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Manufacturing & Distribution

Learning to play the new loonie tune

The effect of the rapid decline of the Canadian Dollar on the Manufacturing sector

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Two years ago, in July of 2013, the Canadian dollar had traded for several years in a range between $.95 to par with the US dollar. It was a comfortable rut that the currency had settled into for several years after the bungee jumps of the early 2000s that saw our dollar trade as low as $.63 to the greenback. It was also comforting in a general sense after the meltdown of 2008 to have a dollar that performed on par with the currency that set the international standard.

Our dollar at or near par did little to assist the country's export and manufacturing sectors, but with oil hovering around $100 a barrel and other commodity prices holding their own, the damage to the country's economy was limited to central Canada and the manufacturing sector in particular. Conversely, the obvious benefit was that Canadian consumers enjoyed buying imported goods with an elevated currency.

Fast-forward two years to July 2015 and the landscape has utterly, completely changed. That strong dollar has sagged to $.76 and many economists, including those at Bank of America-Merrill Lynch, predict it will sink below $.70 by year-end. That 20-25% drop in twenty-four months—with 15% of which occurred between August 2014 and February of this year—has been heavily covered in the news media with the same conclusion frequently made: the dollar's drop is good for manufacturing. As with all generalizations, the reality is significantly more complex.

If you go by the well respected RBC Canadian Manufacturing Purchasing Managers' Index than the answer is a clear yes. After several struggling months earlier in the year the PMI recorded solid growth in the manufacturing sector in June. "The RBC PMI returned to solid growth territory during June, reflecting the lift to Canadian manufacturers provided by an improved US economy and a more competitive Canadian dollar," said Craig Wright, senior vice-president and chief economist, RBC. "As we move through the summer months, we expect a trend improvement in the level of activity in the manufacturing sector."

Key findings from the June RBC PMI report include:

- Output growth accelerated at the fastest pace so far in 2015
- New business volumes increased for the first time since January
- The strongest upturn in export sales in seven months

All of which feeds credibility to the argument that a weaker dollar assists Canadian manufacturers, at least from the aerial view.

On the ground the reality is significantly more complicated.

First, as wonderful as it would be to suddenly have a 25% pricing advantage over your competition, it takes time, logistics and investment to develop new client and customer relationships (which is among the factors for the slow start to the year).

Second, should the goods that you manufacture contain components that are imported, than the benefit of the lower dollar is blunted by the fact that your production expenses have increased accordingly. This has been the situation for Canadian agriculture equipment manufacturers. True, the search for domestically manufactured replacements for these parts and components will further boost the sector; but as with developing new business, this takes time and resources to explore.

A third area of caution is for those manufacturers whose products include commercial or retail packaging. Specifically, any product with a printed price and a bar or UPC code, is locked in to that pricing until new goods and packaging can replace it. This is compounded by the inventory systems such as SAP that most large retailers employ. Forcing new pricing through these marketplaces takes time and resources no matter how nimble the manufacturer may be. Worse still, the 25% pricing advantage may have disappeared by the time these newly priced materials reach their market, which is why most manufacturers proceed with caution in such situations.

Further examples abound which play down the widely held generalization that the lower dollar assists the Canadian manufacturing sector. The reality is complex and contains a diverse mixture of positive and negative results. Managing the risk that currency fluctuations pose for your business is a difficult proposition because of these complexities. A sharp movement up or down in the dollar can offer both positive and negative opportunities, which can make it difficult to know how best to proceed.

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There are few situations in business more applicable for the application of risk management than currency fluctuations, yet undertaking a serious effort at risk management consumes precious time and analytic resources. It is for this reason that many corporations outsource this task to a risk advisory professional.

A qualified risk advisor will assist your organization in establishing a proactive approach to managing—and even exploiting—currency exposure risks. There are several steps that a risk advisor would most likely propose in a situation like our current currency slump. These include:

- Drilling down into all major costs and revenues to understand the impact of changes in exchange rates, both positive and negative.
- Determining if patterns and trends exist within a given currency fluctuation in order to identify the most effective corporate positioning moving forward.
- Discerning the level of protection within existing contract terms with key suppliers and customers, and recommending negotiated changes where necessary to match currency between expenditures and revenues.
- Exploring the possibility of passing on exchange fluctuations to customers and/or suppliers, if possible without damaging these key relationships.
- Contacting alternate suppliers that provide better pricing options because of their positioning within the currency fluctuation, including establishing standing orders with multiple suppliers so that you can rapidly redirect sourcing as needed.

In addition to these points, a qualified risk advisor can recommend key corporate governance initiatives, including internal audit and strategic planning services, that can help your corporation's preparedness to handle future currency fluctuations. For example:

- Establishing your organization's appetite and tolerance for currency fluctuations moving forward—it could be that a better positioning stance would be to reduce risk by pivoting to concentrate on the domestic market; or, conversely, that expansion of export activities best suits your corporate goals.
- Linking currency fluctuations to existing operational effectiveness and budgeting to more accurately reflect true revenues and expenses.
- Establishing a regularly scheduled internal audit to more accurately assess and monitor interrelated risks on an ongoing basis.

The rapid drop in the Canadian dollar has created conditions that are potentially advantageous for Canadian manufacturers; however, the environment is not without risk and mitigating that is the best response for growing your business. BDO Risk Advisory services assists organizations in establishing just such a proactive approach to managing and even exploiting currency exposure risks.

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