



International Local Currency Payments: Alternative to USD Payments



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Paying international suppliers in US dollars is not the only option and, in many cases, may not be the best option. The dollar is certainly the 'world's currency' in the sense that the dollar is accepted globally and more trade is transacted in dollars than any other single currency. Commodities, like grains, oil and metals are priced in US dollars even when traded as far away as Australia and India. And the US dollar really is the currency against which all other currencies are priced. That being said, although the dollar may be the world's 'base currency', so to speak, it may not always be the best choice when paying suppliers outside the U.S.

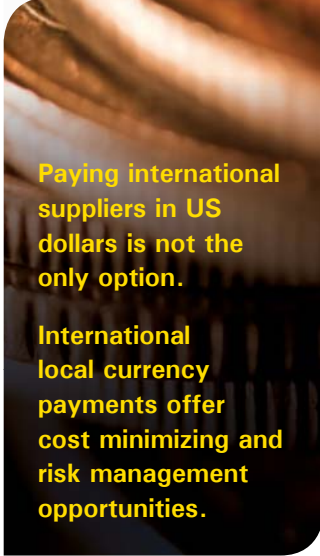
It might make sense to pay international suppliers in their own local currency as opposed to dollars. Although paying suppliers in foreign currencies might conjure up notions of having to open and maintain foreign bank accounts and being subject to the whims of the foreign exchange markets, paying suppliers in their local currency can be simple and cost effective.

Leading international banks and international payment providers offer sophisticated electronic solutions, making international local currency payments as easy as US dollar payments.

The dollar is a foreign currency to international suppliers

When a U.S. importer pays a supplier in Mexico, South Africa or Europe, for instance, in US dollars it is highly unlikely that the supplier actually holds a US dollar account. In most cases, the beneficiary of the payment will hold a local currency account (MXN in Mexico, ZAR in South Africa and EUR in Europe) and the dollars will be converted into the local currency before being deposited to the recipient's account. Sending dollars is easy for the U.S. importer, but receiving dollars poses certain risks or costs to the foreign supplier and they will price these risks and costs into their product. By offering to pay in the local currency instead of dollars, the U.S. importer will relieve the supplier of the risks and costs of receiving dollars and should be able to negotiate a better product price as a result. A discount of two to ten percent would be within the realm of expectations given the benefits to the supplier of receiving payment in their local currency.

What costs might a foreign supplier face on receiving a dollar payment? When dollars are received by the supplier's bank, they are converted into the local currency at a rate prescribed by the foreign bank, and the beneficiary will have little, if any, influence



Paying international suppliers in US dollars is not the only option.

International local currency payments offer cost minimizing and risk management opportunities.

Drawbacks to paying in dollars:

- Dollars are converted into local currency at the bank prescribed rate
- Receiving banks apply correspondent and other transaction fees
- Delays in funds being credited cause additional costs to the supplier

Currency exchange premiums of up to 10% are not uncommon in some parts of the world.

over this rate. The beneficiary account holder is a captive market for the foreign bank and the bank will likely leverage the fact that they are holding the dollars and the beneficiary has no opportunity to shop the exchange rate. Currency exchange premiums up to ten percent over interbank spot rates are not uncommon in some parts of the world. On top of non-competitive exchange rates, receiving banks also apply transaction fees for receiving and processing foreign currency (dollar) payments. A foreign bank will receive and clear the dollars through a USD correspondent in New York and the associated costs will be marked up and passed on to the account holder. Delays will be incurred as many banks will only apply the converted funds after their own New York dollar account has been credited. So, the costs and delays to a foreign recipient of dollars can be substantial, and present an opportunity for the U.S. importer to negotiate better pricing by helping to alleviate these costs. It is really just a matter of minimizing the involvement of the foreign bank in the transaction. Less money in the hands of the foreign bank means more money to be shared between the supplier and the importer.

