# Are Albanian Businesses Protected Against Exchange Rate Risk? A Study on Forward Contracts and Euro Depreciation

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***Abstract***

*Exchange rate fluctuations are a significant challenge in global trade, affecting every stage of the goods and services distribution chain. This study explores the impact of exchange rate volatility on international business and economic exposure, focusing on Albania's recent Euro depreciation and its effects on exporters. The sharp appreciation of the Albanian Lek (ALL) has reduced the competitiveness of Albanian exports, exposing businesses to significant financial risks. The research examines the role of forward contracts as a hedging tool for managing exchange rate risks. Given that businesses are the primary users of such instruments, a survey was conducted among Albanian companies, mainly exporters and importers, to assess their awareness, understanding, and usage of forward contracts. While a few banks offer these instruments, their adoption remains extremely limited. Findings show a high level of exposure to exchange rate risk, a low level of financial literacy regarding hedging tools, and delayed institutional responses to currency fluctuations. The results highlight a substantial gap in risk management practices, underscoring the need for enhanced financial education and institutional support to help businesses safeguard themselves against currency volatility.*

***Keywords:** Forward Contracts, Exchange rate risk, Financial Hedging*

## 1. Introduction

Certain assets or investments, when combined, produce a currency hedge that reduces the risk of foreign exchange rate losses. Managing foreign exchange risk is a necessity for companies operating in the international market, as it enables better protection of their bottom lines through strategies that involve hedging against adverse changes in the global exchange rate. Implementing this plan of action activates a defense against significant losses due to currency fluctuations. To capitalize on opportunities for improving tools that enhance profitability, businesses must incorporate the use of foreign exchange rate risk management by leveraging favorable exchange rate trends. A careful valuation must be conducted when deciding among the tools used in foreign exchange rate risk management, analyzing each instrument alongside the capacities and expertise that the company has in place to manage these risks effectively.

In a simplified view, exchange rates are essentially the price of a country's currency and are related to the prices of other currencies. Like the prices of other goods and raw materials, the exchange rate is determined by market forces of supply and demand. In contrast to other goods and raw materials, foreign currency is typically not purchased independently. They are used as a medium of exchange for foreign goods, services, and securities. Depending on prices and tastes, the amount of foreign goods and services a population in a country will require also varies. This demand gives rise to an interdependent relationship between supply and demand for foreign currency, and consequently, the price. Exchange rates reflect basic economic power and are volatile in a world of unexpected economic change (Alfaro, Cadena, & Varela, 2021).

This paper focuses specifically on the dynamics of the exchange rates of the Albanian Lek (ALL) and the Euro (EUR). The strengthening of the local currency has reduced export competitiveness and has affected the stability of companies' income in international trade. This sudden change has led to a lack of widespread use of financial security measures, including forward contracts, that may contribute to reducing these risks. This study contributes to the existing literature primarily by investigating the leading causes of this gap through a survey to assess the perception, understanding, and use of forward contracts, with a specific focus on exporters and importers of Albanian companies. This approach was chosen because companies are the end users and direct beneficiaries of such products, and they are most affected by currency fluctuations. Banks play a crucial role in providing security measures. Still, their perspectives are more technical and less focused on the widespread dissemination of information about the benefits and risks associated with them. Understanding a perspective like corporate demand therefore provides more implementable insight into the reasons for the low, almost non-existent use of Albanian forward contracts.

In particular, the results demonstrate a significant lack of awareness and practical use of forward contracts as a protective mechanism. This lack of motivation strengthens the safety sensitivity of Albanian exporters in a volatile forex environment. This study concludes by emphasizing the importance of financial education in risk management instruments and advocates for a greater commitment to financial and public institutions to disseminate advanced information on forward contracts and other security instruments as essential tools for economic stability and competitiveness.

The paper is organized as follows. The next section presents a comprehensive literature review on currency risk exposure, its associated problems, and hedging strategies. This is followed by a general overview of the Albanian situation regarding currency fluctuations and the use of forward contracts. The third chapter consists of Methodology, introducing the research methods used, sample selection, and data collection. The fourth chapter presents the results of this paper through a quantitative analysis and concludes this research with general conclusions about the Albanian situation regarding the use of forward contracts.

