6.2 Features of currency risk management in the system of financial and economic protection of enterprises

The current financial instability in the world primarily affects the results of activity of individual industrial enterprises. It leads to the fact that most of them in unjustifiably accelerated pace are approaching to bankruptcy.

At the present stage of economic development for any company the stabilization and integrated protection of its activities are of paramount importance. Today this can be interpreted as achieving by a industrial structure of stable financial condition through a number of financial and economic indicators in terms of protection from various unfavourable both internal and external factors. These indicators through which the basic properties of enterprise are evaluated constantly fluctuate owing to diverse structure of financial resources. In this situation it is important to prevent their long-term decrease to values which are smaller than maximum allowable value owing to timely transformation of strategic management of business, particularly financial and investment management. Research indicates that if the unfavourable situation in the companies still develops, it can be neutralized by implementing an updated management strategy and rational methods of system control. These methods in the short term would strengthen protective functions of industrial and economic structures contrary to the processes of outflow of financial assets from them that requires maintaining of optimal receivable policy. If at the enterprise prevails use of external borrowings, then they should be transferred to finance long-term investment programs, the level of profitability of which would allow to carry out external liabilities according to the principles of sustainability. This will provide additional protection and full and timely payment of debts with less risk.

Recently the imbalance between accounts payables and accounts receivables, unpredictability of financial risks and the downward trend of the main effective indicators toward to the turnover of working capital can clearly be seen according to data of structure of the balance of significant number of businesses entities in the sphere of industry, namely by sections: current assets, long-term liabilities and current liabilities. In addition, long-term accounts receivables as a part of fixed assets in such a situation can be significantly reduced.

In this case, under the strengthened control on the state of economic security of companies can expose such groups of calculation indexes as profitability of assets, profitability of own capital, profitability of implemented products, assets turnover, turnover of commodity and material stocks. Besides there are such indicators as the average term of payment of accounts receivables by customers of enterprise, the average term of payment of accounts payables by suppliers, autonomy coefficient, the coefficient of providence of debts and some liquidity coefficient, including total liquidity coefficient, of immediate liquidity and absolute liquidity. This list can be supplemented by a coefficient of the profitability from operational activity. In practice an analytical evaluation of the state of economic protection of business entity on the basis of the above mentioned indicators is not always straightforward, as the decline of the share of debt in total capital strengthens the financial independence of the company, but at the same time it narrows the funding sources and opportunities to increase the efficiency of its activity. Indicators of the average term of payment of accounts receivables and payment of accounts payables characterize the activity of enterprises in sphere of settlements with partners. However unjustified tendency to its increase could rapidly weaken the economic security and destabilize the current structure of sources of financing in the company that is connected either with the degree of profitability and capital turnover, or with the degree of increased financial risk.

Therefore, achieving and economic protection of business entities, it is aimed to ensure their sustainable economic and financial development under the condition of constant influence of internal and external threats that continually arise in the condition of market instability and should be quickly eliminated by more effective ways. This can be achieved only under condition of the rational management of its own financial resources, ensuring maximum competitive advantages on the market and sufficient sales volumes of finished products or with the help of transformation of the existing structure of financial resources. For advanced planning of economic security at the enterprise and insurance of its long-term impact on business entities there are needed:

rational financial policy with clearly defined financial and economic strategy of a company, particularly with stable formed financial relations and the optimal structure of financial resources. It is needed accurate prediction of variations of basic financial and economic indicators for a defined period of time, control over results of the analysis of financial statements over the last few years and entering them into a database for information processing; predicted estimation of the conjuncture of the market that manage the objectives of company on the basis of its key financial-economic processes, namely the process of lending, emission of securities, of currency settlement, sales of finished products must be performed within the target production function - to maximize profits with minimal or at least reduced cost, particularly in terms of innovation activity.

The current world economic situation is characterized by significant financial instability that primarily affects the results of activity of separate units of economy of the real sector of economy. Usually they constantly fluctuate, having significant range of values that eventually unbalances sustainable financial mechanism of above mentioned entities. This leads to the fact that some businesses successfully pass its life cycle of stage of growth of output, while others, having exhausted the possibilities to resist the trends of stagnation and depression, mutual non-payments crisis, are moving close to bankruptcy or are potential bankrupts [262].

The main reason for non-payment of financially unstable companies is their chosen path of irrational management of its financial and investment activity, which is primarily due to the inefficient use of borrowings and the associated with this unpredictable financial growth and investment risk. The prolonged insolvency of these companies initially limits, and then completely blocks their activity.

The general process of currency risk management in business is presented in Figure 1.

