CERTIFIED GLOBAL BUSINESS PROFESSIONAL

Exam Prep Study Guide

Domain IV – Trade Finance

Acknowledgments & Thanks

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Table of Contents

Table of Contents

Introduction

NASBITE International is a non-profit 501(c)3 corporation organized under the laws of Ohio. Established over 30 years ago as an association of North American Small Business International Trade Educators (NASBITE), NASBITE has become the leading U.S. organization supporting training and education in the field of global business. We are a professional organization of educators, trainers, service providers, and practitioners and our mission is "to advance global business practice, education, and training".

The CGBP "Practice Delineation" is the foundational reference document that articulates the trade skills certified through the attainment of the NASBITE Certified Global Business Professional (CGBP) credential. It is comprised of four top-level domains along with supporting task and knowledge statements and five threads, which represent topics that cut across all four domains

Top Level Domains	Threads (topics that cut across all four domains)
1. Global Business Management 2. Global Marketing 3. Supply Chain Management 4. Trade Finance	a. Documentation b. Legal & Regulatory Compliance c. Intercultural Awareness d. Technology e. Resources

The CGBP is designed to meet the needs of individuals working in the profession or studying for a career related to global commerce. Candidates from both small and large companies will benefit as will students in two-year or four-year post-secondary programs. The credential is also suitable for individuals working in trade assistance organizations, trade promotion agencies, and related educational institutions.

Candidates receiving the NASBITE CGBP designation may use the credential logo and wordmark on resumes and business cards identifying them to employers and the public as individuals proficient and current in global commerce. For companies, the credential establishes a professional development goal for current and future employees. The credential also helps individuals diversify their skills in global commerce and assure they understand a broad range of topics rather than just the specific field within international trade where they have experience.

This document consists of content that is aligned with the four domains – Global Management, Global Marketing, Global Supply Chain, and Trade Finance - found with the CGBP Practice Delineation. These domain summaries are intended to serve as a CGBP Exam Preparation supplement, with content that addresses all of the knowledge statements found in the CGBP Practice Delineation document.

Note that this document is not intended to serve as a standalone study guide. Rather, it is best used as a supplement to augment training or other resources that can more fully speak to the task statements that are found in the CGBP Practice Delineation. The study guide content has been designed to ensure that those who are planning to take the CGBP exam have an appreciation for the full scope of the resources, references, and content that is described within the CGBP Practice Delineation document. If you are planning to take the CGBP exam, we hope that you find this aggregate study guide helpful.

Any identified errors, omissions, or questions should be sent to Ask.The.Expert@nasbite.org (responses will generally be sent within 24-48 hours).

Trade Finance – Domain IV

Task 4.1 - Assess political and economic risks and cultural issues of the target country to establish the financial costs and viability

Knowledge of:

(i) Political and economic risks causing late and/or non-payment from overseas markets (e.g., cancellation/failure to grant U.S. export license, civil unrest, foreign currency delays/shortage)
(ii) Cultural issues of the buyer's country may impact payment methods, money transmission methods, the language used, credit control procedures, level of governmental control, corruption issues, and sources of financing.
(iii) Resources for determining risk (e.g., U.S. government organizations, websites, Moody's, Standard and Poor's, Euromoney, credit bureaus such as Graydon America and Coface)

This study topic focuses on political and economic risks causing late and/or non-payment from overseas markets, cultural issues of the buyer's country which may impact payment methods, money transmission methods, the language used, credit control procedures, level of governmental control, corruption issues, and sources of financing. Also, this study topic considers resources that are available for determining risk.

(i) Political and Economic Risks Causing Late and Non-Payment from Overseas Markets

Political Risks - Any changes in a government's policies regarding international business creates risks. Social unrest, trade wars, war, sanctions, or political elections can also be an impetus for creating payment challenges. Political risks can sometimes be difficult to predict. For example, Nicaragua was not a major problem for political risk after 1990 until unforeseen social unrest occurred in April of 2018, creating several governmental changes, and making it more difficult to receive payment. Following elections in countries where you are doing business can be important. Specifically, it is important to pay attention to see if there is a chance the government will be changing to a different political party with conflicting views on business as this can result in problems. Civil unrest can follow, and conflict created with another country over trade or any other issue can bring difficulty in getting paid as well.

