Rand volatility emphasises the value of hedging for importers

By Lance Rabbie

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The fall in the rand to a four-year low, below the psychological barrier of R9 to the US dollar, serves as a reminder of how critical protection against currency fluctuations is for local businesses. For importers in particular, the implementation of a hedging strategy can be vital to safeguard against any major currency shocks.

The weakening rand increases the cost of imports, which, ultimately, exerts inflationary pressure on pricing. This is further exacerbated by South Africa's high reliance on imported goods as a result of its limited manufacturing capacity - so the lack of an effective hedging strategy will, ultimately, push up prices for the end-user.

Hedging strategies can be considered a critical part of a company's overall risk management strategy. If the hedging strategy is effectively implemented then the importer is able to create more certainty around its costs and, ultimately, its profit margin. In instances where merchandise is pre-sold the importer is even able to lock in its profit margin.

Lower margins and even losses on presold orders

For those importers who have not hedged their foreign currency exposure, dangers include lower margins and even losses on presold orders. In the medium- to long-term - and depending on the particular industry and the extent to which importers are able to pass on cost increases to their clients - the weakening rand could result not only in lower profit margins, but also lower sales volumes.

Blue Strata, through effective hedging strategies, is able to provide its clients with protection against forex fluctuations for both foreign supplier payments and customs duty (calculated according to the foreign exchange rate on the date the merchandise is shipped) both of which, ultimately, impact on the final landed cost of the particular merchandise.

When it comes to devising hedging strategies there is, however, a delicate balance that the importer needs to consider, especially when importing merchandise for future orders. A hedging strategy can sometimes be detrimental to an importer if, for example, the currency strengthens and the company has locked in its currency. This could result in its prices being less competitive than those of its competitors who have chosen not to hedge.

In our experience there is no perfect hedging strategy. Various strategies are employed by different entities with some having a rigid and consistent policy and others managing their currency risk on a more ad hoc basis in conjunction with their particular view at a point in time. Ultimately, importers need to do what is right for their business based on the current market conditions.

ABOUT THE AUTHOR

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