

CASTLE CURRENCY

Understanding Currency Risk

A Practical Guide for Business Leaders

If your business sends, receives, or converts foreign currency, currency risk is already affecting your bottom line.

This guide explains what that means - and what you can do about it.

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What Is Currency Risk?

Currency risk is the possibility that changes in exchange rates will affect the value of your international transactions - and ultimately, your profits.

If you're an exporter selling products in a foreign currency, a strengthening domestic dollar means each sale is worth less when you convert it back to dollars. If you're an importer paying suppliers in a foreign currency, a weakening domestic dollar means each payment costs you more.

This isn't theoretical. Currency rates move every day. On a typical day, exchange rates can move significantly - enough to materially affect your margins on any given transaction. Over a quarter or a year, those movements compound.

Many businesses know this at some level. But not every business has a structured approach to managing it.

Why Businesses Underestimate It

A common approach to currency in a business is also an expensive one: ignore it until you have to transact.

When a payment is due, someone converts currency. When accounting needs to reconcile, someone checks the rate. When the rate moves against you, someone says "What could we have done?"

The problem is that there may have been something you could have done. It doesn't mean trying to predict every market move - it means having a structured approach so your decisions aren't made randomly.

Businesses don't lose money because of bad providers - they lose money because of bad decisions.

The Three Types of Currency Risk

1. Transaction Risk

This is the most straightforward: the exchange rate changes between the time you agree to a transaction and the time you actually pay or receive the money.

Example: You invoice a European customer for €100,000 when the exchange rate is 1.50. By the time they pay 60 days later, the rate has moved to 1.47. That's \$3,000 less in your currency - for the same sale, the same product, the same effort.

This is the risk businesses think of first - and it's the one directly affected by how and when you convert.

2. Translation Risk

If your business has foreign operations or subsidiaries, translation risk affects how those operations show up on your financial statements. When you consolidate foreign results into your reporting currency, exchange rate changes can make the same underlying performance look better or worse from quarter to quarter.

This matters for companies with foreign assets, investments, or branches that report in a different currency than the parent company.

3. Economic Risk

This is the broadest and hardest to measure. It's the long-term effect of currency movements on your competitive position. If your currency strengthens over time, your exports become more expensive for foreign buyers and your competitors in weaker-currency countries gain a price advantage. If it weakens, your imports become more expensive and your input costs rise - even if the price in the foreign currency hasn't changed.

Economic risk doesn't show up on a single transaction. It shows up over quarters and years in your market share, your pricing power, and your ability to compete internationally.

WHICH ONE MATTERS MOST TO YOU?

For many small and mid-sized businesses, transaction risk is the primary concern - and the one you have the most ability to manage through better decisions and structured approaches.

Translation and economic risk become more important as your international operations grow.

How Currency Movements Affect Your Margins

Here's where it gets practical.

When you book a sale or commit to a purchase, you likely have an expected margin built into that deal. If you're an importer, you've set a retail or wholesale price based on what you expect to pay your supplier. If you're an exporter, you've quoted a price that assumes a certain exchange rate when you convert the revenue.

But the currency exposure often starts well before any individual transaction. Companies typically create annual or quarterly budgets using a budget currency rate - the rate they assume when projecting revenue, costs, and margins. That budget rate flows into how they price their products, how they quote customers, and how they plan expenditures. If the actual exchange rate when they convert is worse than the budget rate, every sale and every purchase is less profitable than planned. If it's better, margins improve.

Between the time a budget rate is set and the time money actually moves - which could be months or even a full year - the exchange rate is moving. Every day. In both directions. And between any individual booking date and its settlement date, the rate continues to move. The gap between what you planned for and what you actually get is the gap that erodes margins.

If you convert at whatever rate happens to be available when a payment is due or received, your actual margin is different from your planned margin. Sometimes better, sometimes worse. Always unpredictable.

This is the gap that often goes unmeasured. Businesses measure the rate they got. They measure the spread their provider charged. But they may not measure the gap between what they planned for and what they actually received.

That gap is where real money is lost - or captured.

The Rate vs. The Process

Many businesses spend their currency-related energy on one thing: getting a better rate from their provider. Comparing banks. Negotiating spreads. Shopping for the cheapest transaction.

