires specialist knowledge in the field of management accounting and knowledge of derivatives, which generates additional costs. Additionally, negative experiences related to the financial crisis of 2008/2009, when currency options were a popular tool, may reduce the willingness to use them. The depreciation of the domestic currency and the strengthening of foreign currencies had a negative impact on companies that used currency options as a strategy to improve their financial results, and not as a form of securing actual commercial transactions (Filipiak, 2017, pp. 8–9).

The basic benefits of currency risk management are:

- Reduction of profit and cash flow fluctuations, which facilitates the planning process in the enterprise by eliminating or limiting the impact of exchange rate changes on revenues obtained or costs incurred.
- Effective risk management allows determining the value of future cash flows, and favorable exchange rates can lead to higher profits.
- Improved conditions for managing financial liquidity and eliminating additional financial costs.
- Increased awareness of speculative risk among senior staff, which leads to an improvement in the decision-making process (Miciuła, 2012a, p. 62).

The first step to take any action in the matter of risk management is to identify its factors and the entity's exposure to risk. In practice, there is no ideal method of hedging against currency risk that could be universally applied by the company in all situations. The choice of the appropriate method depends mainly on the type of risk, the size of the company, its involvement in foreign transactions, the efficiency of the currency market, the competence of the risk management staff and the preferences regarding the use of various instruments (Misztal, 2004, p. 68).

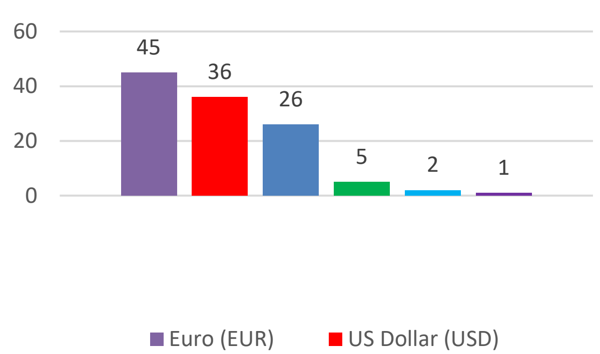
The process of managing currency risk in an enterprise consists of several stages. The first is the analysis of currency risk, which includes the identification and description of the risk and measurement of its scale. Then, decisions are made regarding risk hedging, based on the risk map and the budget of estimated costs. The next stage is the control, monitoring and evaluation of the actions taken, which is important for reporting the effects and recommendations regarding currency risk hedging. The risk management system should be transparent, practical and adapted to the strategic goals of the enterprise, and its interaction with other departments, such as foreign trade and accounting, is crucial for the effective functioning of the company (Ksendzuk, 2017, pp. 65–66).

III. Results

Most companies that took part in the survey conduct settlements in a currency other than the domestic one. This constitutes 85.7% of all responses. Only 14.3% of companies declared that they do not conduct this type of settlement.

The survey asked respondents whether their companies deal in currencies other than their domestic currency. The answer to this question is important from the perspective of currency diversification in international business. The choice of different currencies can be crucial for trading strategies and currency risk management. If the answer is positive, the main currencies used by these companies were investigated. The answers to the question about the main currencies used by companies are varied and include different combinations of currencies. The analysis reveals several conclusions. The Euro (EUR) is the most common currency among the responses, suggesting that it is commonly used in international transactions by the surveyed companies. The US dollar (USD) also appears frequently, indicating its importance to the businesses, especially in the context of international trade. The British pound (GBP) is also mentioned in many responses, suggesting that businesses operating internationally often transact in this currency. Other currencies, such as the Czech crown, Swiss franc and Japanese yen (JPY), also appear in the responses, indicating the variety of currencies handled by these businesses. The conclusion from this data is that companies conducting foreign currency settlements use a variety of currency combinations, which may be a result of the global nature of their operations and the related need to serve different markets and counterparties. Chart 1 shows the dominant currencies used in foreign settlements by the companies participating in the study, illustrating the most commonly used currencies in international transactions.