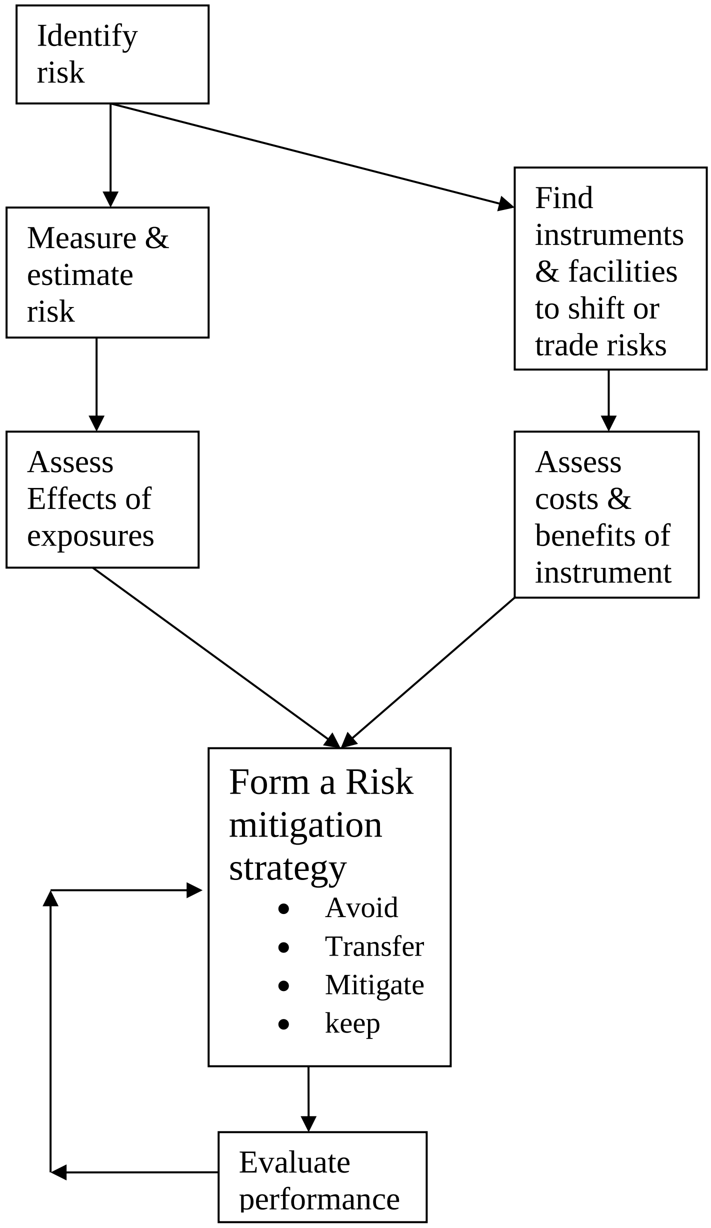

Figure 1. Algorithm and sequence of risk management [263]

Although generally in business structures are concentrated considerable assets of funds, but at the individual enterprises and in industries they can be placed unevenly, so the possibilities of their expansion and development are not the same. This means that it is not possible to protect automatically all enterprises from bankruptcy at the same time. The unevenness of financial provision of certain business entities, primarily due to its own resources, can be simultaneously connected with the internal and external factors. Internal factors that directly affect the deterioration of their financial condition are associated with the imbalance between the level of the organization production, high cost of production and its quality. External factors include taxation, licensing, saturation of the market by certain group of goods, solvency of customers.

The state using financial techniques can stabilize an integrated level of economic security regulating rates and proportions of development of specific industries and of individual companies, especially companies that become bankruptcy. For this purpose should be used especially optimal taxation mechanism and features of currency risk management.

With the growing uncertainty in global and international trade and creating market fluctuation higher than ever demand for management of financial risk constantly increasing due to high chance of market risk from sign of recessions, political turmoil, changes in interest rates and exchange rate in global economy.

Financial globalization, international trade and open market create new opportunities and this opportunity involves new financial risk creating barriers to trade and business. To avoid these risk business are set to do risk management.

One of the integral risk to business both financial and non financial today is the foreign exchange risk mostly to business who engage in international trade or which operation depends on foreign goods and services

Managing currency risk is thus related to preserving the flow of profit so as to earn an adequate return on investment, to maintain a comfortable surplus of assets beyond liabilities in view of corporation.

Exchange rate risk management is an integral part in every firm’s decisions about foreign currency exposure. The issue of currency risk management for non-financial firms. This shows the importance that firms put on risk management issues and techniques.

Currency risk hedging strategies entail eliminating or reducing this risk, and require understanding of both the ways that the exchange rate risk could affect the operations of economic agents and techniques to deal with the consequent risk implications. Mitigating currency risk with targeted strategy through measurement, proper tools and methods; Staying ahead of market fluctuation using instrument like forward contracts, currency swap, future contract and choice of invoicing.

