

FX Risk Advisory

Strike while the dollar is hot: Renegotiating US dollar-denominated contracts

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Key takeaways

- The recent strength in the US dollar (USD) has resulted in a material financial windfall for suppliers outside the US accepting USD payments.
- US-based companies making USD payments have an opportunity to ask foreign suppliers to reduce USD prices and share in their improved economics.
- Looking ahead, switching to foreign currency payments may be a more sustainable and cost-effective strategy.

US-based companies doing business overseas may prefer to transact in US dollars as the simpler and more expeditious avenue versus operating in foreign currencies. The strategy is attractive as it eases the operational burden of dealing in multiple currencies, and it mitigates the potential financial impact of adverse currency movements through asset-liability matching.

The recent USD strength has resulted in a material windfall for their foreign-domiciled suppliers. The USDs received may be converted for more euros, pounds, yen, yuan, just about any currency, resulting in higher revenues and wider margins for suppliers.

Looking ahead to 2023, there is scope for US-based companies making USD payments to proactively reach out to suppliers and ask to share in their improved economics.

There is precedent for such as conversation. Walmart, for instance, who imports a great deal from China still pays most vendors in USDs. In past periods of USD strength, Walmart has been reported to contact as many as 10,000 suppliers to renegotiate terms and request USD price concessions¹.

Impact materiality

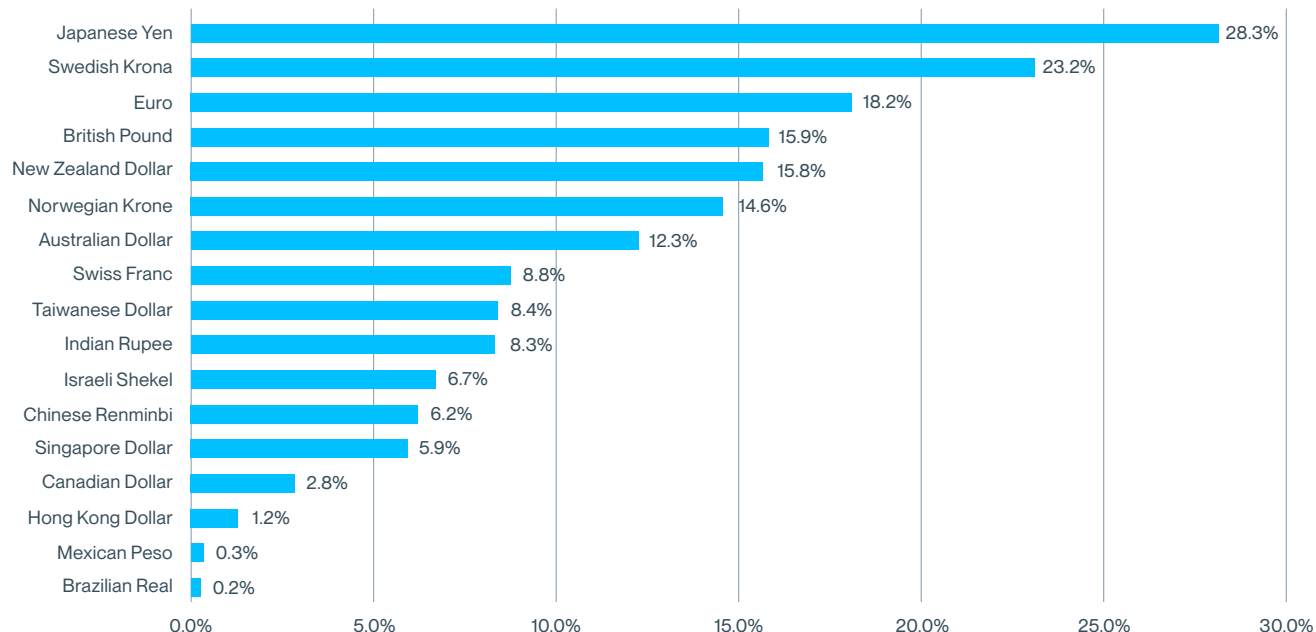
The USD appreciation in recent quarters has been broad-based, but imbalanced.

