# GETTING THE MOST FROM EVERY DOLLAR

## What owner-managed businesses need to know about the exchange rate

The Canadian dollar has borne the brunt of a lot of uncertainty over the last 12 months. As oil prices tumbled in January, the Canadian dollar exchange rate faded to less than $0.70 US – a rate not seen since 2003. While the dollar has rebounded somewhat since that almost 13-year low, some forecasts indicate that the dollar could sink under $0.60 US before the year is out.

As the dollar continues its downward slide, Canadian consumers are starting to feel sticker-shock. With the price of everything from cauliflower and cucumbers to international travel going up, consumers are reigning in their spending. For example, Canadian snowbird traffic to the US is expected to drop as the exchange rate increases the cost of warm-weather getaways.

But while a lot has been said about the impact the falling dollar has had on consumers, the impact on Canadian owner-managed businesses has received less attention. The reality is that there is a lot companies can do in order to adapt to the low dollar and manage currency fluctuations. Weathering the storm is not the only option.

## Exchange rates low and predicted to get lower

After reaching a high of $1.10 US in 2007, the Canadian dollar remained relatively stable for years. But over the past twenty-four months, the value of the dollar has slipped dramatically. There are numerous reasons for the slide. The most notable of course is falling oil prices. In just a year and a half, the price of oil has dropped approximately 70 percent. While Canada may be trying to shift the perception that we are a resource-driven economy – the fact is we aren't there yet. As resource prices drop, so does the perception of our economy. Continued discussion around interest rate cuts and the possibility of negative interest rates in Canada do not help matters, especially in light of the US raising their key interest rate for the first time in a decade.

## Exchange rate impact on owner-managed business

The low Canadian dollar has already begun to have dramatic repercussions on Canadian companies and over time this will only increase. The impact of course is varied and depends greatly on the makeup and industry of the company. In general, companies that export much of their product to the US will see a positive effect, while importers will see a negative one. For importers, the effect can be compounded because if they pass the exchange rate on to their consumers, in the form of increased costs, they may lose sales.

Understanding the potential issues associated with a low or fluctuating Canadian dollar can help businesses make better decisions. By taking advantage of the positive outcomes to their organizations while managing or mitigating the negative ones, companies can set themselves apart from their competition. Four key areas that businesses should consider when it comes to a low Canadian dollar include:

### Expansion opportunities

A low Canadian dollar can provide significant opportunities for companies to expand their business internationally. With the dollar low, Canadian companies can be extremely price competitive in the US as a result of their lower costs of production. This is particularly true for industries that export much of their products south of the border, from manufacturers and consumer products companies to technology developers and agriculture producers. In the case of the agricultural industry, the loonie's drop has also helped cushion producers from falling global agricultural commodity prices.

### Increased foreign investment

For Canadian businesses looking for investment, the low Canadian dollar provides a strong incentive to foreign investors. Already, there have been numerous stories in the media surrounding the dramatic increase in foreign investment in Canada, especially in real estate and technology.

In the real estate sector, foreign investors are poised to account for a record number of commercial property purchases in Canada this year according to a forecast by the world's largest real estate services firm, CBRE.

Meanwhile, Canadian entrepreneurs and emerging technology companies have a distinct advantage in a low dollar environment when it comes to attracting interest from US Venture Capital investors. That's because these companies can stretch every dollar invested further than their US-based counterparts – giving them a better position to compete on price in the marketplace.

### Rising cost of inputs

When it comes to a low Canadian dollar, owner managed businesses need to also manage: the cost to their supply chain. It is easy for companies operating solely in Canada


to imagine they are immune to a fluctuating Canadian dollar. The reality couldn't be farther from the truth.

Most companies in Canada have suppliers based in different countries, or have suppliers who get products from other countries. Many of these suppliers use the US dollar for transactions. As a result, as the Canadian dollar declines against the US dollar, the cost of goods rises. This means that restaurants may pay more for food staples, while retailers pay more for materials and manufacturers pay more for inputs. In the manufacturing industry, where it is widely believed that approximately 50% of inputs are imported, companies need to seriously consider the flexibility of their supply chain and how they will manage significantly increased costs.

Canadian retailers will likely also feel increasing pressure around their supply chain as many rely on products that are manufactured in the US. Whether its books, clothing or higher priced electronics, retailers will have to charge more, which could degrade their domestic sales as their expenses rise.

### Increased currency risk

One challenge Canadian companies have to think about beyond the general decline of the dollar is the way the Canadian dollar is fluctuating. These fluctuations make it more complicated for businesses to predict exactly how they will be affected. When the dollar value can change several cents between one week and the next, the ability to forecast revenues and expenses can get complex. For companies that don't proactively manage their exchange risk, they could find their profitability at risk simply because they've picked a bad day to exchange currencies.

## Making the most of every dollar

As can be seen from the above, the low dollar and currency fluctuations impact every owner-managed business differently.

The current state of the Canadian dollar and predictions of an extended low-value environment bring up a lot of questions: *Should I shift my supply chain to Canada? What kind of currency protection can I put into place? Should I expand into the US? How can I attract foreign investment into my business?*

There is no single right answer to any of these questions; there is only the right answer for your business. This is why you need to examine all aspects of your organization in light of the low and fluctuating Canadian dollar. So, what should you do?

As a starting point, entrepreneurial businesses should consider the following tactics:

- **Understand the impacts to your business:** Investigate your exposure to currency exchange risk, both from a revenue and expenses point of view. By understanding how your organization will be affected by currency fluctuations, you can make informed risk mitigation decisions.
- **Focus on US-dollar sales and Canadian-dollar expenses:** Where possible, focus on increasing your US-dollar sales, either by increasing exports or by setting up operations there. Meanwhile, look for ways to decrease your reliance on imports or suppliers working in US-dollars. As supply contracts come up for renewal, investigate alternatives.
- **Consider export markets:** In addition to exporting to the US, consider other export markets. A low Canadian dollar could make your products more attractive to buyers in a number of foreign markets whose currencies have appreciated against the loonie.
- **Develop a plan to manage fluctuations:** If you have significant operations or suppliers in the US, develop a currency exchange risk plan to manage your exposure to exchange rate fluctuations. This could include opening a US bank account to limit the need to exchange funds to pay suppliers. Alternatively, you could use different types of hedges, like hedging options or forward contracts. Each of these comes with unique costs, so speaking to an advisor can help determine the best option for your organization.

When you look at the different economic forecasts, it is apparent that the low Canadian dollar is here to stay. Whether the value continues to fluctuate around $0.70 USD or sinks lower, businesses need to act now to make sure they can minimize their risks and maximize their benefits.

For an owner-managed business, every dollar counts when it comes to remaining sustainable and profitable. By taking steps to understand your exposure to exchange rate fluctuations, and to mitigate these fluctuations, you will be well positioned to get the most value, regardless of the exchange rate.

For more information on weathering the fluctuating exchange rate and other related issues, please contact your local BDO advisor or one of our industry leaders below:


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