It is also key to watch the political environment in the larger region. Disputes can create challenges in neighboring countries due to refugee situations, cutting off supply flow, and even destroying the income of the company in a more neutral country (due to ties in the country having difficulties). Additionally, when governments decide to nationalize industries such as those in public services or concerning natural resources, just the announcement of the plan can cause stock values to plummet for the private company tying up resources and the subsequent economic impact can create payment challenges.

The main risks are developments that constrain the importer's ability to make or afford the payment when due, such as:

- Devaluations that increase the importer's foreign exchange conversion costs.
- Government rationing of foreign exchange or import permits is needed for the payment.
- Government imposition of prohibitive import duties or non-tariff barriers.

Exporters can protect themselves against political risks in the importing country by purchasing an export credit insurance policy. In the U.S., the U.S. Export-Import Bank offers such insurance at a very low cost. Some other developed countries offer similar government-backed export credit insurance. Several private sources also offer such insurance (e.g., Coface, Meridian, Allianz [formerly Euler-Hermes]).

Economic risks: The risk of not getting paid due to economic risks are often just regarded as changes in the economic cycle. However, recession and depressions are not the only economic risks for businesses. Additional economic risks are as follows:

- Sudden changes in currency valuations can create issues that keep payments from being made on time
- Lack of foreign currency reserves can slow down payments as well
- Inflation in a country can also make it difficult for payees to pay promptly.

(ii) Cultural Issues of Buyer's Country

Payment Methods - Exporters are at risk of not getting paid at all or on time if they ignore warning signs and fail to take precautions. Although buyer default is the most obvious risk, many other factors could also affect whether, how, and when foreign buyers pay for export goods. For example, language and cultural differences could lead to misunderstandings about the method and time of payment. The government controls on imports or methods of payment or money transmissions could impact the buyer's cash flow and access to credit. Graft and corruption could prohibitively delay or increase the buyer's costs to make the payment.

Exporters can mitigate risks of default by vetting the buyers (due diligence) and using more secure methods of payment (e.g., Letters of Credit). If default occurs anyway, exporters can recover losses with export credit insurance. However, exporters need also to recognize other factors (e.g., cultural, and governmental) that could impact payments, and take these into account in their initial interactions and negotiations with buyers.

Money Transmission Methods - Technology has a lot to do with payment transmission methods. Changes in banking regulations and the use of wire transfers with systems such as SWIFT have greatly shortened the actual time required in transmitting and receiving payments. For many years Kenya has had a payment system on mobile phone systems for sending funds to each other to overcome more archaic banking systems. Each country has a Treasury and/or Central Bank authority that regulates payment transmission. Knowing the regulations before providing goods or services without cash in advance is a sound business practice.

Language Used - Not only do things mean different things even using the same general language, but when negotiating between different cultures, the actual intent of words can affect getting paid. Some cultures communicate very directly and others VERY in-directly. So, taking time to fully understand the intent of when payment will be sent can be of utmost importance.

Cultural and language differences can blur meanings as buyer and seller negotiate over price, delivery dates, and shipping and payment methods. The concept of "time" particularly varies among cultures. "Time is of the essence" is a Western concept that puts a premium on timely payments, or at least paying when agreed to. Time has a more leisurely connotation in many other cultures. For example, in Spanish, "mañana" literally means "tomorrow," but a Hispanic buyer who agrees to pay "mañana" may instead mean sometime soon.

The concept of "face" is another differentiating characteristic in many cultures. Asian societies are especially concerned with "saving face" in personal interactions. For example, asking an Asian buyer for a direct "yes" or "no" answer to a payment question (or any other) would be considered rude and likely answered ambiguously. If so, an American would not know for certain if payment would be made on time or at all.

Religious differences can also impact payments. For example, in Islamic countries, Sharia law prohibits usury (interest charges on loans) and also prohibits trading in financial risk (considered a form of gambling). Sharia law also prohibits investing in "unlawful" businesses (e.g., that sell alcohol or pork or distribute gossip or pornography). To avert payment problems in these countries, exporters would need to find banks that do not charge interest or impose fees on late payments, and avoid associating with any companies that engage in prohibited activities.

Credit Control Procedures: Some cultures believe in doing business on a cash-only basis while others use credit very easily. The Muslim religion does not believe in the use of credit for either a debtor or creditor. So, this creates some interesting methods of raising capital for business operations.