## 2. Literature Review

Different studies have traditionally identified exchange rate instability as a significant deterrent to international trade. Various exchange rates allow effective prices of foreign goods and services to introduce risks into uncertainty and international transactions. In 1945, the focus and desire to reduce uncertainty led to the introduction of the Bretton Woods international monetary system. The resulting pressure led to the system being replaced in 1971, as the volatility of exchange rates that characterized the system had increased the need for a forex system where operational capital could protect against the risk of adverse exchange rate movements.

Companies can manage foreign exchange risk through a variety of instruments that serve to mitigate this type of risk, including forwards, futures, options, swaps, and others. Each of the above tools has its advantages and disadvantages, so it is essential to understand the details of each method and the associated risks before deciding what is best for a particular company, considering also the country's macroeconomic conditions in which it operates. Confronted with potential significant losses, most companies have contacted the forward market to limit the negative impact of exchange rate movements, which has led large international banks to traditionally provide forward cover to global clients to mitigate their forex exposure (Falótico & Scudiero, 2023).

### *2.1 Problems related to currency exposure*

The complex nature of currency risk presents significant challenges and opportunities for multinational companies, investors, and financial managers. If globalization continues to strengthen, the understanding and management of foreign exchange risk will become increasingly essential to protect international investments and ensure financial stability. Several studies have examined the motivations and effectiveness of security strategies. In 2001, the study of Alleyannis and Offek confirmed that currency derivatives effectively reduce exchange rate exposure of companies (Allayannis & Ofek, 2001). Studies of Swedish companies in 2004 found that transaction and translation protections significantly reduced exposure to foreign exchange risk, thereby making the size and level of exposure of companies necessary. The results concluded that foreign exchange exposure in Swedish firms decreased with hedging. Studies in 2010 challenged traditional motivations for the use of derivatives, highlighting competitive pricing and internal conclusions of contracts (Aretz & Bartram, 2010).

Nahum Biger (1979). Cushman (1983) and Eric and Steinherr (1989) examine the broader impact of exchange rate fluctuations. Biger in 1979 emphasizes the expected importance of foreign exchange fluctuations in international portfolio diversification, giving a sight to understanding how currency fluctuations affect the overall risk and return of global portfolios (Biger, 1979), Cushman (1983) investigates the overall negative impact on international trade volumes and concludes a nuanced view of actual exchange rate risks which plays a significant role in global trade by directly affecting decision making in companies (O.Cushman, 1983). According to Eric and Stenheirr in 1989, it is important to study the relationship between exchange rate uncertainty and international trade. Based on their study, it is clear that uncertainty in medium-term exchange rates has an adverse effect on commercial currents in developed countries, which vary widely from country to country, and a significant adverse impact is determined (Peree & Steinherr, 1989).

### *2.2 Methods for exposure hedging*

Exchange rate risk management is an integral part of all companies' foreign currency exposure decisions (Allayannis, Ihrig, & Weston, 2001). In their study, the researchers examine the various strategies that firms can employ to manage exchange rate risk using currency derivatives. Ensuring a currency risk strategy involves eliminating or reducing this risk, understanding how exchange rate risk affects the business activities of economic agents, and employing techniques to address the consequences of consistent risk effects. In their book, the authors give a comprehensive guide that focuses on how organizations can implement effective Enterprise Risk Management (ERM) strategies. Due to the complexity of accurately measuring current risk exposures and making informed decisions about which risk exposures to cover, selecting the right security strategy is often a challenging and demanding task that requires careful consideration. The authors highlight that stable currency rates maintained by this risk management approach allow businesses particularly those with significant international operations, to make more informed decisions when determine their pricing strategies and resource allocation, while also emphasizing that hedging choices are influenced by factors like firm size, foreign revenue exposure, and market conditions while also emphasizing that factors like firm size, foreign revenue exposure, and market conditions influence hedging decisions.

#### *2.2.1 Impact of Forward Contracts in Mitigating Economic Exposure*

When determining forward contracts, we define them as customizable contracts with the participation of two parties agreeing to sell or buy an asset on a future date at a specified price (Dao, Nguyen, & Hussain, 2021). In sectors with high currency risk exposure, forward contracts are profitable as they enable companies to guarantee prices in international markets for future financial transactions. Multinational firms must be proactive in understanding the benefits of using forward contracts to lock in an exchange rate for the future. For many companies, especially those with significant economic risks, forward contracts have a profoundly positive effect. This is particularly true for exporting companies in the home appliance and automotive industries, where it is strongly recommended to use forward contracts as a management tool, as they are crucial for maintaining profit margins.

