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Is Invoice Currency Choice Bargaining or Risk Sharing? Evidence from Pairwise Trade Partner Data of Japanese SMEs

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Abstract

Theoretical models predict that the choice of invoice currency in inter-firm trade is determined by negotiation, reflecting the relative bargaining power between an exporter and an importer. On the other hand, in intra-firm trade, the choice of invoice currency is determined by the centralization of exchange rate risk management at the group's head office. To disentangle two different mechanisms in currency invoicing, we conducted a questionnaire survey on Japanese unlisted manufacturers. Our unique questionnaire items include information on the relative size of trade partners compared to Japanese SMEs and on the invoice currency used for export or import with trade partners. By using destination-trade partner datasets, we found the following results: first, in the intra-firm trade, a firm with more equity share of own foreign subsidiary tends to choose trade partner's currency and US dollar so that the head office assumes exchange rate risk, which is consistent with the currency risk sharing hypothesis; second, in the inter-firm trades, the larger the relative size of trade partner compared to Japanese SMEs more tend to choose foreign currencies, which is consistent with the bargaining hypothesis in currency invoicing.

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