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Applying Lean Manufacturing Principles to Improve FX Risk Management

Applying Principles of Quality and Efficiency from the Manufacturing World to Treasury and Finance to Achieve More Efficient FX Risk Management

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Introduction

The quantified negative currency impact for North American and European companies has continued to impact MNCs negatively to the tune of $27.87 billion for Q3, 2021 and is increasing adversely when comparing the quarterly results of the past few years.

The need for a process that mitigates foreign exchange risk becomes even more apparent when organizations experience impact spikes from volatility due to the global COVID-19 pandemic.

Manufacturers first adopted Lean principles and processes where they needed them most: on the manufacturing floor. Revisiting Henry Ford's flow production assembly line model, Kiichiro Toyota created the Toyota Production System (TPS) model, which propelled Toyota and the Japanese industry into a new age of productivity and global competitiveness. Toyota's ideas have since been widely embraced and translated into concepts like Lean production and Six Sigma, who are common in global manufacturing. Companies and consultants who have demonstrated success using these approaches to eliminate wasteful processes and improve quality have extended them to other industries and other disciplines.

While Six Sigma is a very scientific rigor around quality control, Lean looks to produce more with fewer resources and to help processes flow more smoothly. Lean, which tends to be less dogmatic than Six Sigma, describes a process for improvement and a set of workplace best practices. The management techniques include taking a long-term view of the business, as well as active mentorship of staff at all levels.

There is great potential for companies who apply Lean and TPS principles to improving financial processes, as the guiding principle of Lean directly applies to the challenges faced by organizations trying to manage their FX risk. With little standardization and tedious, manual processes, there is a great opportunity for companies to focus more on value and eliminating waste.

However, Lean is more about fixing a specific process. Lean practitioners outside Japan tend to focus heavily on specific analysis tools and omit critical elements of the best practices and management techniques. For Lean implementations to be successful, companies need to go beyond a specific project approach and integrate Lean as a guiding principle so that it can lead to continuous improvement.

Applying Lean to Foreign Exchange Risk

A growing number of companies in the U.S. are beginning to take a closer look at the principles of Lean and how they can help improve the costly, inefficient and often ineffective FX exposure management processes typical of most organizations today. By taking a methodical and disciplined approach, they are able to significantly reduce the time and effort spent aggregating, validating, and analyzing foreign currency data to make better risk mitigation decisions. Equally important, they create visibility to the entire process and support an environment that makes continuous improvement possible.

Companies of all sizes with FX exposures can benefit from extracting and compiling their exposures from various systems whether they be ERPs, procurement or billing systems and applying Lean methodologies and processes to ensure hedging activities and other related processes like trading, confirmations, and settlements are all done as efficiently and effectively as possible with appropriate policies and procedures applied.

Focus on Value and Eliminate Waste

One of the principal tenets of Lean is a focus on customer value. Activities that do not have a direct bearing on the value of the product or end result are targeted for elimination. Our customers, using our platform and Lean principles work to transition their foreign currency related systems and processes to create greater automation and efficiency.

Finance and IT must be partnered and work to assemble project teams with representatives from finance, treasury, and IT along with strong project sponsors to set sights on creating greater value and eliminating waste across the overall foreign exchange exposure management process.

Finance and treasury, supported by IT, must methodically go through and aggregate transaction data from their ERP or other related systems to identify exposures and, in turn, deliver the capacity to make appropriate hedging decisions to mitigate risk. Pulling together regional experts and business unit representatives or various department leaders is a significant investment of resources, but it gives companies undergoing the exercise of streamlining FX and other processes exactly what was needed to gain visibility of the entire process, end to end.

These cross-functional reviews often result in identifying manual processes required to pull together the data and validate results through the use of spreadsheets to calculate exposures.

Once identified wasteful, manual processes are mapped out, it's important to take the appropriate steps and have commitment from your executive leadership team and stakeholders to make the changes. For instance, the use of automation can cut the number of steps required to go from data aggregation to risk mitigation decision in half, while delivering greater transparency to the process as a whole.

Assessing the Whole Value Stream

Another tenet of Lean involves taking a holistic view of any process, considering the impacts and dependencies of other processes, both up and downstream. Manufacturing plants designed along Lean/TPS principles allow leadership to witness the entire process, end-to-end, from any place on the factory floor. To be effective, that same sense of transparency can be applied to the foreign exchange exposure management process.

For many companies, finance is responsible for aggregating foreign currency transaction data from their ERP systems, which is then typically passed to treasury for appropriate risk management; whether it's simply allowing the risk to reside on the balance sheet, as part of a natural hedge, actively managing the risk through a derivative and identifying how the impact to the income statement should be accounted for. Automation creates the bridge between data aggregation, validation, and analysis, so that both finance and treasury have visibility to detail and summarize views of the company's currency exposures. As a result, discrepancies and potential errors become easier to spot, with instant visibility by every stakeholder in the process. That visibility extended beyond Treasury, Finance, and IT to executive management, who could gain a better understanding about how business practices impacted the company's exposure to foreign currency risk. Automating FX processes illuminates underlying business practices driving overall financial practices and put a new lens by looking at the big picture.

Strive for Continuous Improvement: Momentum Building

The concept of continuous improvement is a key component of Lean; one that prods companies to go from one-time process improvement initiatives to making customer value and waste elimination a way of doing business. Companies benefit most from implementing software tools to support their new process workflow and provide greater transparency, achieving ongoing improvements requires continuous communication, teamwork, and leadership.

As part of the analysis of waste elimination from FX exposure management processes, it is important to quantify the time saved on non-value-added activities and defined how that time/effort would be reapplied to creating additional value. In this way, Lean practices have the potential to build and "snowball" from one process to the next, where the more time saved and value added, the greater the opportunity to save more time and create even more value.

Source: April 2021 Currency Impact Report

https://info.kyriba.com/kdc/currency-impact-report-april-2021?_mv=7c03508c-fad8-4dd4-b5e1-e3e99263b3df

ABOUT KYRIBA FX

Kyriba Risk Management is the leading provider of corporate foreign exchange exposure management technologies. Kyriba Risk products and solutions are developed as the first solution to automate foreign exchange exposure management for multinational companies, delivering unparalleled expertise and driving measurable results.

Kyriba is dedicated to helping companies quantify their foreign exchange exposure and cost-effectively isolate their organization from the uncertainty of currency volatility. Through a combination of web-based software solutions and client services, Kyriba Risk helps organizations to ensure they have the proper accounting in place to accurately measure and manager foreign currency exposures, providing software tools and expert analysis that make it easy to maintain reliable FX exposure data, analyze foreign exchange exposures and their root causes, and make optimal decisions to eliminate exposures and reduce risk.

For more information, visit **https://www.kyriba.com/solutions/kyriba-risk-management/**