Chart 1. Dominant currencies in foreign settlements



Source: own study based on survey

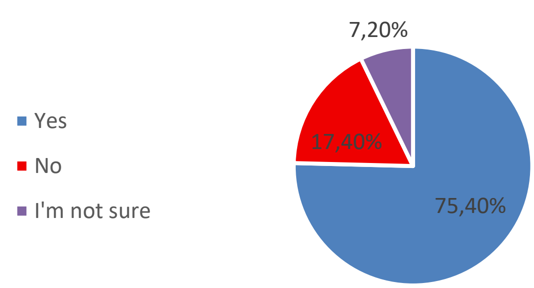
The majority of respondents (75.4%) believe that their company is exposed to currency risk. This clearly indicates that a significant proportion of companies are aware of the potential risks associated with currency fluctuations. These companies are likely to be involved in international transactions or operate in markets where currency volatility may affect their operations. This also suggests that these companies should actively employ currency risk management strategies to protect themselves from the adverse effects of these changes. Less than one-fifth of respondents (17.4%) believe that their company is not exposed to currency risk. This may mean that these companies operate mainly on the domestic market, do not engage in international transactions, or already have effective currency risk hedging strategies in place. Alternatively, it may also indicate insufficient awareness of the actual currency risk.

A small proportion of respondents (7.2%) are not sure whether their company is exposed to currency risk. This indicates the need for increased awareness and education on currency risk in these companies. The lack of certainty about the risk exposure may be due to insufficient knowledge or complexity of currency operations in the company.

A significant percentage of companies (75.4%) are aware of currency risk, which indicates the need for continued education and training in managing this risk. Companies need to be well-informed to effectively manage risk and minimize its negative effects.

Chart 2 illustrates how companies assess their exposure to currency risk, which is key to planning and implementing effective risk management strategies to protect against the negative effects of currency changes.

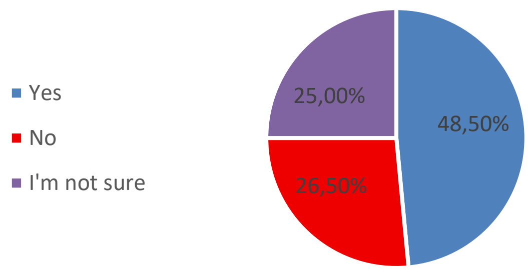
Chart 2. Assessment of entities' exposure to currency risk



Source: own study based on a survey

Chart 3 presents the answers to the question "Does your company have a currency risk management policy?" " Analysis of the results shows that 48.5% of respondents gave an affirmative answer, which means that almost half of the companies have a currency risk management policy. This is a positive phenomenon, suggesting that many entities are aware of the risk related to currency fluctuations and take actions to control it. In turn, 26.5% of respondents gave a negative answer, which indicates that more than a quarter of companies do not have a formal currency risk management policy. The lack of such a policy may mean that these companies are more exposed to the negative effects of currency changes or do not conduct settlements in foreign currencies and feel the need to manage currency risk. However, as many as 25% of respondents said they were not sure whether their company had a currency risk management policy. In summary, the results of Figure 3 indicate a significant awareness of currency risk among the surveyed companies, but at the same time they highlight areas requiring improvement, such as increasing the number of companies with formal risk management policies and educating employees about existing policies.