The impact of currency fluctuations on profit margins is evident in German automakers. In this case, German companies deal with a strong euro, which increases the price of European exports in international markets such as the US and China, making them less competitive. For companies that utilize forward contracts in their security strategies, this approach can effectively mitigate the risks associated with currency fluctuations, thereby ensuring ongoing profitability and competitiveness in foreign markets.

*2.3 Albanian currency towards EUR and USD in the period of 2004 – 2024 (Graphic and Analysis)*

In Albania, companies, according to a 2020 study by Kolli, use natural hedging to manage currency risk. This involves importing goods in euros and then selling them in the same currency, thereby avoiding currency fluctuations (Kolli, 2022).

**Table 1.** Official Currency exchange Lek to Eur (2015-2024)

| Year | December Average (ALL per 1 EUR) |
|---|---|
| 2015 | 137.65 |
| 2016 | 135.27 |
| 2017 | 133.25 |
| 2018 | 123.45 |
| 2019 | 122.17 |
| 2020 | 123.55 |
| 2021 | 120.81 |
| 2022 | 114.93 |
| 2023 | 102.78 |
| 2024 | 98.3 |

**Source:** Bank of Albania

Studying the EUR/ALL currency rate movements for the period from 2015 to 2024, it can be observed that the Albanian lek (ALL) experienced consistent appreciation against the euro (EUR). In December 2015, the average exchange rate stood at 137.65 ALL per 1 EUR. By December 2024, this figure had fallen to 98.30 ALL, marking an overall decrease of approximately 28.6% over the last ten years. It creates a mix of effects on the Albanian economy, like the effects of a stronger lek. While it helps reduce the cost of imported goods and lowers imported inflation, on the other hand, it challenges the competitiveness of Albanian exports, making locally produced goods relatively more expensive in foreign markets.

**Table 2.**Official Currency exchange Lek to USD (2015-2024)

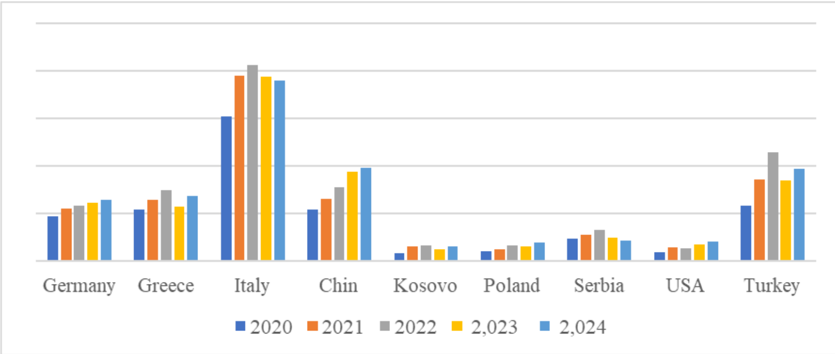
| Year | Average December Rate (ALL per 1 USD) |
|---|---|
| 2015 | 126.64 |
| 2016 | 128.29 |
| 2017 | 112.56 |
| 2018 | 108.43 |
| 2019 | 109.94 |
| 2020 | 101.59 |
| 2021 | 106.86 |
| 2022 | 108.52 |
| 2023 | 94.16 |
| 2024 | 93.89 |

**Source:** Bank of Albania

The trend of the Albanian currency toward the USD has also followed a similar path to the euro, where between December 2015 and December 2024, the Albanian lek (ALL) displayed a general appreciating trend against the US dollar (USD). The most notable strengthening occurred between 2016 and 2017, during which the rate dropped significantly from 128.29 to 112.56 ALL (approximately a 12.3% appreciation), reflecting macroeconomic factors such as increased foreign investment, strong remittance flows, and a favorable trade balance.