Level of Governmental Control: Common law or civil (code) law are descendants of two different government systems. Civil law comes from Napoleonic influence where codes were put into place and used to define the correct procedure. Common law comes from British influence where previous cases are used to determine the correct behavior or responsibility. Business law in western countries has been defined for a long time. This has been built from the free-market economy premise. However, planned economy governments are learning and building new business laws almost daily as these economies transition to a more market-based system. The reliance on court decisions versus the use of mediation or arbitration for dispute resolution may also impact the ease of getting payment promptly. Court decisions can take a much longer period and generally are difficult to litigate in another country.

Additional controls such as import duties, health/safety/technical standards, currency devaluations, and limits on access to foreign exchange -- can also affect both the cost and ability to pay for imported goods. In most cases, such controls are already known and factored into the initial negotiations about price and payment. The problems arise if, for political or economic reasons, unanticipated new controls are imposed before the payment is due. For example, if an unexpected trade war were to develop, the importing country might slap higher duties unaffordable to the importer. If the government decided to ban an ingredient in a consumer product (e.g., cosmetics) for health or safety reasons, any product containing that ingredient could be banned for entry and payment. If economic conditions deteriorated, the Government might resort to a currency devaluation that would increase the importer's costs or ration foreign exchange the importer would need to make the payment. Exporters should anticipate and try to protect against these possibilities (e.g., export credit insurance, currency hedging, substitutions for banned ingredients; fallback buyers in other countries for unpaid goods).

Corruption Issues - Corruption in the business world and by government officials is a significant challenge even today. Corruption is endemic in many countries and can substantially increase the cost of doing business, including payments. The corrupt parties are not usually the buyers, particularly if previously vetted for reputability and financial viability, but rather government officials involved at some level for approvals needed for imports and payments. In the "petty-graft" form of corruption, low-level bureaucrats typically expect payoffs to "move paper" expeditiously to the next approval step. These payoffs are generally small, but failure to pay could hold up clearance of goods from customs or approvals for import permits, foreign exchange, or import working capital. "Bribery" is a higher level and more costly form of corruption, usually involving a senior government or bank official demanding a large sum (bribe) to approve a significant contract, foreign exchange allocation, or loan. U.S. businesses are prohibited, under the Foreign Corrupt Practices Act (FCPA), from bribing foreign government officials. The FGPA does not apply to private sector bribes and has been interpreted not to apply to routine payoffs to petty government bureaucrats. Exporters should take note of the more egregious corrupt countries and determine whether they can afford to deal in these environments. The Corruption Perceptions Index is a useful tool that measures "the degree to which corruption is perceived to exist among public officials and politicians." While not all companies in countries with a high corruption score are poor risks, it does provide a warning to dig deeper into the potential debtor before offering payment terms.

Dates or Holidays – All around the world there are religious and secular holidays when banking transactions do not occur. The only holiday that the entire world does not operate on is January 1 or the calendar new year. Every country and religion has a set of holidays on which banking transactions do not occur. In the United States, no banking transactions occur on Sundays. It is important to review the holiday calendar of the country doing business transactions to know when any kind of banking transaction can occur.

(iii) Resources for Determining Risk

Companies need to determine the credit or payment risk of buyers. The risk of losing money is of utmost concern to global traders. Money losses can result from many unforeseen developments (e.g., buyer default, government actions that deny or limit foreign exchange or money transfers; corrupt practices that increase the costs of doing business). These risks are avoidable or at least can be mitigated with reasonable due diligence. A key first step is to identify situations that pose the highest risk potential. These can be either **country-specific** (is this country risky to do business in?) or **company-specific** (is this company risky to do business with?). Many websites and other resources are available to determine both types of risks.

Country Risks of greatest concern are the potential for military, political, or economic instability; currency inconvertibility, vulnerability to environmental disasters; government nationalization or expropriation; pressure to comply with corrupt demands; theft of intellectual property; and prohibitive new tariffs or non-tariff barriers.