CHART 3. ANALYSIS OF THE PRESENCE OF CURRENCY RISK MANAGEMENT POLICY IN COMPANIES



Source: own study based on a survey

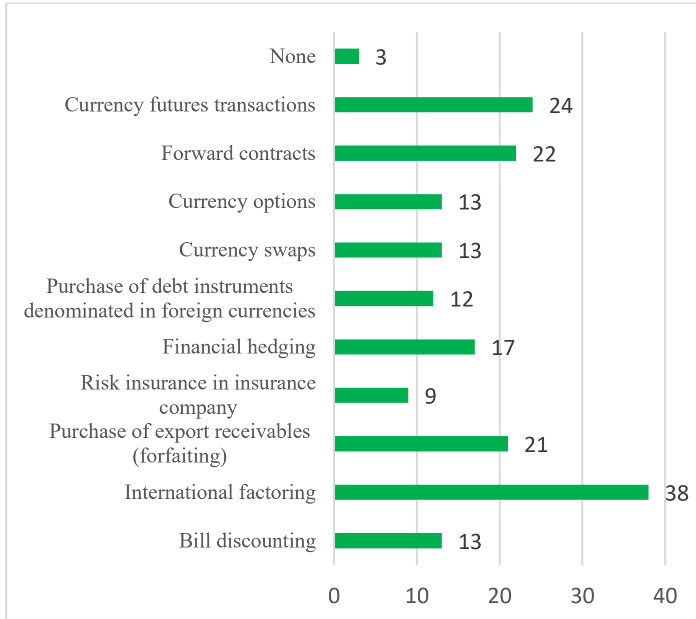
To sum up, the analysis of the presence of a currency risk management policy in enterprises is a strategic element of the study, which enables a comprehensive understanding of the readiness of enterprises to cope with this type of risk in their organizations and may indicate areas requiring further educational and regulatory activities.

To understand which tools are most commonly used by companies to manage currency risk, an analysis of various available financial instruments was conducted. Respondents were asked about the methods and tools they use. The results of the study show which techniques are the most popular and which are less used. Chart 4 shows the extent to which companies use different tools to manage currency risk, such as hedging or forward or futures contracts. This analysis allows us to understand which tools are more popular and effective than others. Analysis of the results regarding the main tools for managing currency risk in companies shows that companies use a variety of strategies and financial instruments. The most frequently used tool is international factoring, which was indicated by 38 respondents. This result suggests that many companies value the possibility of immediate financial liquidity and protection against the risk related to late payments from foreign contractors.

The second most commonly used tool is currency futures, indicated by 24 respondents. These transactions allow companies to protect themselves against unfavourable changes in currency rates by setting the exchange rate for a future date. On the other hand, forward contracts were mentioned by 22 respondents, which also confirms the popularity of this tool as a hedge against currency fluctuations. Purchase of export receivables (forfaiting) is another common tool according to the survey, used by 21 companies. Forfaiting allows companies to sell their future export receivables at a discount, which eliminates the risk associated with trade credit. Financial hedging, which was indicated by 17 respondents, is another popular method of hedging against currency risk.

Currency options, currency swaps, and bill discounts were selected 13 times each. Currency options give companies the right, but not the obligation, to exchange currencies at a predetermined rate, providing flexibility in managing this type of risk. Currency swaps allow two parties to exchange currencies on specified terms, which can be useful in long-term obligations. Bill discounts allow companies to obtain cash before the bill matures.

CHART 4. ASSESSMENT OF THE DEGREE OF USE OF VARIOUS TOOLS FOR CURRENCY RISK MANAGEMENT



Source: own study based on survey

The purchase of debt instruments denominated in foreign currencies was indicated by 12 companies, which indicates the use of a strategy consisting in investing in debt in currencies in which the companies conduct operations.

Risk insurance in insurance companies, with 9 responses, shows that few companies from the survey prefer to bear (often quite high) costs and transfer currency risk to insurers.

Three companies indicated that they did not use any tools to manage currency risk, which may suggest lower exposure to currency risk, lack of awareness of available financial instruments or no settlements in foreign currencies and therefore no exchange rate risk.

In summary, these results show that companies use a wide variety of tools to manage currency risk and often use more than one solution, with the greatest emphasis on international factoring, futures and forward contracts. The choice of these tools reflects the need to hedge against exchange rate volatility and to improve the financial liquidity of economic entities conducting transactions on the international market.