The USD has gained more versus currencies it enjoys a yield advantage over, and less versus the currencies of commodity-producing economies, especially those that offer higher yields such as Brazil and Mexico.

Overseas vendor contracts struck over the last 18 months, for which payment is due in USDs, are prime for renegotiation. The chart lists appreciation in the USD since January 2021 versus the most actively traded currencies by Silicon Valley Bank clients. The larger the currency move, the larger the potential price accommodation.

¹Source: <https://www.reuters.com/article/us-wal-mart-stores-china/exclusive-wal-mart-presses-suppliers-to-share-benefits-of-cheaper-yuan-idUSKCN0RN2IQ20150924>

US dollar appreciation since January 2021



Source: Bloomberg as of 9.8.2022

Structuring new contract terms

Suppose a cross-border contract that fixed USD prices between a US-based company sourcing goods from a European vendor was finalized in January 2021, with the EUR/USD spot rate trading at 1.1800. Monthly invoices of \$100,000 generated €84,746 in revenue for the European vendor. Fast forward to September 2022, with the euro at parity versus the US dollar, the same \$100,000 generated €100,000 resulting in 18% more revenue and wider margins (up to 33% from 13%).

This was not a zero-sum outcome, however, as one side's gain did not come at the expense of the other. In other words, the USDs received went further for the European vendor, but the cost base for the US company remained the same. Typical of non-zero-sum game situations, there are advantages for both sides to come to the table to renegotiate.

A natural starting point is a price concession equal to 50% of the gains from USD appreciation since inception of the deal. If both sides agree on a \$7,627 price cut, (half of the rise in revenues realized by the vendor), the US company receives a much-welcomed price concession, while the European vendor retains some of the currency gains - still higher revenues and wider margins - while solidifying the client relationship by improving the terms of the deal. It is a win-win for both sides.

	January-2021	September-2022	Starting point for renegotiation
EUR/USD spot rate	1.1800	1.0000	1.0000
US company perspective			
US dollar invoice	\$100,000	\$100,000	\$92,373
European vendor perspective			
Revenues	€84,746	€100,000	€92,373
Cost of goods sold	€75,000	€75,000	€75,000
Gross margin	13%	33%	23%

Hypothetical example for expository purposes only.
Source: SVB FX Advisory

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Looking ahead to best practices: Sending foreign currency payments

Maturing global industries have the tendency to gravitate towards doing business in the functional currency of the side receiving payments. This generally occurs due to competitive pressures, or at the request of overseas vendors who may prefer to be paid in their own currencies. For US companies, this would imply sending foreign currency payments abroad which is widely considered a 'best practice' for global finance/treasury functions.

USD strength presents an opportunity to proactively switch to foreign currency pricing to monetize the gains from a stronger dollar.

Economics aside there are also ancillary benefits.

1. Price transparency: Avoids unnecessary "padding" that may be included when foreign vendors quote outside their functional currencies.
2. Price discovery: Arrives at contract terms that better align with true unit economics.
3. Asset-liability matching: Paves the way for the matching of revenues and expenses in foreign currencies when foreign revenue bases become established.
4. Risk management: Foreign currency payments crystallize the currency risk from sourcing goods and services outside of the domestic economy², better defining the terms for efficient hedging practices.

In closing

Once both sides have entered negotiations, there are other elements of the contract that may be amended such as shipping considerations, minimum volumes, timing guarantees, and so on. The foreign supplier may be more amenable to adjusting terms because of the windfall received from foreign exchange.

The strength of the dollar presents a great opportunity to revisit the terms of your contracts with overseas suppliers. Sharing in the financial windfall created by the currency mismatch is a win-win for everyone.

If you'd like to discuss your specific situation or for information regarding SVB's tailored FX risk management services, reach out to your SVB FX contact or GroupFXRiskAdvisory@svb.com.

² The strategy of sending USD payments also incurs currency risk, albeit indirectly. For instance, in a weakening US dollar cycle, vendors may want to change payment terms, or cancel contracts altogether.

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