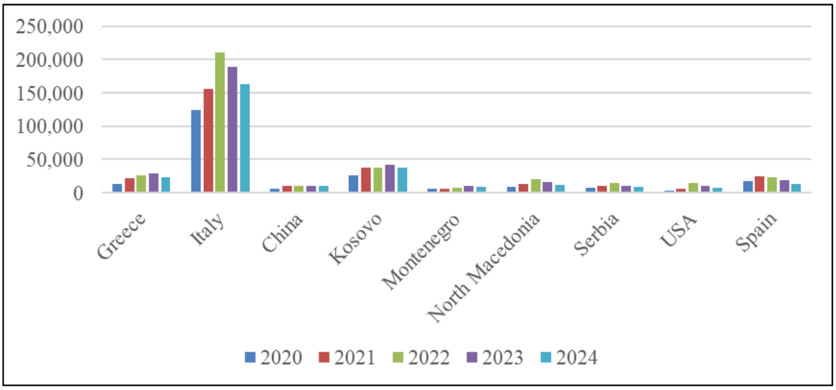
*2.3.1 Business exposure to the euro currency through export and import*

For companies that operate their business using multiple currencies, determining a specific exchange rate ensures that revenues, cost structure, and profits do not fluctuate unexpectedly due to changes in production prices caused by depreciation or the recognition of foreign currency in the domestic currency.



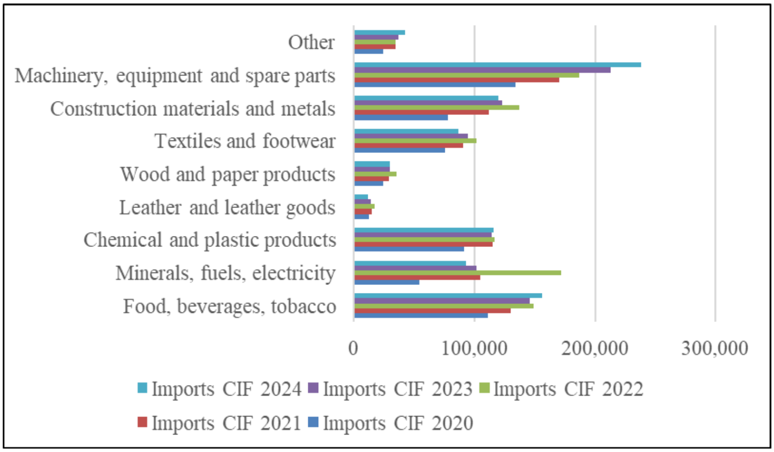

**Graphic.** 1 Imports based on countries 2020 – 2024 (mln ALL)
**Source:** INSTAT

Italy has consistently held the first position with the highest number, although there has been a decline since 2022. Greece and Kosovo show steady growth until 2023 but then record a decrease in 2024.



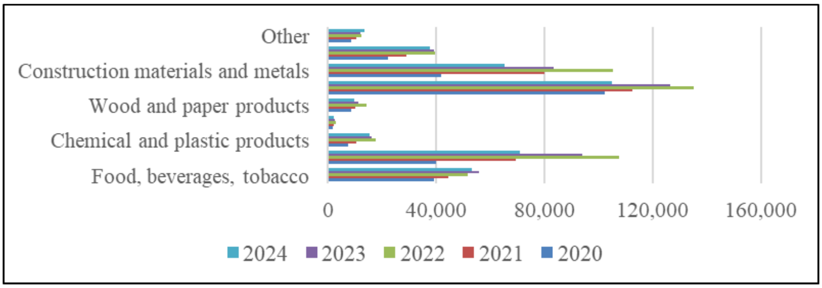

**Graphic. 2.** Exports based on countries 2020 – 2024 (mln ALL)
**Source:** INSTAT

Italy has contributed the most to the total each year, followed by Turkey and China, which have also shown steady growth. Greece and the USA have experienced fluctuations, while Kosovo and Serbia remain at lower levels but show gradual growth.




**Graphic. 3.** Imports based on products 2020 – 2024 (mln ALL)
**Source:** INSTAT

Imports have increased the most in machinery and equipment, which continue to dominate the market every year. Chemical products and food have remained stable with slight growth, whereas imports of minerals and textiles have declined after 2022.




**Graphic. 4** Exports based on products 2020 – 2024
**Source:** INSTAT

Between 2020 and 2024, Albanian exports experienced a significant increase, particularly in the categories of minerals and textiles, until 2022. In 2023 and 2024, there was a decline in the production of construction materials, minerals, and textiles.