Country-Risk Resources include:

- USDOC Country Commercial Guides (CCGs)
- USTR National Trade Estimate Reports on Foreign Trade Barriers
- Euromoney Country Risk Research
- Coface Country Risk Analyses and Evaluation
- Moody's Country Ratings
- S&P Sovereign Risk Indicators
- Allianz (formerly Euler-Hermes) Country Risk Reports

Company Risks primarily relate to a company's financials, ability to perform, and character. Exporters can minimize the risk by thoroughly vetting the bona fides of each prospective partner. They should ask each prospect for pertinent "qualifications" information, as well as seek more objective opinions and reports from third parties (e.g., other foreign companies they deal with, their banks, government trade assistance organizations, and credit-reporting agencies). The information-gathering should focus particularly on the subject company's capabilities (e.g., to stock, promote, and, if needed, provide user training and after-sales service); stature (e.g., respected, reputable, reliable, honest); experience (e.g., knowledge of the product and distribution channels); financials (capitalization, credit-worthiness) and bank and trade references. For a more detailed checklist of illustrative questions, see Questions to Ask an Overseas Distributor. Any serious negatives in these respects could result not just in non-or delayed payments, but entanglement in costly litigation.

Additional Public Resources that can assist in this process are as follows:

- USDOC's International Company Profile service provides details on any named foreign buyer or distributor going well beyond financials – basically assessing the company's overall suitability as a rep for a U.S. exporter. Credit-reporting agencies focus mostly on the financials, not performance or character. The following credit-reporting agencies are well-established internationally and can provide reports on virtually any foreign company.

- EXIM Bank assists clients with checking credit risks as part of the credit insurance program. This should not be the first choice for assessment or insurance.

Private Resources that can assist in this process are as follows:

- **Credit bureaus** are everywhere for both consumer and business credit reports. Below is an example of one online company to observe.

- **InternationalCreditReports.com**
  - provides trade and bank references to verify payment history
  - Information on legal information and operations
  - Can design questions to best address needs

- **Banks** will provide services for clients that have accounts with the banking institution.

- **Credit insurance companies** can be found in many countries around the world. It is wise to also check the background and standing of any company hired to do the research and provide services. Two well-respected U.S.A. companies are shown here.

  - **Coface for Trade -** Risk assessment for payment delays or non-payment. Provide in-depth resources for local market or buyer (see Coface Analyze my Customers and Prospects and Debtor Risk Assessments) at www.coface.com
  - **Graydon America -** Provides high-quality international credit reports to both private companies and governmental agencies (see Graydon's International Credit Reports)
  - **Also, see:**
    - Equifax International Credit Reports
    - Experian International Business Credit Reports
    - FCIB Worldwide Credit Reports
    - Dun & Bradstreet (D&B) Credit Evaluator Plus

Task. 4.2 - After evaluating foreign currency exchange risk, select, implement, and manage risk mitigation techniques to protect the company against fluctuation of foreign exchange

Knowledge of:

(i) Foreign exchange risk mitigation techniques and required documentation (e.g., hedging tools, currency option contracts, transfer pricing)

This study topic focuses on foreign currency exchange risk, foreign exchange risk mitigation techniques, and required documentation (e.g., hedging tools, currency option contracts, transfer pricing).

(i) Foreign Currency Exchange Risk Mitigation Techniques and Required Documentation

Foreign Currency Exchange Risk – Exporter Perspective

Sales contracts for exports and imports usually stipulate the price for the goods in a single currency (e.g., US dollars, Euros, etc.). However, anytime a seller agrees to receive payment in a foreign currency at some point in the future, that seller is potentially exposed to exchange rate risk. In particular, in situations where the foreign currency that is going to be received at a future date will need to be converted to the seller's domestic currency, exchange rate gains or losses can be realized – as follows:

- Consider a situation where a US-based exporter agrees to sell a container-load of product to a European buyer for 30,000 Euros payable in 30 days. Assuming an exchange rate of 0.9 Euro/USD on the contract date, the US exporter would expect to receive $33,333 USD for the goods. However, if the Euro depreciates against the USD to 1.0 Euros/USD (i.e., more Euros needed to buy 1 USD) during the 30 days while the exporter awaits payment, when the 30,000 Euros are received by the exporter, the exporter will only receive $30,000 USD (less than expected).

- On the other hand, in the same scenario where the exchange rate is 0.9 Euro/USD on the contract date and the US exporter expects to receive $33,333 USD for the goods, if the Euro appreciates against the USD to 0.8 Euros/USD (i.e., fewer Euros needed to buy 1 USD) during the 30 days while the exporter awaits payment, when the 30,000 Euros are received by the exporter, the exporter will receive $37,500 USD (much more than expected).

