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Think global, pay local when trading overseas

Why businesses need to explore this new opportunity

The ecommerce revolution means that US companies are no longer restrained to trading in regional or national markets. Instead, they have unprecedented access to potential customers and suppliers across the world - and many small to medium sized enterprises (SMEs) are already building successful businesses by expanding their supply chain, sales and marketing horizons.

As a country, the US is one of the world's largest exporters and importers. In 2021, it was the second largest exporter with goods and services worth $2.5 trillion, behind China, and the largest importer with $3.1 trillion.

In fact, nine out of 10 US SMEs that already sell overseas believe that international markets offer a major growth opportunity, while 30% predict that revenues derived from exports will increase by more than 50% over the next five years, up from just 18% who projected this increase in 2017.

[1] https://www.thebalance.com/u-s-imports-and-exports-components-and-statistics-3306270

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The US in 2021[1]

2nd

Largest exporter in the world (behind China)

$2.5 tn

Value of exported goods and services

1st

Largest importer in the world

$3.1 tn

Value of imported goods and services

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Achieving lower business costs

But while international trading may be increasingly common for US SMEs, payment strategies may not have kept pace. The vast majority of payments made by US companies to overseas vendors continue to be made in US Dollars, despite the clear benefits of paying in local currencies, including better payment terms and reduced costs.

So why the disconnect? Quite simply, the prevailing view is that 'we do it because we've always done it' - and there's also an understandable belief in the USD as the world's leading trading currency. However, economic trends have created the perfect environment and opportunity to weigh up the benefits of local currency payments with overseas suppliers.

The first factors to consider in this regard are the increased globalization of the US economy and the fact that the USD value of imported goods increased by 63% in the years 2009-2021.

The problems with paying in USD

The Bloomberg USD Index, which reflects the value of the USD against a basket of currencies, shows that the USD increased in value by 14% since

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2018. Additionally, since 2011 the value of the USD has increased by 38%. The question companies should ask themselves now is whether their invoices have reflected this change.

Traditionally, US companies have always believed that paying in USD would help overseas customers by removing pricing volatility and eliminating foreign currency risk.

But what actually happens in periods of USD strength is that pricing seldom decreases, while in periods where the value of the USD decreases, foreign suppliers are quick to raise prices. So volatility and foreign currency risk still exist – they are just masked by pricing fluctuations.

Seeking extended payment terms

Meanwhile, some US companies have realized that they are paying more for goods and services when paying in USD and have rationalized that these additional costs are reasonable to compensate for the perceived hassle in converting payments to local currency.

Yet continuing to make international payments in US Dollars (USD) rather

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than in local currencies can cost companies in a number of ways. In fact making the change to paying for imported goods in a local currency can reduce costs by as much as 10% and in most cases, also allows for extended payment terms.

This is largely because overseas suppliers need to convert all their USD payments to local currencies, rather than pay them into a USD account. In fact an independent industry survey has found that 95% of all USD payments are ultimately converted by suppliers.

Avoiding unforeseen charges

As well as taking time and effort, the conversion process carries costs that reduce the supplier's margins. As a result, suppliers need to control their costs and protect margins by increasing or padding out their USD invoices by as much as 10%, while also adjusting payment terms.

If the value of USD has strengthened between the time of agreeing to a price and receiving payment, the foreign supplier not only gains the padding, but also any additional value due to the USD moving higher.

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In addition to currency conversion costs, USD payments are also subject to intermediary bank fees which a supplier will also include in their pricing. When the supplier's bank receives a payment in USD, it is converted into the local currency at a non-transparent rate prescribed by the bank rather than by the beneficiary, often resulting in unforeseen, hefty charges.

The benefit of cross-currency payments

Conversely, local currency payments are usually not paid through intermediary banks and will not have fees deducted.

A further benefit to U.S. companies of paying in local currency is the impact on their own cash flow. As JP Morgan explains[3]: "When you make a payment in US dollars, your bank immediately withdraws the funds from your account. This ensures the dollars are sent to the vendor's bank right away. By contrast, when you make a cross-currency payment, funds are not wired until they've been converted from dollars to the vendor's currency."

Making life easier for overseas suppliers

So what about buyers' concerns about creating complexities for overseas vendors? It has now been established that most foreign suppliers would

[3] https://www.jpmorgan.com/commercial-banking/insights/fx-vendors-payment-currency

accept local currency payments when trading with US companies rather than USD.

And a survey of 100 U.S. middle-market clients found that importers can indeed negotiate lower pricing by using local currencies:

- Six in 10 respondents reported receiving discounts of 1-2%
- 11% of respondents reported savings of 3-5%
- 11% reported savings exceeding 10%

In total 82% of companies were successful in negotiating better deals in return for local currency payments.

Negotiating smarter deals

One example cited by Capital One[4] describes how a German company quoted one of its US clients $5 million for a certain piece of equipment. When the client responded by asking the vendor to invoice in euros, it quoted a price of 3.5 million euros, which translated into US$4.5 million. In effect, the client saved $500,000 just by paying in euros instead of USD.

[4] https://daily.financialexecutives.org/have-you-considered-paying-foreign-suppliers-in-their-local-currency/

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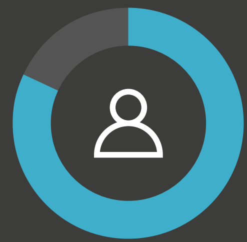
A survey of 100 US middle-market clients found:



82%
of companies negotiated better deals by paying in local currencies

71%
made savings of up to 5%

11%
saved over 10%

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“By paying in the supplier’s local currency, and assuming the FX risk, they will generally be more open to extending terms”

Many companies surveyed also found that extended payment terms were available to them. Typically, USD payments have a 30-day limit but sending local currency extended payment terms to 60- or even 90-day periods.

