AFRICA MULTINATIONAL CORPORATIONS- NAVIGATING CURRENCY RISK

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Global Consulting

When implementing its strategic plans (regional expansion and M&A activity) and/or financing its operations the multinational corporation (MNC) has the option to either borrow locally in the home market or borrow internationally in the export market or beyond.

However, vagaries in economic conditions or changes in government policies (this list is not exhaustive) in either the home market or export market will impact valuations of either the home currency or the export market currency or both.

MNCs, therefore, need to take a long-term view to their financing needs and ensure that returns from investments funded through borrowing are able to cover, at the minimum, the cost of that borrowing- both interest and principal.

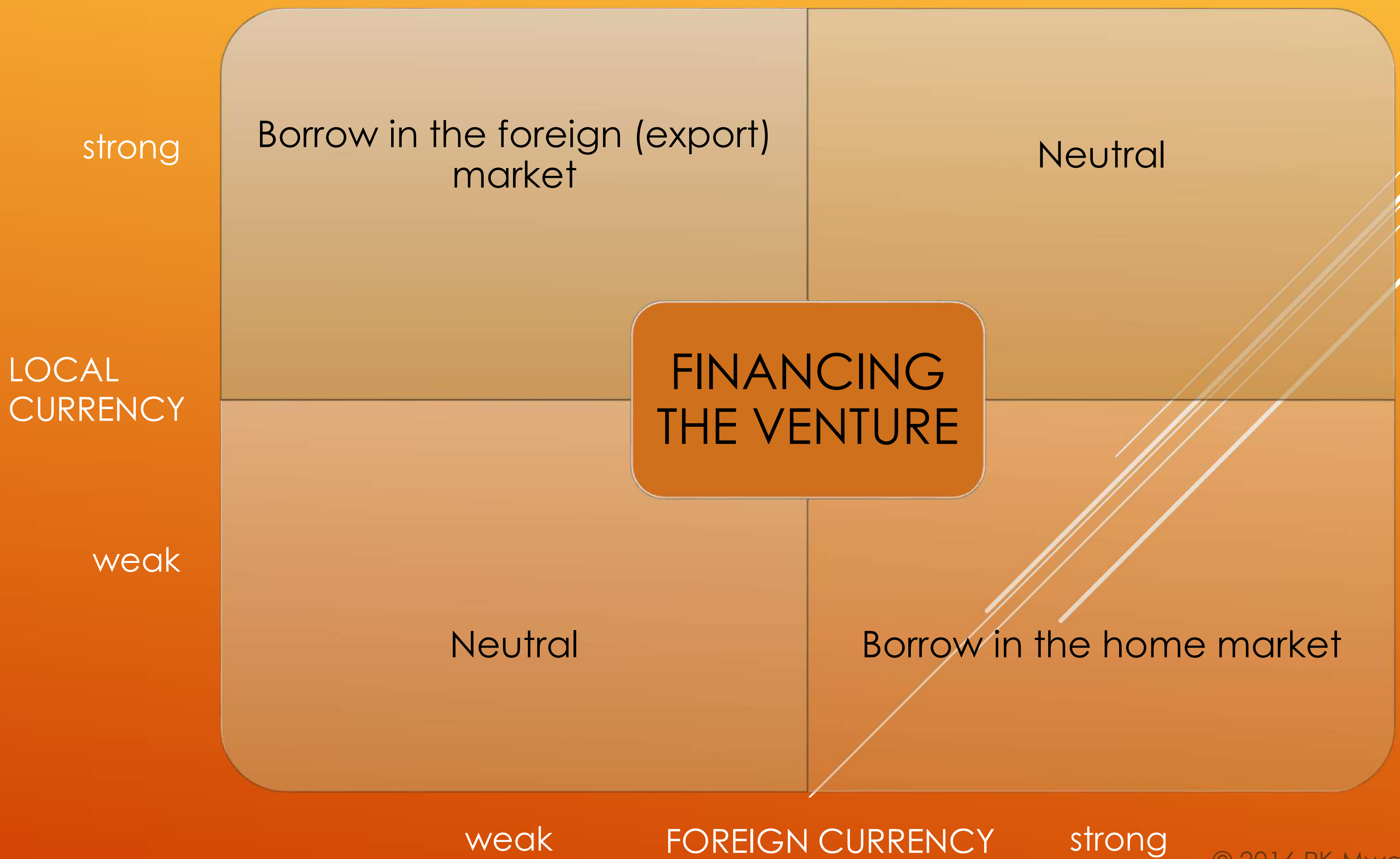
Consider the case of Athi River Mining Ltd. (ARM) headquartered in Kenya but with operations in Kenya, Tanzania and South Africa. Where there is sudden or regular devaluation of any of these export market currencies, say the South Africa Rand (ZAR), or a revaluation of the Kenya Shilling (KES), or both, every export currency unit of profit earned would be worth less than previous when repatriated back to Kenya.

This has the effect of increasing the cost of servicing debt where finance has been acquired by ARM in the Kenya market but have the opposite effect were much of ARM financing acquired in South Africa (in this scenario).

Conversely, where there is a sudden or regular revaluation of the KES, or a devaluation of the ZAR, or both, every export currency unit of profit earned would be worth more than previous when repatriated back to Kenya. This has the effect of decreasing the cost of servicing debt where finance has been acquired by ARM in the Kenya market but have the opposite effect of increasing the burden of debt servicing were much of ARM financing done in ZAR.

To better navigate this currency or foreign exchange risk, PK Mwangi Global Consulting has developed the following matrix to serve as an initial screen when sourcing finance.

MANAGING CURRENCY OR FOREIGN EXCHANGE RISK



CAVEATS

However, a number of caveats apply.

- The matrix ignores diversification in financing beyond the two markets
- A long-term view of the currency movements needs to be taken into account as:
  - these will fluctuate over time, and
  - interest payments (and the principal amount) will be paid into the future
- Hedge instruments (in currency forwards, futures, options and swaps) are available in addition to diversifying financing options

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