*2.3.2 Actions held in the Albanian market as innovations to foreign exchange risks*

In this section, we will analyze the top events held by the Central Bank of Albania in 2023 and 2024, including actions taken in the foreign exchange market. In 2023, the Bank of Albania actively intervened in the foreign exchange market to bolster its foreign reserves. During the fourth quarter, it conducted four foreign currency purchase auctions, three of which used forward contracts and one spot transaction. The total amount purchased for the quarter was € 66 million, in line with previous periods. These auctions injected 5.35 billion lek into the banking system, contributing to a total liquidity injection of 25.1 billion lek for the year through foreign currency operations. The Bank maintained its 2023 target of purchasing between 160 and 220 million euros through auctions, while the number of auctions scheduled for 2024 increased from 17 to 20, with individual auction sizes remaining between 5 and 10 million euros. The EUR/ALL exchange rate during Q4 2023 traded within a narrower range of 101.20–106.20 lek per euro, averaging around 104.00 lek. By the end of the year, the rate had strengthened to 103.30 lek, representing a 2.8% appreciation from the start of the quarter. In parallel, the Ministry of Finance (MoF) closed its 85 million euro SWAP agreement with the Bank of Albania by year-end and expressed interest in increasing the SWAP ceiling to 50 billion lek for 2024. Additionally, € 2.1 million was purchased from IPA program funds.

In 2024, the Bank of Albania intensified its foreign exchange market interventions. It conducted four purchase auctions in the latest quarter, comprising three forward contracts and one standard auction, acquiring € 55.2 million. Cumulatively for 2024, 283.8 million euros were purchased through auctions. Simultaneously, direct purchases totaling 335.3 million euros were executed, bringing the year's total foreign currency acquisitions to 932.8 million euros. Notably, 649 million euros of this amount were allocated to maintaining the minimum reserve level. The central bank has set a 2024 target of purchasing 250–330 million euros, which is expected to rise to 270–350 million euros for 2025. Plans for 2025 include 22 auctions, each ranging from 5 to 10 million euros, involving both 1-month and 3-month forward contracts. Foreign exchange interventions in 2024 injected 36.8 billion lek into the banking system's liquidity, a notable increase from 28.3 billion lek in the prior quarter. However, fluctuations in liquidity persisted, influenced by rising currency in circulation and falling government deposits. The Ministry of Finance did not engage in SWAP agreements during the second half of 2024. Still, it did exercise its option to purchase foreign currency from the central bank, amounting to 14 billion lek. Furthermore, € 1.83 million was acquired from the IBRD and € 3,600 from the IPA program funds.

## 3. Methodology

Choosing an appropriate methodology to study the role of forward contracts as hedging tools in the Albanian market is challenging due to the multitude of factors influencing companies' behavior and capacities (Heta & Mulleti, 2013). In attempts to find the most appropriate method for studying companies' exposure to currency exchange risk and the tools used to manage it, we considered a survey delivered to import-export companies to assess their awareness, understanding, and usage of forward contracts.

### *3.1 Data Collection and Sampling*

Primary data were collected through a structured survey, designed to gather insights into the sector of activity, annual income, the main currency in import and export, the impacts of exchange rate fluctuations, as well as knowledge of forward contracts and their use.

The survey was distributed to a sample of 25 companies targeting only companies that deal with import or export at a level of over 85%.

### *3.2 Data Analysis Techniques*

The collected data were analyzed using graphics and descriptive analyses, interconnecting and summarizing the received information.

## 4. Results

The primary data for our research were collected through surveys, each consisting of thirteen questions. The design of the study was conducted after reviewing the literature, identifying key elements that affect exposure to exchange rate risk and the benefits of forward contracts.

**Table 3.** Activity Type

| | |
|---|---|
| Exporter | 0.00% |
| Importer | 17.65% |
| Both | 82.36% |

**Source:** Author's calculation (Survey results)

A significant portion (82.36%) engages in both import and export activities, showing a high level of internationalization and involvement in global supply chains.

**Table 4.** Sector of Activity

| | |
|---|---|
| Manufacturing | 17.65% |
| Agriculture | 0.00% |
| Trade | 41.18% |
| Services | 52.94% |
| Other | 5.88% |

**Source:** Author's calculation (Survey results)

The main activity of the participating companies (52.94%) operates in the services sector, indicating a strong orientation toward service-based economic activity such as consulting, IT, tourism, education, or finance. This reflects broader economic trends in urban or semi-urban areas.