That's not wrong. Better rates help. But the spread difference between competitive providers is typically a fraction of what the market moves in a single day. If you saved a few points on the rate but converted at a poor time, the savings are irrelevant.

The rate your provider charges matters. But how and when you convert matters more.

This is why companies that focus only on spread shopping often see inconsistent results despite having "good rates." The process around the decision is where the real opportunity is.

What Managing Currency Risk Actually Looks Like

Managing currency risk doesn't mean spending hours watching markets or becoming a currency expert - that's time better spent running your business.

It means having a structured approach to how and when your business converts currency - so that your results are less random and more aligned with your financial goals.

A Structured Approach Includes:

Knowing your budget rate. What exchange rate did you assume when you set your prices or built your budget? If you don't know this number, you can't measure whether your currency activity is helping or hurting.

Having target levels. Instead of converting whenever a payment is due, having pre-defined levels where converting makes sense relative to your budget and financial goals - decisions made with intent, not by deadline.

Consider using expert guidance. Our Daily Best Rate Conversion Strategies give your team specific targets on the days you are wanting to convert.

Using forward contracts when appropriate.

Forwards let you lock in a rate for future transactions. They're not speculation - they're planning. If you know you have a payment due in 90 days, a forward can remove the uncertainty about what rate you'll pay. The same applies to expected revenue in foreign currency.

What many companies don't consider is that forwards can be part of their broader annual planning. If you've built your budget around a specific currency rate, and you have expected sales and expenditures in foreign currency over the coming year, it makes sense to consider whether protecting some of that exposure could help you meet your financial targets.

There are different ways to approach this. Some companies set a floor - a minimum acceptable profit level or margin - and use forwards to ensure they don't fall below it, while keeping the ability to benefit if rates move favorably. Others align their hedging directly to their annual budget targets, adjusting coverage as the budget period progresses and cash flows, expectations, or currency conditions change. The right approach depends on your company's specific financial situation, risk tolerance, and goals.

For companies not using forwards, managing currency becomes more of a booking-to-settlement exercise - trying to improve how and when individual conversions happen. Both approaches benefit from structure. Forwards simply give you a longer planning horizon.

Forward contracts are one tool worth understanding - whether they belong in your approach depends on your specific situation.

Consider using expert guidance. Our Weekly Hedging Strategies provide guidance on when and where to place forwards - which you can align to your specific financial goals.

Measuring results. Not just the rate you got, but whether your overall approach is producing consistent results aligned with your budget. If you're not measuring, you're guessing.

Not trying to be perfect. The goal is better and more consistent - not perfect. A simple, repeatable process beats a brilliant strategy that nobody follows.

Five Questions to Assess Your Current Approach

Answer these honestly. They'll tell you whether your current currency approach is working for you or against you.

1. Do you know your budget rate? If someone asked you right now what exchange rate your budget assumes, could you answer? If not, you're converting blind.
2. How are conversion decisions made today? Is it based on targets and a plan, or based on when a payment is due or received, when accounting asks, or when someone has time?
3. Do you know what your conversions are actually costing you? Not just the rate your provider charges - but the total cost including timing, process, and the gap between your budget rate and your actual rate?
4. Have you ever used forward contracts? If not, they're simpler than many businesses expect - and they may be a practical way to protect your margins. Many companies either don't use them when they should, or use them incorrectly.
5. Are you measuring improvement over time? If you changed providers, changed your process, or started using strategies, would you be able to measure whether it actually helped?

If you answered "no" or "not sure" to some of these questions, your currency process may be costing you more than it should. Not because you're doing anything wrong - but because there's room to do it better.

What You Can Do Next

This guide is a starting point. Understanding that currency risk exists and that your current process has gaps is the first step.

The next step is finding out what those gaps are costing you specifically. Not in theory - in dollars.

Castle Currency offers a free Currency Review that does exactly that.

No cost. No obligation. Just clarity.

If you want ongoing expert guidance, our Daily Best Rate Conversion Strategies give your team specific targets on when to convert and our Weekly Hedging Strategies provide guidance on when and where to place forwards - giving your team a structured approach to every decision without spending time watching currency markets. Both are available as subscriptions through Castle Currency.

READY TO SEE WHERE YOUR CURRENCY PROCESS CAN IMPROVE?

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