Foreign exchange risk also called currency risk, risk that arises from open or imperfectly hedged positions in a particular currency [263]. A common definition of exchange rate risk relates to the effect of unexpected exchange rate changes on the value of the firm. In particular, it is defined as the possible direct loss (as a result of an unhedged exposure) or indirect loss in the firm’s cash flows, assets and liabilities, net profit and, in turn, its stock market value from an exchange rate move [264]. Any business that trades in foreign markets is almost compelled to exchange currency as part of its day-to-day routine. When a business sells to a foreign buyer, usually payment will be in the currency of the buyer’s country. Some part of the value of the sales proceeds will be lost to the foreign exchange market.

Foreign exchange rate directions are almost impossible to predict but can be managed hedge to minimize risk by employing several strategies that meet objectives and goals.

Changes in exchange rates can affect a business directly or indirectly. Exposure that result in a gain or loss in exchange rate for the company, which relatively immediate affect the business balance sheet and income statement is understand to be direct effect. Indirect that is difficult to measure and control as a result of dependent on the surrounding world. Three main types of exchange rate risk: transaction risk, translation risk and economic risk. Transaction risk - the risk that the exchange rate will move in a direction adverse to the business part way through a transaction. It is basically cash flow risk and deals with the effect of exchange rate moves on transactional account exposure related to receivables (export contracts), payables (import contracts) or repatriation of dividends. Translation risk - translation risk, which is basically balance sheet exchange rate risk and relates exchange rate moves to the valuation of a foreign subsidiary and, in turn, to the consolidation of a foreign subsidiary to the parent company’s balance sheet. Translation risk for a foreign subsidiary is usually measured by the exposure of net assets (assets less liabilities) to potential exchange rate moves. One most important goal in risk management is identifying the type of currency risk adverse to a business. Risk can be identify by asking some question and figuring out what section of the business stand to devalue as a result of exchange rate fluctuation. Multinational firms are participants in currency markets by virtue of their international operations. To measure the impact of exchange rate movements on a firm that is engaged in foreign currency denominated transactions, the implied value-at-risk (VAR) from exchange rate moves, we need to identify the type of risks that the firm is exposed to and the amount of risk encountered [264].

Hedging strategy is possible after measuring the impact of exchange rate movement on the firm that is engaged in foreign currency denominated transaction [263]. Measuring the level of exposure helps a firm to decide what risk to engage in and how to approach it. At present, market risk is primarily measured by a widely used method called value-at-risk (VAR) model. VAR is the maximum loss over a target horizon such that there is a low, prespecified probability that the actual loss will be larger.

There are different kinds of tools the companies can use to insure themselves from risks that occurs in times of currency changes. The hedging tools are all serving the same purpose; the currency management instruments enable the firm to take a short or a long position to minimize the risks. These tools are for example hedging with forward contract, future contract or with option, swaps and debts. When the ex-change of currency is done right now to the current currency rate, it is called the spot market or spot exchange rate. Forward contract is an agreement between two parties in which the currency exchange rate is set at the same time as the agreement is written, but for a specific time in the future. This means that while the amount of the transaction, the value date, the payments procedure and the exchange rate are agreed about in advance, no exchange of money takes place until the actual date in the future [266]. A forward contract is binding, which means that both parties involved are obligated to fulfill the contract and its meaning.

A currency swap is a financial instrument that helps parties swap notional principals in different currencies and thus pay interest on the received currency. The purpose of currency swaps is to hedge against risk exposure associated with exchange rate fluctuations, ensure receipt of foreign monies and to achieve better lending rates. Currency swaps are comprised of two notional principals that are exchanged at the beginning and end of the agreement. Companies that have exposure to foreign markets can often hedge their risk with currency swap forward contracts.

One possibility to reduce the foreign exchange risk is by inserting a foreign exchange clause in the contract of sale, established between the buyer and seller. The clause prescribes that after the parties have signed the contract, they should consider exchange rate variations. For example, it could be that the exchange rate is allowed to fluctuate within a specific interval, and if the exchange rate exceeds this interval the buyer needs to pay an additional amount [267].

So therefore management of currency risk should involve the evaluation of all type of currency risk, take proper measurement of all forms of currency risk and have a strategy to mitigate all currency risk in order to stay ahead of unexpected loss and currency fluctuation.

To minimize these above mentioned risk a firm can use different kinds of hedging instruments, and the most used derivative are forward contracts, currency swaps and futures.

Currency swap contract not only provide hedging means but also provides flexibility and gives opportunity for choice of rates. It permits restructuring of contracts which forward and future does not offer. Early termination of contract make possible.