IV. . EVALUATION OF THE EFFECTIVENESS OF CURRENCY RISK MANAGEMENT STRATEGIES

In order to understand how currency risk affects financial results of companies, respondents were asked about the effectiveness of applied hedging strategies. Respondents were asked to rate, on a scale of 1 to 5, the extent to which currency risk affects financial results of the company. Chart 5 presents a comparison of the average rating of effectiveness of hedging strategies against currency risk, which allows for an assessment of the general level of confidence of respondents in the current actions used to manage currency risk in the company.

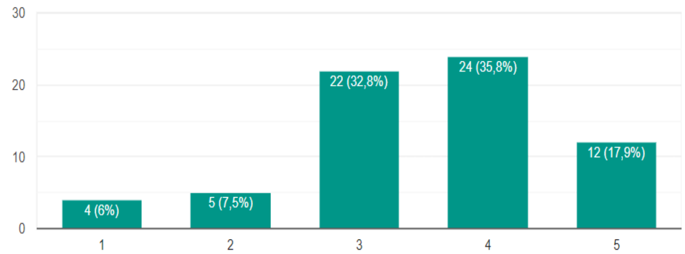
CHART 5. COMPARISON OF THE AVERAGE EFFECTIVENESS RATING OF THE CURRENCY RISK HEDGING STRATEGY

Source: own study based on a survey

The analysis of the results of the effectiveness of the hedging strategies conducted by the entities suggests that the majority of respondents consider their currency risk management strategy in the company to be effective. The largest number of responses were received in category 4 (28 responses), which indicates the level of trust in the methods of limiting currency risk in the surveyed entities. It is also significant that a total of thirty-nine responses (eleven in category 5 and twenty-eight in category 4) assess the strategy as effective. However, there is also a smaller group of respondents who chose lower ratings: five responses in category 2 and two responses in category 1.

Respondents also assessed, on a scale of 1 to 5, how significant the changes in exchange rates are to the results achieved by their companies. Chart 6 illustrates the assessment of the impact of currency risk on the financial results of companies. Analysis of this chart allows us to understand the extent to which companies feel the effects of currency fluctuations in their financial results. A part of the respondents (6%) believe that currency risk has no impact on the financial results of their company. Another group of respondents with five votes (7.5%) assesses that the impact of changes in currency rates is small, which may suggest that this risk is of minimal importance to their companies. On the other hand, a significant part of the respondents (32.8%) believe that currency risk has a medium impact on the results achieved by companies, which may indicate medium awareness of the significance of this issue. A relatively large group of respondents with twenty-four votes (35.8%) consider that currency risk has a significant impact on their company's results, which suggests that they are aware of the significance of this risk for their financial stability. In addition, 17.9% of respondents consider that currency risk has a very high impact on the company's financial results, which shows that for some respondents this is a key issue, as they conduct a significant amount of transactions in foreign currencies. The largest group of respondents (54% in total) assessed the impact of currency risk on the company's financial results as significant (ratings from 4 to 5), which suggests that the majority of respondents consider currency risk to be an important factor influencing the financial condition of the company.

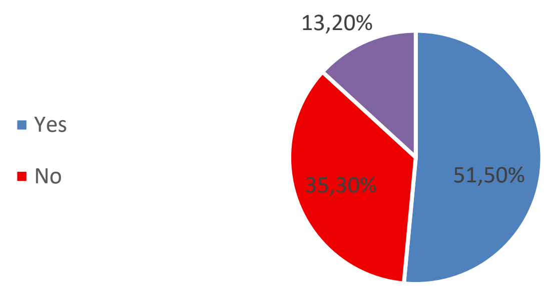
CHART 6. ASSESSMENT OF THE IMPACT OF CURRENCY RISK ON THE FINANCIAL RESULTS OF COMPANIES



Source: own study based on survey

The analysis of the presence of a currency risk management team in companies allows us to understand the organizational structure and approach to currency risk management in the surveyed companies. Chart 7 presents the percentage of companies that have a designated person or team responsible for currency risk management and those that do not have such a team or are not aware of its presence in the organizational structure of the company.

