

Currency Risk in Procurement: Effectively Mastering Foreign Exchange Rate Changes

Currency risk in procurement refers to the danger that exchange rate fluctuations between the purchasing currency and the reporting currency negatively affect procurement costs. For industrial buyers, it is a relevant cost and planning factor particularly for procurement from the dollar area, Asia or Eastern Europe. Those who systematically identify, assess and hedge foreign currency risks can better control price dynamics and plan margins reliably.

Key facts

- Currency risk in procurement arises when the order currency and the reporting currency diverge and rates fluctuate between contract conclusion and payment.
- Typical levers are currency adjustment in contracts, final price escalation clauses and company-wide hedging with the finance department.
- Three risk areas are relevant: transaction risk (ongoing business), economic risk (long-term competitive position) and translation risk (consolidation).
- In practice, management starts with an exposure analysis: which suppliers, volumes and payment terms are tied to which currencies?
- Currency risk is part of price risk and should be systematically interlinked with the commodity strategy and the market monitoring process.
- Clear procurement policies on currency hedging prevent operational buyers from entering into hedging transactions on their own authority.

Definition: currency risk in procurement

Currency risk in procurement describes the possibility that procurement costs increase due to unfavourable exchange rate developments, or that planned savings from foreign currency contracts are nullified by exchange rate losses. It is a subset of price risk and affects all transactions where the order, invoice or payment currency differs from the company's home currency. The magnitude of the risk results from volume, remaining term of the commitments, payment terms and the volatility of the relevant currency pairs.

Transaction, economic and translation risk

Transaction risk relates to individual transactions: between the order and payment, the rate can shift so that the procured item becomes more expensive in euros than budgeted. Economic risk has a longer-term and more strategic effect: a sustained appreciation of a sourcing currency worsens the relative cost position compared with competitors who buy in the same currency. Translation risk, finally, relates to balance sheet consolidation and is primarily a matter of financial reporting, but it also influences the valuation of procurement metrics.

Distinction from price and country risks

Currency risk and price risk frequently overlap: a commodity price may rise in dollars while the dollar simultaneously appreciates against the euro, multiplying the effects. Supplier relocations also noticeably change the currency profile of procurement, for example when shifting procurement volumes to new procurement markets. In addition, country and payment risks may arise that are not exchange-rate related but occur in the same supplier relationship. Buyers should therefore assess and document currency and country risks jointly but separately.

Methods and approach for managing currency risk

Management usually follows a multi-stage process: stocktaking of foreign currency positions, assessment of the impacts, definition of a hedging strategy and subsequent ongoing monitoring. Close cooperation between procurement and finance is decisive, as hedging instruments such as hedging typically fall within the remit of Treasury. Procurement provides the forecast data; Treasury implements the hedge.

Exposure analysis as a starting point

First, it is determined in which currencies open commitments, framework agreements and planned procurement volumes exist. It is important to distinguish between firm commitments (e.g. call-off orders with fixed prices) and expected volumes not yet contractually bound. Systematic market monitoring of the relevant currency pairs and the underlying commodity and market prices complements the analysis. On this basis, it can be assessed which part of the risk has a short-term effect and which affects medium- to long-term planning horizons.

Contractual instruments

In the contract, currency adjustments can be agreed: a clause for price adjustment when defined rate thresholds are exceeded, an exact exchange rate fixing with a cut-off date rate, or an article on future price escalation clauses that explicitly itemise currency components. In tenders, the target currency should be bindingly specified in the specification of services so that bidder rankings remain comparable. Alternatively, procurement can offer to pay in EUR, with the supplier building the exchange rate risk premium into the price – often more expensive in practice, but easier to handle.

Financial hedging

Classic instruments include forward contracts, currency options and maturity translations, which are implemented by Treasury. Procurement is primarily the data provider here: it supplies supplier cascades and expected payment dates as the basis for hedging volumes. In practice, the period for which hedges are concluded frequently lies between six months and two years. The goal is not to predict rates, but to achieve planning certainty for costing and sales prices.

Key KPIs for managing currency risk

Currency risk is measured using exposure metrics, hedging effectiveness and the price variance arising from exchange rate changes against planned rates. These metrics should be aligned with Treasury at regular intervals – in practice monthly or quarterly.

Exposure and hedge ratio

Foreign currency exposure summarises which amounts in which currencies fall due in which period. The

hedge ratio sets the hedged amount in relation to the total exposure. In practice, partial hedge ratios between 50 and 100% are frequently used for firmly bound commitments, while expected volumes not yet contractually bound are often hedged to a lesser extent or not at all.

Exchange-rate-induced price variance

The price variance arising from exchange rate changes against planned rates is one of the most important metrics: it shows how strongly the variance between planned and actual procurement costs is caused by exchange rates. This metric can be well interlinked with the price variance workflow, as exchange rate changes should be reported there as a separate variance reason. In addition, an extended duplicate score can help consolidate material master data and refine the exposure analysis.

Risks and controls in dealing with foreign currencies

The greatest operational risk is the unconscious acceptance of exchange rate risks by individual buyers, for example through spontaneous contract negotiations without coordination with Treasury. Additional risks arise from unclear responsibilities, poor forecast quality and contract clauses that unintentionally provide for the full exchange rate to be passed on to the buyer.

