

Currency hedging (FX): systematically limiting currency risks in industrial procurement

Currency hedging (foreign exchange hedging, FX) refers to the protection of cash flows and contract values against fluctuations in exchange rates. In industrial procurement, this primarily affects purchases in foreign currencies such as USD, CNY or CHF as well as export revenues in foreign currencies. The aim is not speculation on exchange rate movements but planning certainty for material costs, margins and cash flow. For buyers and supply chain managers, FX hedging is therefore an integral part of risk policy and cost security along the supply chain.

Key facts

- Currency hedging protects foreign currency positions in procurement and sales against exchange rate losses and secures calculations.
- Common instruments are forward contracts, options, NDFs and natural hedging through currency matching.
- In practice, positions above a defined approval threshold are typically hedged in accordance with the company's risk policy.
- Hedge ratios of 50 to 100 per cent of plannable annual demand are common guidelines depending on the currency risk profile.
- Hedging costs (forward points) and margin calls on forward transactions must be taken into account in liquidity planning.
- Commodity indexation and currency risks are closely linked: many commodities are traded in USD, regardless of the delivery currency.

Definition: currency hedging (FX)

Currency hedging (FX) is the use of financial instruments or operational measures to neutralise currency fluctuations from existing or expected payments. The focus is on transaction hedging: specific payments from procurement or sales contracts are fixed at a plannable rate. In addition, there is the hedging of supply chain prices (economic hedging) and the hedging of the group balance sheet (translation).

Distinction: hedging versus speculation

Hedging pursues the goal of creating plannability, not generating additional returns. A hedged rate may turn out to be worse than the market rate in hindsight – forgoing a more favourable rate is the price of certainty. Companies should communicate this logic internally so that hedging losses compared with unhedged scenarios are not judged as wrong decisions.

Currency risks in the procurement context

Procurement encounters currency risks on three levels: with payment terms of existing PO orders, with long-term framework agreements and delivery schedule agreements, and with prices linked to USD-based market indices through commodity indexation. Even if an invoice is issued in EUR, the supplier may have priced in a USD parity internally – an analysis of the price sheets often reveals this only at second glance.

- Transaction risk: specific payment in foreign currency
- Economic risk: medium- to long-term competitive and margin effects
- Translation risk: consolidation of foreign subsidiaries

Methods and approach of currency hedging

Hedging follows a structured process: identify risks, quantify them, define a hedging strategy, select suitable instruments and control the implementation. The prerequisite is a sound demand analysis, because only known or forecast foreign currency positions can be sensibly hedged.

Risk identification and demand analysis

First, all currency-relevant positions are recorded: open PO orders, call-off quantities from delivery schedule agreements, planned requisition volumes and indexed price components. A systematic market analysis of expected procurement volumes per currency forms the data basis. It is important to coordinate with category management, which often possesses more accurate quantity and price forecasts through category intelligence than the finance department.

Financial hedging instruments

Forward contracts secure a rate at a fixed date – suitable for plannable payments. Currency options secure a worst-case rate but allow for exchange rate gains, at the cost of an option premium. NDFs (non-deliverable forwards) are used for restricted convertible currencies. For small amounts, currency accounts or subsequent cover (spot) are also used, though this is not a genuine hedge.

- Forward: fixed rate, fixed date, plannable
- Option: rate corridor against a premium
- Currency matching: natural offsetting of purchases and sales in the same currency

Operational currency management in procurement

In addition to financial instruments, procurement reduces risks operationally: actively negotiating the contract currency, equipping price sheets with defined currency adjustment mechanisms, steering payment terms so that currency matching becomes possible, and connecting suppliers to central hedging processes through supplier enablement. In framework agreements, exchange rate thresholds can be agreed above which a price negotiation is triggered.

Key KPIs and metrics of currency hedging

Success is measured not by the absolute rate but by the deviation between the hedged and planned rate as well as by costs and the degree of implementation of the strategy. The following indicators have established themselves in practice and should be calculated using a uniform methodology – ideally in line with the internal risk policy.

Degree of hedging and effectiveness

The hedge ratio indicates what proportion of plannable foreign currency demand is hedged; typically it lies between 50 and 100 per cent depending on risk appetite. Hedge effectiveness measures how well the instrument counteracts the risk. The deviation of the hedged rate from the budget rate shows whether the calculation assumptions were upheld.

Costs and process indicators

Hedging costs arise from forward points, option premiums and bank fees – usually stated as over-/underwriting in basis points against the reference rate. The proportion of volumes hedged on time, the number of open positions outside procurement approval thresholds and the effort required for coordination between procurement and Treasury are further practical indicators.

- Hedge ratio: typically 50–100 % of plannable demand
- Hedging costs: often in the range of a few basis points for forwards
- Budget rate deviation: plan-actual comparison per currency

Risks and controls in currency hedging

Hedging creates new risks: credit and margin requirements from banks, complexity, compliance requirements (for example with hedge accounting) and the danger of mis-steering when procurement and finance organisations pursue different objectives. Clear governance is therefore indispensable.

Governance and risk policy

A written risk policy governs which currencies, instruments and volumes may be hedged, who holds decision-making powers and which approval thresholds procurement and Treasury must observe. Excessive hedging without an underlying commercial transaction (overhedging) is to be avoided just as much as unhedged residual positions. Regular reporting to executive management creates transparency.