CHART 7. ANALYSIS OF THE PRESENCE OF THE CURRENCY RISK MANAGEMENT TEAM IN COMPANIES

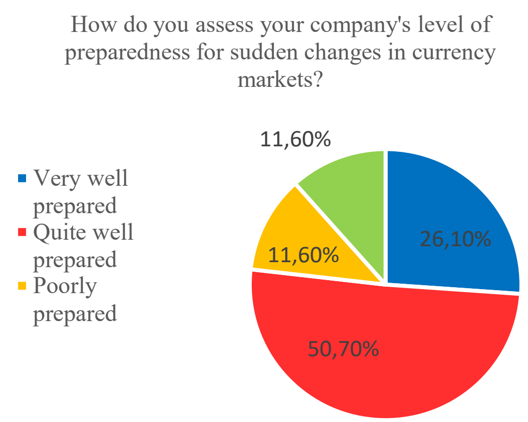


Source: own study based on survey

More than half of the respondents (51.5%) confirmed that their company has a designated person or team responsible for currency risk management. This suggests that most companies recognize the importance of currency risk management and are involved in consciously taking action in this area. At the same time, there is a significant number of companies (35.3%) that do not have a designated team or person responsible for currency risk management. This may indicate a need for greater engagement in this area and increased awareness of the benefits of professional FX risk management. The undecided group of respondents (13.2%) is a minority, but suggests there is some uncertainty or lack of clarity within firms about the existence or role of a FX risk management team. Overall, there is scope for improvement in FX risk management within firms, both through greater engagement and improved communication and awareness of the issue.

Analyzing the level of preparedness of companies for sudden changes in currency markets provides an understanding of the readiness of companies to respond to unexpected changes in the currency environment. Chart 8 shows the percentage of companies that are classified as very well prepared, fairly well prepared, poorly prepared and those that are not sure about their level of preparedness. This is a key tool for assessing the stability and flexibility of companies in the context of currency market volatility and identifying areas that may need to be strengthened to better cope with sudden changes in the currency market.

CHART 8. ANALYSIS OF THE LEVEL OF PREPARATION OF COMPANIES FOR SUDDEN CHANGES IN THE CURRENCY MARKET

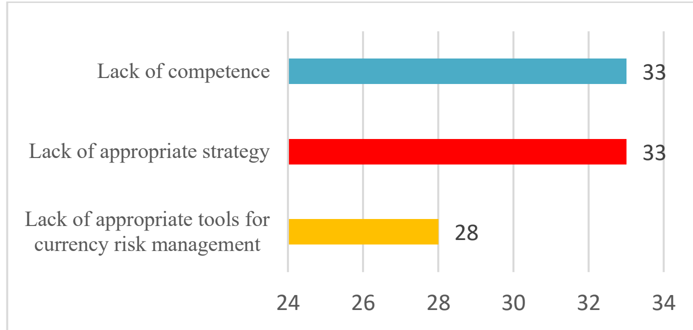


Source: own study based on a survey

When analysing the results obtained, it can be seen that the largest group of respondents, as many as 35 people, assessed the level of preparation of the company for sudden changes in currency markets as quite well prepared. On the other hand, 18 respondents considered their company to be very well prepared for such changes. Poorly prepared was assessed by 8 respondents. In addition, 8 respondents also expressed uncertainty about the level of preparation of their company. In total, the results show that the majority of respondents (a total of 53 people) assessed the level of preparation of their company for sudden changes in currency markets as satisfactory (quite well prepared or very well prepared). This may indicate that most companies are able to respond appropriately to sudden changes in the currency environment, which may be the result of using appropriate risk management strategies and having flexibility in decision-making. At the same time, there is a group (16 people) who described the level of preparation as unsatisfactory (poorly prepared or uncertain). This may suggest that some companies may not be adequately prepared for sudden changes in currency markets, which may lead to negative consequences for their business, such as financial losses or increased risk.