In this scenario, where the exporter has priced the product in the customer's local currency (i.e., Euros), it is very customer friendly because it removes any exchange rate risk for the customer. The customer in this situation already does business in Euros and has been asked to make the future payment in Euros, so there is no currency exchange risk for the customer at all. However, the exchange rate variability described above creates very real currency risks for any exporter that prices his/her products in the currency of the customer. So, this is a risk that should be mitigated.

Foreign Currency Exchange Risk – Importer Perspective

To eliminate the risk described above, many US exporters simply provide **pricing in USD** to their customers. This does eliminate the currency risk for the exporter, but at the same time, it shifts that currency risk to the importer. This is not very customer-friendly and may even be unattractive to some buyers – as follows:

Consider a situation where a US-based exporter agrees to sell a container load of products to a buyer in Mexico for 10,000 USD payable in 30 days. Assuming an exchange rate of 20 pesos/USD on the contract date, the Mexican importer would expect to pay 200,000 pesos for $10,000 worth of U.S. goods. However, if the peso depreciated from 20 pesos/USD on the contract date to 25 pesos/USD by the payment date (i.e., more pesos needed to buy 1 USD), the Mexican importer would need to pay 250,000 pesos on the settlement date for the same $10,000 USD worth of goods (more than expected).

Of course, the opposite situation could also occur in the same situation. Assuming an exchange rate of 20 pesos per US$ on the contract date, the Mexican importer would expect to pay 200,000 pesos for $10,000 worth of U.S. goods. However, if the peso appreciated from 20 pesos/USD on the contract date to 18 pesos/USD by the payment date (i.e., fewer pesos needed to buy 1 USD), the Mexican importer would need to pay only 180,000 pesos on the settlement date for the same $10,000 USD worth of goods (less than expected).

Foreign Exchange Risk Mitigation Techniques

Given that currency exchange rates fluctuate daily, it should be clear that currency values could vary substantially (appreciate or depreciate) during the period between contract signing and the payment date. Indeed, these foreign exchange fluctuations can result in either the importers or the exporters paying/receiving either more or less than expected which is not ideal for the importer or the exporter.

So, exporters who are planning to offer the buyer time to pay, are advised to employ risk mitigation techniques to remove some (or all) of this risk for both parties. This will allow them to make offers to prospective buyers that are less risky and therefore attractive. Several approaches can be used for this purpose:

1. Inflating the Quoted Price

One simple method that a US exporter can use to offset risks associated with currency fluctuations (when a buyer asks for a quote in their currency), is to put together a quote in USD, convert the figure to the foreign currency (using the current exchange rate) and then inflate the quoted price. The additional margin that is earned using the higher price is intended to serve as a buffer that can offset losses associated with currency fluctuations.

The advantages of this approach are that it is easy to implement and the customer has no currency risk at all. However, the disadvantage is that the increased price may not be competitive with other bids from other suppliers, or it may simply be too expensive for the buyer. Additionally, the increase in the price may not be an adequate buffer for currency exchange losses if the value of the foreign currency drops considerably in value while the exporter is awaiting payment.

2. Currency Risk Sharing

Another simple method that a US exporter can use to offset risks associated with currency fluctuations (when a buyer asks for a quote in their currency), is to quote half the contract in USD, and the other half in foreign currency. In this scenario, the importer is assured that when payment is due, only half of the owed amount will be in USD. Similarly, the exporter is assured that when payment is due, only half of the owed amount will be paid in foreign currency. This cuts the risk associated with currency fluctuations in half for both the exporter and the importer. The disadvantage of this approach is that both the importer and exporter are exposed to currency exchange risks associated with 50% of the contract value, and depending on the size of the contract, that still may be enough to represent an unacceptable amount of risk.

3. Forward Contracts

Many banks (with offices that specialize in international business), sell **forward contracts** as a tool that individuals and companies can use to eliminate currency risks associated with exchange rate fluctuations. Specifically, a forward contract is a product offered by a financial institution that will guarantee a specific rate of exchange for an agreed-upon amount of foreign currency to be exchanged at a future date. The rate that the bank agrees to pay for the agreed-upon amount of foreign currency at the agreed-upon date, is known as the **forward rate of exchange** (as opposed to the **"spot rate of exchange",** which is the term we use for the current rate of exchange). Forward contracts are commonly used to offset currency exchange rate risks associated with 30, 60, 90 days open account payment terms, but much longer timeframes (more than a year) are also available, which makes this a very effective hedging tool for longer-term contracts.

