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Currency Risk Management Practices Among Export-Oriented SMEs: A Comparative Study

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ABSTRACT: Export-oriented small and medium enterprises (SMEs) face significant exposure to currency fluctuations, yet often lack the financial sophistication or resources to implement formal hedging strategies available to larger multinational firms. This study examines the currency risk management practices adopted by SMEs across different export sectors, ranging from informal natural hedging techniques to limited use of financial derivatives. Drawing on survey and interview data from 247 SME exporters across four countries, the paper identifies key barriers to adopting formal hedging instruments, including cost, financial literacy gaps, and limited access to banking relationships that offer derivative products. The findings reveal a strong correlation between firm size, export market diversification, and the sophistication of risk management practices employed. The paper concludes with policy recommendations for trade finance institutions and banks to develop more accessible currency risk products tailored to SME needs.

KEYWORDS: currency risk management, SME exporters, foreign exchange hedging, natural hedging, financial derivatives, trade finance, exchange rate exposure

1. INTRODUCTION

Exchange rate volatility represents one of the most persistent and consequential financial risks facing internationally active SMEs. Unlike commodity price risk or interest rate risk — which can often be partially offset through domestic hedging markets — currency risk is inherently international in character, requiring access to foreign exchange derivatives markets that are predominantly structured to serve larger institutional clients. For SMEs, whose export revenues may be denominated in foreign currencies while their costs remain largely in domestic currency, unmanaged exchange rate exposure can transform profitable export contracts into loss-making obligations with minimal warning.

The academic and policy literature on currency risk management has historically focused on large multinational corporations, which possess dedicated treasury functions, sophisticated risk management systems, and access to a full range of derivative instruments. SMEs, by contrast, have received comparatively limited scholarly attention despite their significant and growing role in global trade. This gap is consequential: SMEs account for approximately 34% of total export value in OECD economies (OECD, 2022), and their capacity to manage currency risk effectively is directly linked to their ability to maintain stable export pricing, build long-term customer relationships, and sustain profitable international operations.

This paper addresses this gap through a comparative analysis of currency risk management practices among export-oriented SMEs, drawing on primary survey and interview data collected across four countries with diverse institutional contexts and export profiles. The study identifies both the range of practices currently employed and the structural barriers that prevent wider adoption of formal hedging instruments, generating insights relevant to both policy design and financial institution strategy.

2. LITERATURE REVIEW

2.1 Currency Risk Exposure in Exporting SMEs

Currency risk in exporting SMEs manifests primarily as transaction exposure — the risk that exchange rate movements between the time a contract is agreed and the time payment is received will erode the domestic-currency value of foreign-currency receivables. For SMEs with limited working capital, even modest adverse exchange rate movements can create significant cash flow difficulties, particularly when export contracts are denominated in major trading currencies (USD, EUR, GBP) while the SME's financing costs and wage bill are denominated in a more volatile

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local currency (Pramborg, 2005).

2.2 Hedging Instruments and SME Accessibility

The primary instruments used for currency risk management include forward contracts, currency options, currency swaps, and natural hedging strategies. Forward contracts — agreements to exchange currencies at a predetermined rate at a future date — are the most widely used derivative for transaction exposure management, offering certainty of cash flows at a known cost. However, their accessibility for SMEs is constrained by the requirement for credit lines or collateral deposits, which many smaller firms cannot provide (Géczy et al., 1997).

Natural hedging — matching foreign-currency revenues with foreign-currency costs through strategies such as invoicing exports in the domestic currency, sourcing inputs internationally, or borrowing in the export currency — represents an accessible alternative to formal derivative instruments. However, natural hedging is inherently incomplete and context-dependent: invoicing in domestic currency shifts exchange rate risk to the buyer, potentially undermining competitive positioning, while foreign-currency borrowing introduces refinancing risk.

2.3 Barriers to Formal Hedging Adoption Among SMEs

Survey-based studies consistently identify several barriers to formal hedging adoption among SMEs: the perceived complexity of derivative instruments (Marshall, 2000); the fixed costs of establishing and maintaining derivative positions, which create economies of scale that disadvantage smaller hedgers (Nance et al., 1993); limited financial literacy among SME owner-managers regarding the mechanics and costs of hedging; and inadequate access to the banking relationships through which derivative products are typically sold (Fabling & Grimes, 2015).

3. METHODOLOGY

3.1 Research Design and Sample

The study employs a sequential mixed-methods design, beginning with a quantitative survey of 247 export-oriented SMEs across four countries (United Kingdom, India, Poland, and South Africa), followed by semi-structured interviews with 32 purposively selected survey respondents. The four countries were chosen to represent diverse institutional contexts — including differences in financial market development, banking system accessibility, and export support infrastructure — while maintaining a common characteristic of significant SME participation in international trade.