Contract and price design as prevention

Many risks can be reduced before hedging: agreeing a currency clause with defined adjustment triggers in price sheets, separating the currency and price components in commodity indexation, and specifying the contract currency early in tenders. Budgeting according to the principle of zero-based budgeting can also help to make currency-driven cost increases visible instead of hiding them in the base budget.

Liquidity and banking relationships

Forward contracts generate margin calls or line utilisation on credit lines depending on rate movements. Advance payments to suppliers in foreign currency create additional exposure. These liquidity effects belong in financial planning; for smaller companies, a bank guarantee for advance payments can also be an alternative to pre-financing in foreign currency. The tax and accounting treatment must be clarified case by case with tax advisers and auditors.

Current developments and digitalisation of FX hedging

FX management is increasingly being automated: platforms and Treasury systems link ERP data with rate data and automate booking and reporting. At the same time, geopolitical factors, interest rate differentials and trade conflicts are changing volatility – processes must be designed to enable

short-term responses.

Integration of procurement and Treasury

The greatest lever lies in the data interface: if procurement provides its planning positions in a structured way from master data management, requisition data and contract calendars, Treasury can hedge faster and more precisely. Mutual coordination meetings and a shared understanding of risk replace the traditional separation of responsibilities.

Keeping sustainability and the supply chain in view

Currency decisions can interact indirectly with sustainability objectives: anyone switching suppliers due to currency advantages must assess supply chain, quality and CO2 impacts, for example in the context of Scope 1 emissions and Science Based Targets. A sound market analysis before supplier changes prevents short-term rate spikes from leading to long-term suboptimal decisions.

Typical metrics

Hedge Ratio: typically 50–100 %

Proportion of plannable foreign currency demand that is hedged

Budget Rate Deviation: typically < ±3 % p. a.

Deviation of the realised effective rate from the budget rate

Hedging Costs: often in the range of a few basis points (forwards)

Forward points plus fees, varying considerably depending on pair and term

Timely Hedging of Open Positions: > 95 %

Proportion of positions above the approval threshold hedged in line with the policy

Practical example

A mid-sized mechanical engineering company purchases components worth around EUR 12 million annually in USD and USD-indexed raw materials; sales are predominantly in EUR. After noticeable margin losses due to USD appreciation, the company established a structured FX process.

- Procurement and Treasury jointly compile a quarterly currency position list from open PO orders, delivery schedule agreements and planned requisition volumes.
- Risk policy with approval thresholds for procurement and Treasury defined: 70–90 % hedge ratio of plannable USD demand via rolling forwards.
- Price sheets based on USD with defined exchange rate thresholds; commodity indexation presented separately from the currency component.
- Payment term and currency matching introduced with a USD export customer, which noticeably reduced the net hedging requirement.

Conclusion

Currency hedging (FX) is not purely a financial matter for industrial procurement but a core task of cost security and risk policy. It begins long before the forward contract: with a clean demand analysis, appropriate contract and price designs and close collaboration between procurement, Treasury and category management. The right degree of hedging depends on risk appetite, planning quality and the volatility of the relevant currencies. Companies that systematically record and manage FX risks

calculate more reliably and avoid unexpected margin losses. The prerequisite is clear governance with defined approval thresholds and regular reporting.

Frequently asked questions

What does currency hedging mean in procurement?

Currency hedging (FX) means protecting payments and contract values in foreign currencies against exchange rate fluctuations. In procurement this is achieved through financial instruments such as forward contracts or options as well as through operational measures such as choosing the contract currency and currency matching. The aim is plannable material costs and a secured margin.

How does a forward contract work?

With a forward, the company and the bank agree today on a fixed rate for a currency transaction at a future date. Regardless of the actual market rate on the settlement date, settlement takes place at the agreed rate. This creates planning certainty for calculations, but costs arise from interest rate differentials (forward points) and potential exchange rate gains are excluded.

How high should the hedge ratio be?

In practice, hedge ratios of 50 to 100 per cent of plannable demand are common, depending on risk appetite, planning certainty and volatility. Many companies hedge short-term, well-plannable positions to a higher degree and result risks only partially. The ratio should be defined in the risk policy and reviewed regularly.

What alternatives are there to financial instruments for currency risks?

Operational alternatives include contracts in the home currency, currency matching between procurement and sales, price sheets with exchange rate thresholds and adjustment mechanisms, and the use of currency accounts. Supplier selection based on currency considerations is also possible, but should always be assessed jointly with quality, supply chain and sustainability criteria.

Who is responsible for currency hedging within the company?

Responsibility typically lies with the Treasury department, which executes the instruments. Procurement provides the data basis: plannable demand, contract positions and price structures. Governance is governed by policies with approval thresholds for procurement and Treasury; where no Treasury function exists, executive management often takes on this role with external advice.

What does currency hedging cost?

The costs consist of forward points (interest rate differential between the currencies), option premiums and bank fees. For forwards, the costs in practice are often in the range of a few basis points of the volume, but depending on the currency pair and term they can also be significantly higher. A total cost assessment should include liquidity commitment and internal expenses.