CONDUCTING INTERNATIONAL BUSINESS IN FOREIGN CURRENCY

Over the past two decades, the U.S. economy has become increasingly linked to global markets, for both sourcing and sales. According to the Bureau of Economic Analysis, Census and Economic Information Center, in 1995, trade amounted to 22% of the U.S. gross domestic product. In 2015, the World Bank reported that it was 28% of U.S. GDP.[1]

Historically, U.S. companies tended to prefer to negotiate all international agreements in U.S. dollars (USD), believing this insulated them from exposure to foreign currency exchange rate volatility. However, in doing so, they increasingly placed themselves at a competitive disadvantage to companies that were willing to transact in the local currency. In recent years, U.S. businesses have recognized the competitive and cost advantages of transacting in local currencies and have adopted the use of hedging tools to better manage the foreign exchange risk.

Advantages of Conducting Business Abroad in Local Currency

Exchange rate volatility exists between most currencies. Depending on the currency, historical volatilities show that the value of foreign payables and receivables can change by as much as 35% during a one year timeframe. By transacting in the local currency, U.S. companies are able to manage exchange rate risk on their end, effectively reducing potential premiums they may be charged if the risk were managed by their overseas counter-party.

Selling in local currency and hedging the volatility risk better protects market share by allowing prices to be held constant. Hedging against adverse currency moves can also help shield U.S. companies from rising costs associated with appreciating foreign currencies.

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GLOBAL CURRENCY MOVEMENT VERSUS THE DOLLAR		
Weak USD	• Foreign currency receivables convert to more dollars. • Hedge strategy with optionality may increase profit margin. • Ability to lower prices to customers or pass on benefit.	• Foreign currency payables cost more in dollars. • Hedge to lock in cost of goods. • Maintain your profit margin.
Strong USD	• Foreign currency receivables convert to fewer dollars. • Hedge strategy to lock in revenue. • Maintain your profit margin.	• Foreign currency payables cost less in dollars. • Hedge with optionality may reduce cost of goods. • Ability to price more competitively.

Challenges of Conducting International Business in USD

U.S. Importers Who Pay in USD to Foreign Suppliers

Foreign vendors receiving payment in dollars are likely to price in currency risks and transaction costs in their product's export price. Currency exchange premiums are not uncommon in some parts of the world, resulting in a higher cost for the importer.

If the USD falls in value against the foreign currency, foreign vendors may raise their U.S. dollar price to compensate, which may reduce profit margin. This lack of control on the part of the U.S. importer makes it much more difficult to manage currency exchange rate risk.

U.S. Exporters Who Price in USD to Foreign Customers

Customers in foreign markets may choose a competitor's product that is priced in their local currency because they will not be subject to higher prices if the U.S. dollar rises. The cost of a product sold in U.S. dollars may become prohibitive if the USD strengthens, resulting in lost sales and market share.

Customers may be inclined to delay payment, waiting for favorable exchange rates to improve their actual cost.

FX Strategies Can Help Manage Revenues, Relationships and Control Costs

When contracting with a foreign counter-party, make sure to get the price quote in both U.S. dollars and the local currency. Work with a PNC FX representative to determine cost-effective and efficient ways to conduct transactions. Various hedging instruments are available to enable U.S. companies to effectively manage foreign exchange risk. This approach can result in significant savings and enhanced international market share.

READY TO HELP

At PNC, we combine a wider range of financial resources with a deeper understanding of your business to help you achieve your goals. For more information regarding this article or foreign exchange strategies in general, please contact your Relationship Manager or visit **pnc.com/fx**.

1 http://data.worldbank.org/indicator/NE.TRD.GNFS.ZS?locations=US

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