3.2 Survey Instrument

The survey instrument comprised four sections: (1) firm characteristics (size, sector, export markets, years of exporting experience); (2) currency risk exposure assessment (proportion of revenues in foreign currency, primary trading currencies, invoice currency choice); (3) currency risk management practices (current hedging instruments used, frequency of use, decision-making process); and (4) barriers to enhanced risk management (21 items rated on a 5-point Likert scale, based on items from the Marshall (2000) barrier taxonomy). The survey was pilot-tested with eight SME finance managers before fielding.

3.3 Analytical Approach

Quantitative data were analysed using descriptive statistics, cross-tabulations, and ordered logistic regression to examine the determinants of hedging sophistication (measured as an ordinal scale from no hedging to full formal derivatives use). Interview data were analysed using thematic analysis (Braun & Clarke, 2006), with emergent themes verified through member-checking with six interview participants.

4. FINDINGS AND ANALYSIS

4.1 Prevalence of Currency Risk Management Practices

Survey results reveal significant variation in currency risk management sophistication across the sample. Approximately 38% of respondents reported using no formal currency risk management strategy whatsoever, relying entirely on natural exposure from domestic-currency cost structures. A further 31% reported using informal natural hedging techniques — primarily domestic-currency invoicing and accelerated payment terms — while 21% used basic forward contracts for some portion of their foreign currency exposure. Only 10% reported using a comprehensive hedging programme including options or swaps, with this group concentrated among larger SMEs (50–249 employees) with established banking relationships.

4.2 Barriers to Formal Hedging Adoption

Factor analysis of the 21-item barrier scale identified four principal barrier dimensions: cost-related barriers (derivative pricing and collateral requirements), knowledge barriers (understanding of instrument mechanics and accounting treatment), relationship barriers (access to banks offering FX derivative products), and perception barriers (belief that hedging is unnecessary or counterproductive). Cost and knowledge barriers received the highest mean ratings ($M = 4.1$ and $M = 3.9$ respectively on the 5-point scale), while perception barriers were rated lowest ($M = 2.7$), suggesting that SME managers generally recognise the existence of currency risk but are prevented from acting on this recognition by structural and informational constraints.

4.3 Firm Size and Hedging Sophistication

Ordered logistic regression confirms that firm size is the strongest predictor of hedging sophistication (OR = 2.14 per size category, 95% CI [1.67, 2.74], $p < 0.001$). Export market diversification — measured as the number of distinct export markets served — is also a significant positive predictor (OR = 1.31 per additional market, $p < 0.01$), consistent with the hypothesis that firms serving multiple currency markets develop greater FX risk awareness and build banking relationships that facilitate derivative access. Country of domicile significantly moderates the size-sophistication relationship, with UK SMEs demonstrating higher hedging sophistication at all size levels compared to Indian and South African SMEs of equivalent size.

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5. DISCUSSION

The finding that nearly 70% of exporting SMEs in the sample rely on informal or no currency risk management strategies represents a significant vulnerability in the international trade system. For these firms, currency risk is not managed but absorbed — either through implicit price adjustments that erode export competitiveness, or through cash flow losses that undermine financial stability. The concentration of formal hedging among larger SMEs with established banking relationships suggests that market solutions alone are unlikely to extend risk management access to the full SME exporter population.

The identification of cost and knowledge barriers as the dominant impediments to hedging adoption has clear implications for policy design. Financial literacy initiatives targeting SME owner-managers — specifically addressing the mechanics, costs, and accounting treatment of foreign exchange derivatives — could meaningfully shift the knowledge barrier dimension. However, knowledge alone is insufficient if structural cost barriers remain: the development of simplified, standardised, low-cost currency hedging products specifically designed for SME transaction sizes is a necessary complement to financial education.

6. CONCLUSION

This paper has documented the currency risk management practices of export-oriented SMEs across four countries, finding pervasive under-hedging driven by a combination of cost, knowledge, and relationship barriers. The strong size gradient in hedging sophistication — with formal derivative use concentrated among larger SMEs with established banking relationships — suggests that the foreign exchange market is structured in a way that systematically disadvantages smaller exporters.

The policy implications are clear. Trade finance institutions, export credit agencies, and commercial banks should develop simplified, standardised FX hedging products — analogous to the standardised trade insurance products that have successfully extended export risk coverage to SMEs — at price points accessible to firms with transaction sizes below the minimum thresholds currently imposed by wholesale derivative markets. Simultaneously, export support agencies should integrate FX risk management education into their SME internationalisation support programmes as a standard offering, recognising currency risk management as a core competency for sustainable international trade engagement.

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