

Pharmaceutical manufacturers must hedge against rand volatility

By [Carlos Martins](#)

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The South African rand is one of the most fascinating currencies in the world, and pharmaceutical and medical-device businesses that can manage their currency risk are likely to enjoy enhanced profitability.



Source: [Pexels](#)

Consider for a moment that the rand is one of the top 20 most actively traded currencies in the world. Simultaneously, it is also one of the top 10 most volatile according to some recent research out of PwC.

Now imagine running a business where you are pushing through millions of rands of imports or exports each year. It only takes a knee-jerk reaction to an interest-rate fluctuation or a geopolitical event in Russia, China, Taiwan or any of the other global hot-spots and you could find your business plans derailed.

This is where it makes sense to consider outsourcing your treasury and foreign-exchange activities to industry experts which allows you to focus on running your core business.

Let's look at a practical example. Exporter X is a manufacturer of cosmetic products for export into the US. It has received an order of \$100,000 for its products in September 2022 when the rand-dollar exchange rate was trading at around

R18.1460 to the US dollar.

Our exporter worked out that they would be receiving R1,814,600 in three months' time when the customer pays them. They took the view that with the rand mostly weakening, they might even get a bit more upside which could assist them to generate a slightly higher margin on their products.

Their view on the currency market was in fact incorrect and the rand started strengthening and it became a waiting game for our exporter that was constantly hoping that the local currency would weaken again.



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Enter the next part of the equation: The exporter is not sure of the exact date of when it would receive the dollars. The dollars eventually arrived at the end of December 2022 and the bank converted the currency at R17.00.

It had planned on receiving R1,814,600 but now only received R1,700,000 which translated into a loss of R114,600. This was greater than the profit margin that it had built into its price: for every dollar of the contract, it had lost close to one rand.

The advisable procedure for the exporter should have been to have hedged its exposure in September 2022 - on the day that it received the order - and to sell the dollars three months forward. In other words, it could have fixed its exchange rate for the date of the expected receivables. Had it sold its dollars forward on that day it would have, in fact, received at least an additional 15 cents in its favour.

A hair's breadth away from losses

This is the reality for many exporters and importers – factors out of their control can make the difference between realised profits or losses on their contracts and it is critical that they try and put in place strategies to mitigate these risks.

In the same way that the pharmaceutical and cosmetics industry requires industry-specific skills, so too does the world of treasury and foreign exchange. You wouldn't ask an accountant to take responsibility for your traceability any more than you would ask your production manager to handle your audits.



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For the example, which we have outlined above, we have touched on the exchange rate but there are many other moving parts that impact the profitability of a transaction including interest rates, commodity prices and liquidity.

Importantly, an external party can introduce an element of independence which brings a fresh set of eyes to each transaction and eliminates bias that might creep in when the entrepreneur prices its deal or has an allegiance to a specific financial institution.

Importers and exporters that are transacting in rands operate in one of the most challenging emerging markets in the world. The introduction of high quality professionals to support the treasury function of your business could make a material difference in profitability and should be a key consideration as part of your strategy in 2023.

ABOUT THE AUTHOR

Carlos Martins is responsible for compliance and advisory at Change Financial Solutions. He has spent more than 24 years in large South African corporates where he worked in various treasury-service companies as well as a major South African bank. His areas of expertise include international funding as well as currency, interest-rate and commodity-risk management. Having had exposure to both the corporate and the banking philosophies of the financial markets provides Martins with the ability to devise risk-management strategies which are appropriate to corporate South Africa.

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