3 strategic measures to protect businesses from the impact of a weakening rand

By Stian van Zyl

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The rand experienced a significant drop, hitting an all-time low of R19.80 against the dollar this month. This decline was prompted by multiple geopolitical factors, such as allegations of Russian military involvement, persistent economic risks of severe load shedding, and a recent credit rating downgrade by S&P.

Source: Supplied. Stian van Zyl, currency and treasury manager at South African foreign-exchange (FX) company Kuda.

The rand is still facing pressure and remains at risk of further weakening. It's not surprising that local businesses are becoming more cautious about the South African investment landscape and considering offshore options, and are bracing themselves against making impulsive decisions.

But despite the headwinds, I urge companies to explore the opportunities that arise during crises. One such opportunity is hedging, which involves using financial tools or strategies to reduce or eliminate the risks associated with currency fluctuations.

Hedging can help local businesses manage risk and limit their exposure to potential losses in volatile markets with unpredictable currency fluctuations.

With the rand still experiencing instability, I recommend three hedging strategies that businesses can use to protect themselves.

- **Swaps:** A currency swap is an agreement between two parties to exchange cash flows based on a specific set of criteria. Swaps can be used to hedge against interest-rate risks, foreign-exchange rate risks, and commodity price risks.

- **Forward contracts:** Similar to futures contracts, which are standardised contracts traded on a centralised exchange, a forward contract is a private agreement negotiated between two parties to buy or sell an underlying asset at a predetermined price and date in the future. It offers more flexibility than a futures contract as it can be customised to suit the needs of the involved parties.

- **Collars:** A collar is a risk-management strategy that involves combining options contracts to limit the potential range of gains and losses of an underlying asset. By setting a floor and a ceiling on its price, collars can be used to hedge against price movements while limiting potential gains or losses.

Mitigating exchange-rate fluctuations

As a small open emerging market, South African exporters and their revenues are severely affected by exchange-rate fluctuations. To address this, I suggest businesses enter into forward contracts and lock in the exchange rate at the time of the contract. This ensures a fixed price for goods in their local currency, removing the uncertainty and volatility associated with exchange-rate movements.


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It also enables exporters to plan and forecast their cash flows more effectively. Similarly, importers’ costs can be significantly impacted by exchange-rate fluctuations. By engaging in currency futures contracts, importers can secure the exchange rate for a specific period, reducing the risk of adverse currency movements during that time.

This helps them to manage their cash flows, plan their expenses and protect their profits more effectively.As the South African Reserve Bank looks to raise rates once more, it is even more crucial to employ hedging strategies to mitigate inflation risks and ensure stability.By adopting these smart strategies, investors and businesses can proactively safeguard their positions, plan for the future and turn volatility into a pathway for financial resilience.

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