

THE FIXED EXCHANGE RATE CLAUSE: SAFEGUARDING FOUNDERS IN CROSS-BORDER FINANCING

INTRODUCTION:

Funding is a key aspect of every Startup. In the pursuit of capital or investments, founders often focus on other critical elements such as valuation, equity dilution, interest rates, and repayment terms. However, a frequently overlooked but pivotal detail in transactions involving funding in foreign currencies or transactions involving foreign investors is the **exchange rate**.

A characteristic feature of emerging markets such as Nigeria is the stability (or not) of its economy. Considering that most private equity (and venture capital) funds are domiciled in USD, GBP, and Euro, oversight of the exchange rate can have far-reaching financial implications, especially in economies with volatile currencies.

This article sheds some insight into a seemingly simple yet profoundly impactful tool Startup founders can use to mitigate currency exchange risks, ensuring financial predictability and stability for founders navigating cross-border financing.

THE FIXED EXCHANGE RATE CLAUSE:

The Fixed Exchange Rate clause (also known as the "**Pegging Clause**") is a contractual provision that establishes a predetermined exchange rate for financial transactions, regardless of the subsequent fluctuations in the currency market. By locking in the exchange rate at the outset, this clause ensures that repayment obligations are consistent, shielding parties from the adverse effects of currency volatility.

It is commonplace for Startups, particularly those operating in emerging markets, to raise capital in foreign currencies while conducting business in local currencies. Without a fixed exchange rate, founders risk facing exponentially higher repayment costs in the event of currency depreciation. For example, a Nigerian Startup that secures \$100,000 in funding when the exchange rate was ₦800/\$1 would be required to pay nearly double the amount in Naira at the time of repayment should the Naira depreciate to ₦1,500/\$1 (as was evident in 2024) - without a fixed exchange rate clause. Conversely, with an agreed exchange rate in place, the repayment obligation would remain tied to the initial rate of ₦800/\$1, preserving the startup's financial stability and ensuring predictable cash flow management.

BENEFITS OF THE FIXED EXCHANGE RATE CLAUSE:

In addition to the benefits highlighted above, the Fixed Exchange Rate Clause offers several other benefits to founders (mostly). These benefits include:

1. Clarity and certainty in repayment obligations.

Effectively incorporating a fixed exchange clause provides an unambiguous understanding of repayment terms - both for the investors and the founder and further minimizes the potential for disputes arising from exchange rate fluctuations.

2. Increased Investor confidence:

Investors are usually more confident in negotiating with founders who demonstrate sound financial understanding and a proactive approach to risk management, thereby streamlining negotiations by eliminating uncertainty related to currency exchange risks.

3. Protection against currency volatility:

The Fixed Exchange Rate Clause safeguards founders in emerging markets (and frontier markets) from the unexpected financial strain caused by currency depreciation and encourages long-term financial planning and forecasting.

A SIMPLE GUIDE TO DRAFTING A FIXED EXCHANGE RATE CLAUSE:

Start by specifying the exchange rate to be used for repayment. Then, indicate the date on which the exchange rate is determined (for example, the commencement date, the signing date, the disbursement date, etc). It is helpful to define the currencies involved in funding and repayment, and finally, outline the process for resolving disagreements related to the application of the exchange rate.

CONCLUSION:

The Fixed Exchange Rate Clause is an indispensable tool for founders engaged in cross-border financing. Incorporating a Fixed Exchange Rate Clause offers protection against currency volatility and ensures financial predictability, while safeguarding the interests of founders.

At Roothe-Kharis, we specialize in providing expert legal guidance to founders navigating the complexities of cross-border transactions. Our team is committed to crafting tailored solutions that protect your interests and ensure compliance with applicable laws. We are available for consultations to secure the financial future of founders who are seeking to achieve business objectives with confidence.

Contact us today to learn more about how we can support your growth journey.