MillTechFX
by Millennium Global

How can digitisation help firms manage currency volatility?

After a period of sustained calm, volatility has become a dominant theme of the foreign exchange (FX) market. The US dollar soared to numerous highs throughout the second half of 2022, only to recently slide to a near seven month low. The pound has also heavily fluctuated; having reached a 37 year low in September 2022, it has since recovered to a seven month high. The euro too shows signs of bouncing back from its 20 year low last Autumn, recently hitting a nine month peak against the backdrop of possible European interest rate hikes.

The pressure on corporates, a segment of the market that has traditionally struggled with its FX set up, has intensified in this new environment. According to Kyriba's October Currency Impact Report, companies in Europe and North America reported $37.27 billion in currency headwinds in the second quarter of 2022 alone.

Some of the biggest firms are beginning to feel the pain, particularly those that consolidate in the US as the dollar's surge has lowered the value of their international sales. In October 2022, Coca Cola said that foreign exchange effects have dented its margins, earnings per share and other metrics. Likewise, according to Goldman Sachs, share prices of S&P 500 companies with large overseas exposure are down about 23% since the beginning of 2022.

For many firms, FX volatility has shone a light on outdated processes that make it harder to mitigate the risk of currency fluctuations. So, how can corporates adapt their operations to protect their bottom lines during these turbulent times?

New challenges, old processes

Despite the renewed focus on managing the growing threat of currency movements, many firms still lack the necessary tools to mitigate the impact of FX volatility.

For many corporates, FX processes are manual, cumbersome and time-consuming. Nearly two-thirds (65%) use manual execution processes and over a third (36%) still primarily use email for instructing financial transactions, while 29% rely on phone calls.

FX price discovery can often involve multiple phone calls, e-mails or online platforms to log in just to get comparative quotes from counterparties. Because the market is constantly moving, price discovery requires a team of people to collectively decide which of these counterparties can offer the best quote.

This entire process can be a huge drain on time and resources. Corporate treasury teams spend around 1.85 days per week on FX-related matters, while nearly half (47%) spend 2-3 days on such matters.

It is therefore somewhat unsurprising that over a third (35%) of corporates rating their FX set up as below average or worst-in-class.

Turning to technology and automation

With FX moving up the list of priorities, many CFOs and treasurers at corporates are beginning to consider moving away from traditional providers and legacy infrastructure.

Instead, there has been a notable increase in organisations embracing digitisation to streamline these functions, with 89% of senior-finance decision makers now looking into new technology and platforms to automate their FX operations.

These solutions offer a number of benefits, including:

1. **Centralised price discovery -** For many corporates, it is operationally inefficient to set up and manage multi-bank relationships, meaning they often rely on a single bank or broker to meet their FX hedging requirements. Automated solutions enable firms to compare prices from multiple liquidity providers on a single marketplace. Not only does this bypass the onerous phone call and email exchanges, but it also enables firms to get the best available price and lock it in with the simple click of a button.

2. **End to end workflow -** Post-trade execution processes can be fully automated, from settlement to onward payment, regulatory reporting or sharing trade data with third parties. This saves much-needed time and resources, enabling firms to focus on core business matters.

3. **Transparency -** By embracing digitisation, firms can benefit from complete transparency through real-time reporting and FX transaction cost analysis (TCA). TCA can be used to help firms understand how much they are being charged for the execution of their FX transactions, in addition to demonstrating good governance to internal stakeholders.

4. **Fast onboarding -** Rather than spending months (even years) setting up multiple FX facilities with different counterparties, a digital FX marketplace enables firms to begin transacting within weeks.

With currency volatility expected to continue well into 2023, FX is likely to become an increasingly important priority for corporate treasury teams. CFOs which harness automated, technology-driven solutions that can heighten efficiency and streamline operations will be best placed to navigate the challenges that lie ahead.