Not only is a supplier subject to the costs associated with having dollars received and converted by their bank, but the supplier is also assuming considerable foreign exchange risk by invoicing in and receiving dollars. As we all know, the dollar has weakened considerably against most currencies over the past seven years and this dollar devaluation has resulted in foreign exchange losses to companies exporting to the U.S. Exporters in developed countries have the ability to hedge their US dollar receivables in the forward foreign exchange markets to some extent, but in developing markets like Mexico and South Africa, for instance, the forward currency markets are not established and many companies are not able to hedge their dollar receivables. Their only option for offsetting the risks posed by the falling dollar is to increase their prices and this, of course, is absorbed by the customer, the U.S. importer. Here is another opportunity for a U.S. importer to positively influence product pricing by eliminating the foreign exchange risk to the supplier

The local side of international payments

So far so good for the supplier, right? The U.S. importer is going to pay the supplier in their local currency and eliminate foreign exchange risks and costs to the supplier and, hopefully, negotiate pricing discounts in turn. The obvious question now though is: Isn't the U.S. importer now stuck with having to manage the foreign exchange costs and risks? The short answer is yes, but it is important to realize that the initiator of a foreign currency payment has a lot more leeway and flexibility to manage the associated costs and risks than does a recipient. For one, the payor is able to shop his or her foreign payment business to various providers and negotiate competitive exchange rates and transaction fees (remember, the recipient of a dollar payment has to accept the rate and fees charged by the foreign bank). And, with advances in technology, paying a supplier in MXN, ZAR or EUR is just as easy as paying in dollars. U.S. international banks offer international payments in many currencies, as do independent payment solution specialists. The leading providers offer sophisticated electronic multiple payment platforms that make it easy to upload payment instructions for various currencies and payment methods (wire, check, draft, etc) seamlessly via interfaces to accounts payable systems. The payments provider quotes the cost of processing the batch of payments in dollars based on pre-negotiated foreign exchange margins and transaction fees. The payor approves the foreign currency payments and settles in dollars with the solutions provider. Foreign currency payments made simple and easy.

Leading international payment providers not only offer sophisticated and user friendly software, but they also maintain extensive correspondent bank relationships enabling them to process foreign payments accurately and swiftly. They minimize reliance on intermediary banks by operating local

currency accounts in-country. Local payments are made directly from accounts in Poland or Thailand, for instance, thereby converting what is an international payment from the perspective of a U.S. entity into a low-cost local currency payment to a beneficiary in Poland or Thailand. If the provider does not operate a local account of its own, it will route payments through correspondents with direct access to the local clearing networks. The payment provider will also provide expertise with regards to what information needs to accompany foreign currency payments to minimize delays or problem payments. Whether it's identifying the need for an IFS code for a payment to India or an RUT number for a payment to Chile, an international payments specialist will positively impact the rate of straight through processing, thereby minimizing costly delays and investigation charges.

Taking charge of foreign exchange risk presents opportunity

As a result, processing international payments in the local currency can lead to cost savings and need not require an investment in internal infrastructure as there are leading payments providers to outsource this to. What about the associated foreign exchange risk though? Surely if the U.S. importer agrees to pay a supplier in the local currency, he or she has direct exposure to the risk of a falling dollar? This is certainly the case, but the difference is that, unlike the dollar recipient in many countries (Mexico and South Africa for example), the U.S. entity is able to cost effectively manage the foreign exchange risk through various hedging instruments available in the U.S.

Foreign exchange forward contracts are now available in several, popular currencies, including MXN and ZAR, for example. Forward contracts allow an importer to lock in today's rate on their foreign currency needs for the next 12 months or more and then draw down on the contract as required. And an added benefit of hedging in today's low interest rate environment in the U.S. is that many foreign currencies trade at a forward discount to the spot market because interest rates are higher in many other countries. The Indian Rupiah, for instance, currently trades at a 1.7% discount one-year forward, making it very cost effective to hedge future INR requirements. The bottom line is, the U.S. importer is often in a better position to manage currency risk and, rather than leaving it for a supplier to price that risk into their product, should be able to negotiate more favorable pricing by paying in the foreign currency and then cost effectively manage the associated exchange risk, especially if it is a currency trading at a forward discount.

As discussed above, paying international suppliers in their local currency does not have to be an onerous undertaking, and doing so puts the importer in a position of price negotiating strength. You are saving the supplier from considerable exchange rate risk and cost and should negotiate accordingly.

At the very least, when contracting with a foreign supplier have your invoice quoted in both dollars and the local currency and then check with a competitive foreign currency payments provider to see if it isn't more cost effective to pay in the foreign currency.

As the saying goes, it doesn't hurt to ask.



About Western Union Business Solutions

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Our distinguished service portfolio and deep industry expertise enable clients to operate across borders and currencies in fast, reliable and convenient ways. Through our account-to-account payment platform, international payment tools, currency risk management solutions, and financial service partnerships, we help clients improve cash flow, manage currency risk and seize global market opportunities.

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