The presentation of the main challenges in currency risk management, divided into individual categories, is presented in Chart 9. The results show that the main challenges are the lack of appropriate tools for currency risk management, which was indicated by 28 respondents, the lack of an appropriate strategy, which was also indicated by 33 respondents, and the lack of competences in the area of currency risk management, noted by another 33 responses. These results show that companies face different challenges in managing currency risk, both in terms of tools, strategies and competencies. Analyzing this data can help companies identify areas that require improvement and develop appropriate strategies to effectively manage currency risk.

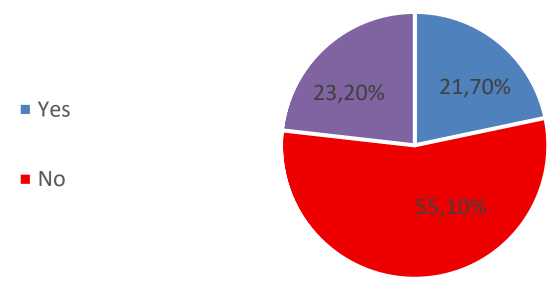
CHART 9. PRESENTATION OF THE MAIN CHALLENGES IN CURRENCY RISK MANAGEMENT BY CATEGORY



Source: own study based on survey

The last question for respondents was whether their company uses the services of companies specializing in currency risk management. Chart 10 presents the percentage share of companies that answered this question in the affirmative.

CHART 10. PERCENTAGE SHARE OF COMPANIES USING THE SERVICES OF COMPANIES SPECIALIZING IN CURRENCY RISK MANAGEMENT



Source: own study based on a survey

Analysing the answers to the question about using the services of companies specialising in currency risk management, several conclusions can be drawn. Firstly, only 21.7% of respondents answered that their company uses the services of such companies. This means that the vast majority of the companies surveyed (55.1%) do not use external assistance in the field of currency risk management. Secondly, there is also a certain group of respondents (23.2%) who described themselves as uncertain whether their unit uses the services of companies specialising in currency risk management. This may indicate certain gaps in awareness or internal communication in companies regarding the practices used in currency risk management.

The survey results provided important information on the current state of exchange rate risk management practices and strategies, which may be useful for further analysis and practical recommendations for enterprises.

V. CONCLUSIONS

- Exchange rate risk is an inherent element of the activities of companies conducting transactions in foreign currencies. Changes in exchange rates can have both a negative and positive impact on financial results,

- Despite the prevalence of exchange rate risk, only half of companies take action to limit its impact on their operations. This is an area that requires further research and analysis,
- To achieve the expected profitability in the face of exchange rate risk, it is crucial to develop and implement an appropriate risk management process. This process should be formal and documented, with a clear division of responsibilities and authorities. When creating risk management procedures, various risk management methods, both internal and external, should be taken into account,
- When implementing risk management principles, companies should remember that their goal is to ensure the achievement of planned financial results. By using risk mitigation methods, companies minimize the probability of incurring losses and can generate additional profits as a result of changes in exchange rates.

VI. Summary

Understanding the topic of exchange rates and risk is crucial for companies operating in international markets for several reasons. First, the volatility of exchange rates can have a significant impact on the financial results of companies, introducing uncertainty and risk into their operations. Knowledge of these issues allows for better preparation for possible fluctuations and making informed investment and trading decisions. In addition, skillful management of currency risk can contribute to increasing the financial stability of a company and its competitiveness on the market. Additionally, knowledge of strategies and tools for hedging against exchange rate risk can be crucial to achieving success in the global market, enabling effective planning and implementation of business activities in conditions of changing exchange rates.

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