No upfront payment is required for this protection, but the forward contract represents a contractual commitment to bring the bank the agreed amount of foreign currency at the agreed-upon future date to be exchanged at the agreed-upon forward rate. Failure to deliver on this contractual obligation can result in penalties being levied by the bank.

For an exporter, the advantage of a forward contract is the certainty provided because the exchange rate that will be available at the time of settlement is known in advance. The disadvantage of a forward contract is that the exporter is locked into that exchange rate, and therefore the exporter cannot profit if the value of the foreign currency appreciates while awaiting payment.

4. Exposure Netting

Exposure netting is another simple way that companies can offset currency risks. In this approach, a company will attempt to match anticipated receivables in a foreign currency with payables in that country to be paid in the same currency. To the extent that a company can match receivables and payables in a foreign currency, currency exchange rate fluctuations become irrelevant (i.e., because the foreign currency being received does not have to be converted/exchanged. Instead, it is used to pay payables that are denominated in the same currency). Mainly, this sort of approach to hedging currency risks is accomplished in two ways:

1. First, if a company has **employees or suppliers located in the country where the payment is coming from**, this is an easy way to reduce currency risks (i.e., by offsetting receivables in a foreign currency with payables in the same foreign currency). This is not easy to set up spontaneously when a payment in a foreign currency is expected. However, when companies have ongoing receivables being received in a foreign currency, a strategic way of reducing currency risk is to develop suppliers or hire employees in that country so they can match anticipated receivables in that currency with a comparable level of payables in that same currency.

2. The second way in which this is accomplished is with a **money market hedge.** Some larger companies that want to reduce currency risks associated with a large receivable they are expecting in a foreign currency will create a matching payable in the same currency by borrowing a roughly equivalent amount of money from a bank in that country (or from their bank if the bank offers loans denominated in that currency). The money that is borrowed is converted into the company's domestic currency immediately, and the foreign currency they receive when the receivable comes due is used to pay off the loan they have with the foreign bank.

With a money market hedge, it doesn't matter if the foreign currency appreciates or depreciates while awaiting payment, because when the payment is received, the foreign currency doesn't need to be exchanged/converted. That payment is simply used to pay off the loan. At the same time, the company is holding the initial amount of the loan that has already been converted into their currency. Since the conversion of the borrowed amount occurred when the loan was first organized, the risks associated with currency fluctuations after that time have been removed. The advantage of this approach is that a money market hedge can be set up quickly for any amount. However, many small-to-medium-sized businesses don't have the capital to support this sort of spontaneous borrowing (i.e., banks may not approve their loan request) so the approach tends to be more frequently used by bigger companies.

5. Currency Option Contracts

Currency Option Contracts are also a great tool for protecting a company against losses when a future payment in a foreign currency is expected. The key advantage of this approach is that while potential losses can be prevented, the contract is only used when losses are going to occur. If the contract isn't needed (i.e., if the foreign currency appreciates while awaiting payment), it isn't used. In effect, this is a tool that provides currency risk protection when needed, but it leaves open the possibility of potential gains (if the currency being received has appreciated while awaiting payment). Currency option contracts can be set up and purchased on an organized exchange (e.g., The *Chicago Board Options Exchange*) with the assistance of a stockbroker or by opening a trading account with a brokerage firm. Currency option contracts are purchased with an upfront payment, and they are for an agreed-upon amount of foreign currency and a specified exchange rate, a rate that is guaranteed for the duration of the contract.

Foreign Exchange Risk Mitigation Techniques - SUMMARY

Exporters have many tools at their disposal to help them offset foreign exchange risk. A summary of the advantages and disadvantages of each of these approaches is provided in the table below:

Foreign Exchange Risk Mitigation Technique	Advantage	Disadvantage
Pricing in USD	● Eliminates 100% of the currency risk for the exporter	● Places 100% of the currency risk on the importer (not customer friendly)
Inflating the quoted price	● Eliminates some of the currency risks for the exporter	● Extra margin in the inflated price may not cover all of the currency risk experienced. ● Inflated price may not be competitive or may simply be too expensive for the importer
Currency Risk Sharing	● Eliminates some of the currency risk for both the exporter and importer (usually half)	● Both the exporter and importer remain exposed to some of the currency risk (usually half)
Forward contract	● Easy to set up with bank ● No upfront cost ● Eliminates 100% of the currency risk for the exporter	● No possibility of gaining if the foreign currency being received appreciates while awaiting payment
Exposure netting	● Can be used to eliminate 100% of the currency risk for the exporter	● Not easy to set up operations and find suppliers in the foreign market ● Smaller companies may not have the capital to borrow foreign funds if money market hedge used
Currency option contracts	● Can be used to eliminate 100% of the currency risk for the exporter ● Leaves open the possibility of upside gains if foreign currency appreciates in value	● Upfront cost to purchase ● Many smaller companies do not have a brokerage account