**Table 5.** Revenue Range

| | |
|---|---|
| Less than €500,000 | 18.75% |
| €500,000 – €5 million | 50.00% |
| More than €5 million | 31.25% |

**Source:** Author's calculation (Survey results)

The revenue distribution shows that most of the surveyed businesses are medium to large in scale, with relatively few operating on a small revenue base.

**Table 6.** The main currency in which exports/imports are made

| | |
|---|---|
| Euro (€) | 65.00% |
| USD | 10.00% |
| Other | 25.00% |

**Source:** Author's calculation (Survey results)

The Euro is the most used currency in international trade by the surveyed businesses. This is expected, especially in Albania and its surrounding regions, due to the country's strong trade ties with the Eurozone.

**Table 7:** The impact of exchange rate fluctuations on the businesses

| | |
|---|---|
| Positive | 29.41% |
| Negative | 47.06% |
| Not sure | 23.53% |

**Source:** Author's calculation (Survey results)

Exchange rate fluctuations have a notable impact on businesses, with nearly half experiencing negative effects. This is common in companies that rely on imports for over 85%, as sudden currency depreciation can raise costs or reduce revenue.

**Table 8.** The negative effects on business due to currency changes

| | |
|---|---|
| Decrease in profit margin | 53.85% |
| Loss of customers due to high prices (increased costs) | 15.38% |
| Delays in payments or contract renegotiations | 30.77% |
| Other | 7.69% |

**Source:** Author's calculation (Survey results)

Over half of the businesses report a reduction in profit margin due to increased costs resulting from currency fluctuations, and nearly one-third face challenges related to cash flow management and dealing with delayed payments.

**Table 9.** Percentage of sales or purchases exposed to exchange rate risk

| | |
|---|---|
| Less than 25% | 6.67% |
| 25–50% | 13.33% |
| 51-75% | 53.33% |
| Over 75% | 26.67% |

**Source:** Author's calculation (Survey results)

Over half of the businesses report a high exposure risk to their sales, which is also related to the above question regarding decreased profit margins. A smaller group falls into the low-risk category, indicating that they work in foreign currency, even in the local market.

**Table 10.** Use of forward contracts to manage currency fluctuations

| | |
|---|---|
| Yes | 11.76% |
| No | 88.24% |

**Source:** Author's calculation (Survey results)

Most answers are directed towards the non-use of forward contracts, as expected, with a minimal number who have used forward contracts.

**Table 11.** The main reasons for not using forward contracts

| | |
|---|---|
| Lack of information or training | 29.41% |
| Difficulty understanding the instruments | 0.00% |
| Not offered by financial institutions | 35.29% |
| We do not see it as necessary | 29.41% |
| Other | 5.88% |

**Source:** Author's calculation (Survey results)

The most cited reason is that forward contracts are not made available by banks or financial institutions, creating a complex problem that is further exacerbated by a chain of other obstacles. The primary reasons for non-usage include a lack of access (35.29%), a lack of information (29.41%), and not perceiving it as necessary (29.41%).

**Table 12.** Interest in participating in a training on exchange rate risk management

| | |
|---|---|
| Yes | 58.82% |
| No | 17.65% |

**Source:** Author's calculation (Survey results)

A clear number of businesses participating indicates interest in training on exchange rate risk management, with a small group not showing interest, suggesting that training alone may not be sufficient to initiate the use of risk management tools, such as forward contracts.

## 5. Limitations of the Study

While this research offers valuable insights, it has some limitations that should be addressed in future studies. Companies engaged in this case study deal with over 85% of their activity with import and exports, making the conclusions drawn from the above data more precise, but due to the small number of companies that participated, we cannot provide comprehensive conclusions into determining the concluding benefits that would bring the use of forward contracts.

## 6. Conclusion

This study aims to investigate the usage level of forward contracts as hedging tools by businesses in the Albanian market due to increased exposure to currency risk. Through a targeted survey conducted in Durres city, the research provides insight into the level of exposure and access to the possibility of hedging through forward contracts.

The finding indicates clearly that while Albanian businesses exhibit significant exposure to exchange rate fluctuations, there is an extreme limitation on the practical adoption of forward contracts. The main barriers are found to stem from a lack of institutional offering (35.29%) and insufficient financial literacy or information (29.41%), rather than business disinterest.

Overall, we conclude that although the Albanian market remains underdeveloped in currency risk hedging, there is a need for increased encouragement from financial institutions to utilize forward contracts or other types of financial solutions to moderate the level of currency fluctuation risks.

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