Joshua Quiroz, senior vice president and head of electronic foreign exchange sales at US Bank points out[5]: “When a foreign supplier is getting paid in U.S. dollars, they prefer shorter payment terms not only for cash flow reasons, but also to minimize the time during which adverse currency-value fluctuations can occur. If you agree to pay in the supplier’s local currency, and assume the FX risk, the supplier will generally be more open to extending terms.”

No USD account? No problem

So why are US companies able to negotiate these far more favorable prices and terms when paying in local currencies? In a nutshell, most overseas suppliers prefer payments in their home currency because they do not tend to maintain a USD account.

It means that when they receive a payment in their local currency, they know exactly how much they will receive, thereby increasing their ability to

[5] https://financialiq.usbank.com/index/improve-your-operations/manage-payments/Pay-foreign-suppliers-in-their-currency.html

manage cash flow. They are not subject to the fluctuations in their own local currency versus USD or ongoing changes to bank and FX charges, so can be surer they will be paid the amount they have invoiced.

Local currency payments attract lower fees than USD payments, and are also credited to the supplier sooner than USD payments. This is because the importer's local bank, and other potential intermediaries, do not need to be involved in the process.

A positive trading relationship

On top of that, reconciling a USD payment makes it difficult if not impossible for suppliers to determine the exact cost of goods in advance. If their accounts receivable ledger is in euros and the payment credit arrives as USD, it may struggle to match it against the euro amount on the invoice, especially if reference details are missing.

Making life easier for overseas customers has other benefits too, not least a positive trading relationship. By displaying price transparency from the outset, US vendors enable customers to compare offers against local vendors' propositions, for example, while reducing the time and effort.

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And in a world of accelerating cross-border trade, organizations that insist on sticking with USD payments will risk appearing to be backward, rather than forward looking, in the mistaken belief that because the USD has long been the world's dominant currency, overseas suppliers will always want to be paid in USD.

As well as damaging your reputation, restricting payments to USD may even result in lost business opportunities.

This is the way forward

Since the 2008 financial crisis, technology advances have simplified the currency conversion process and it has never been easier, less costly and more transparent to pay in local currencies.

The top six steps to think about are as follows:

1. When dealing with overseas vendors, request billing in both local currency and USD terms so you can decide which denomination is more advantageous.

"An independent industry survey found that 95% of all USD payments are ultimately converted by suppliers."

2. Ask your vendor whether it is able and willing to extend payment terms in return for purchasing in their local currency
3. If appropriate, include a clause in your contract with an overseas vendor that means your agreement can be renegotiated if there is a substantial change in the exchange rate between USD and a local currency
4. Consider a 'forward contract' that locks in an agreed exchange rate between USD and a local currency so there are no surprises for either party
5. Remember that, under US law, you have different obligations when paying for contracted services from overseas providers than when paying for products
6. Understand that some vendors, especially those in less stable economies or countries where currencies are heavily regulated, will still prefer to be paid in USD

Financial institutions increasingly position themselves as trusted advisors for international payments, demystifying foreign exchange and international payment processes and helping SMEs establish the structure and execution of payments.

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"Paying invoices in local currencies creates a win/win situation for US SMEs and overseas suppliers"

This is a win/win situation

New technology means banks and other third party payment services providers can offer sophisticated flexible platforms that enable SMEs to log on, upload payment instructions in different currencies and via different channels, while also linking back into accounts payable systems.

For example, Brookline Bank operates the secure online payment platform BrooklineBank-FX. This includes an intuitive AI capability that identifies information needed for successful payments by country, a digital e-wallet and on-the-spot conversion confirmations.

Paying invoices in local currencies creates a win/win situation for US SMEs and their overseas suppliers. SMEs are positioned as flexible and easy to do business with and are open to transactions with the widest possible range of suppliers. They can also expect lower prices and better payment terms.

Why local currency payments work

Suppliers, meanwhile, get the benefits of transparent FX arrangements, faster payments, less complexity and a more predictable cashflow. "Many suppliers will consider it a huge benefit," Quiroz says. "They know exactly how much they'll be paid for each transaction, they're no longer managing the foreign exchange risk, and they can price their products more competitively."

Taken together, together, SME and supplier benefits have a multiplier effect on the US economy by removing friction from electronic, cross-border transactions and helping to reduce prices of foreign goods and services.

As JP Morgan concludes: "Of course there are some instances when paying in US dollars is best. Certain industries have dollar-functional supply chains where currency conversion should not occur. Multinational vendors may want dollars for their own operations, or they may have an arrangement to convert currencies in bulk using preferred exchange rates. But if these considerations don't apply to your business, there can be significant benefits to changing your approach."

Ecommerce means that US SMEs have access to the widest possible global array of products and services, as well as a potentially limitless target marketplace. To really take advantage of the opportunities that this provides, US companies that are paying their international invoices in USD should consider the benefits of local currency payments without delay.

About the author

Bob Murray, Director of Foreign Exchange at Brookline Bank

Bob has been involved in foreign exchange markets since the early 1980s. Before joining Brookline Bank, Bob held leadership positions in foreign exchange for over a decade at large national banks. Throughout the years, he's seen how foreign exchange can really touch all areas of a bank. From international payments to wire transfers, having a solid foundation in foreign exchange markets is critical to the success of a bank.

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