Governance and procurement policy

A clear procurement policy defines which currency contracts are permissible, which rate thresholds trigger an adjustment and who makes hedging decisions. Without such rules, there is a risk that operational buyers enter into informal hedging transactions or silently accept exchange rate changes. Lessons learned from completed projects should be systematically fed back into the policy, for example when price escalation clauses have proven too complex in implementation.

Controls in the operational process

In the operational process, the currency check is part of the standard check for every order line in a foreign currency: does the stored rate match the contractually agreed rate? Exception management can help here to systematically identify and address variances. In addition, supplier visits and supplier evaluations should also examine how the supplier itself deals with currency risks, especially when it procures in foreign currency itself.

Current developments: currency risk in the age of volatile supply chains

The discussion about resilience in supply chains has once again elevated the topic of currency risk: supplier relocations, regional procurement strategies and new procurement markets continuously change the currency exposure. At the same time, the demands for transparency are rising, as management and controlling expect reliable planned costs even with volatile currencies.

Interlinking resilience and procurement strategy

Supply chain resilience management and currency risk management complement each other: those who diversify procurement markets often automatically diversify their currency exposure as well. Conversely, a targeted commodity strategy that takes multiple currency areas into account can reduce the overall risk. Demand aggregation across sites can also help bundle larger and therefore better hedgeable volumes.

Digitalisation and planning quality

Digital procurement platforms and spend analysis systems improve the data basis for the exposure analysis by automatically evaluating order volumes by currency. Automated price variance workflows can make exchange rate changes visible early on. Human judgement nevertheless remains important: forecasts of currency developments are uncertain, and models should be understood as decision support, not as a replacement for professional judgement.

Typical metrics

Foreign currency exposure: Complete capture (100% of positions)

Volume per currency and maturity; the basis of any hedging strategy

Hedge ratio: 50–100% for fixed commitments

Typical guideline; expected volumes are often hedged to a lesser extent

Exchange-rate-induced price variance: reported regularly (monthly/quarterly)

Variance between planned and actual rate, reported as a separate variance reason

Share of foreign currency in procurement volume: depends on procurement structure

Metric for strategic decisions on procurement market diversification

Practical example

A medium-sized mechanical engineering company with strong euro revenues sourced components predominantly in US dollars. After a period of dollar appreciation, effective procurement costs rose significantly above planned costs, without procurement being able to identify the cause. The company subsequently introduced systematic currency risk management.

- Creation of a complete exposure analysis of all open commitments in foreign currencies, differentiated by supplier and maturity.
- Agreement of price escalation clauses with currency components in new framework agreements; existing contracts were adjusted upon renewal.
- Establishment of a quarterly exchange between procurement and Treasury to align hedging volumes and hedge ratios.
- Integration of the variance reason 'exchange rate' into the existing price variance workflow for clean cost cause analysis.

Conclusion

Currency risk in procurement is not a marginal topic for the finance department, but a direct influence on procurement costs, costing certainty and competitiveness. Successful companies combine contractual instruments in procurement, a clear procurement policy and structured cooperation with Treasury for hedging. The prerequisite is a clean exposure analysis based on reliable master data and planning volumes. Those who systematically manage currency risk can better explain price variances, plan margins more reliably and evaluate procurement decisions such as supplier relocations more soundly. The investment in process and governance pays off quickly in practice as soon as the first stronger exchange rate fluctuations occur.

Frequently asked questions

What is currency risk in procurement?

Currency risk in procurement describes the danger that exchange rate fluctuations between the purchasing currency and the reporting currency negatively affect procurement costs. It encompasses transaction risks for individual transactions, long-term economic risks to the cost position, and translation risk in the balance sheet. All procurement is affected where the order or payment currency differs from the home currency.

How can procurement hedge currency risk?

There are three levers: contractual provisions such as exchange rate fixing or price escalation clauses with a currency component, financial hedging via hedging instruments such as forward contracts carried out by Treasury, and strategic levers such as diversifying procurement markets. In practice, a combination is frequently used. It is important to have a clear alignment of responsibilities between procurement and finance.

Who is responsible within the company for hedging currency risk?

Financial hedging using derivatives is typically the responsibility of the Treasury or finance department, as this requires specific expertise and banking relationships. Procurement provides the data basis: expected volumes, maturities and supplier commitments. The underlying principles, such as permitted currencies and hedge ratios, should be anchored in a procurement policy.

Should you fix prices in euros when buying in foreign currency?

Fixing prices in euros transfers the currency risk to the supplier, who will usually build a risk premium into the price. Whether this is cheaper than hedging it yourself depends on the negotiating position, the volatility of the currency pair and the internal hedging costs. In practice, it is worth comparing both options for each procurement category.

Which metrics are relevant for currency risk in procurement?

Central metrics are the foreign currency exposure (volume per currency and period), the hedge ratio (hedged amount in relation to the exposure) and the exchange-rate-induced price variance against planned rates. These metrics should be aligned regularly with Treasury. The exchange-rate-related price variance can be easily integrated into existing variance analyses.