Transfer Pricing

Some companies have subsidiaries in one or more other countries and these entities can be used to offset currency risks. As noted in the exposure netting section above, to the extent that a company can match anticipated receivables in a foreign currency with payables in that country to be paid in the same currency, currency risks can be reduced or eliminated. Companies that have ongoing receivables in a particular foreign currency may therefore be inclined to set up suppliers, or even set up one or more wholly owned subsidiaries, in that foreign country to ensure that exposure netting can be used to reduce/eliminate the risks associated with fluctuating exchange rates.

However, companies that set up or use a subsidiary for this purpose need to be aware of tax laws related to transfer pricing (i.e., the prices used when contracts are being established between companies that are related to one another). For example, if a parent company owns a subsidiary in another country and buys goods/services from the subsidiary, the price paid for those goods/services (by the parent company, to the subsidiary) is known as the transfer price. Tax authorities are watching for transactions between related companies (known as non-arm's-length transactions) where a subsidiary is in a low-tax (or no-tax) jurisdiction and is overcharging the parent company for goods and services. This practice can be used to capture more profit in the country where less tax is payable and drain profits away from a parent company that resides in a higher tax jurisdiction. For this reason, most governments have established tests for reasonableness and expect transfer pricing to be identical to the pricing you would provide to an unrelated company (in an arms-length transaction).

Suffice it to say that transactions between a parent company and its subsidiaries are subject to transfer pricing rules and scrutiny by the tax authorities. So, companies that are using subsidiaries to accomplish exposure netting and reduce currency risks need to be aware that the arm's length principle is the standard that will be applied to transactions between the parent and the subsidiary. Tax authorities will compare the prices and profit margins earned when the subsidiary deals with the parent to the prices and profit margins earned when dealing with unrelated companies. In general, this is done to ensure that one of the two related entities is not taking advantage of the non-arm's length status of the relationship by using inflated pricing to siphon profits away from the other (i.e., to reduce the corporation’s overall tax liability).

Currency Convertibility Risk

There is also **currency convertibility risk** – this happens when a foreign currency is so devalued that it’s no longer convertible into US dollars, or when a country invokes local restrictions on currency conversion. When you operate in a country with high economic volatility, you will need to get currency convertibility insurance to protect yourself against such eventuality.

In the US, the **U.S. International Development Finance Corporation (DFC)** offers political risk insurance to cover risks of loss associated with Foreign Direct Investments in other countries caused by expropriation, currency inconvertibility, and political violence (details here). Also, the **World Bank Multilateral Investment Guarantee Agency (MIGA)** provides “Currency Inconvertibility and Transfer Restriction Coverage”, for protection against losses arising from an investor’s inability to legally convert local currency (i.e. capital, interest, principal, profits, royalties, and other remittances) into hard currency (i.e. Dollar, Euro or Yen), and/or to transfer hard currency outside the host country where such a situation results from government action or failure to act (details here). However, it is important to note that normal currency depreciation is not covered by this insurance.

Task 4.3 - Research and analyze the credit history and payment capacity of the potential buyers/partners to assess the commercial risk of the buyer and maintain credit management and control procedures and documentation.

Knowledge of:

(i) Sources of credit reports (e.g., credit bureaus, D&B, Hoovers, US Department of Commerce - International Company Profile)
(ii) Costs, usage, and value of credit reports
(iii) Commercial risks of late and/or non-payment from an overseas buyer
(iv) Methods of payment (e.g., Letters of Credit, documentary collections, cash in advance, sight draft)
(v) Mitigating techniques (e.g., credit risk insurance from US International Development Finance Corporation [DFC] and U.S. Export-Import [Ex-Im] Bank)

This study topic focuses on researching and analyzing the credit history and payment capacity of the potential buyers/partners, which requires knowledge of sources of credit reports, costs, usage and value of credit reports, and commercial risks of late and/or non-payment from overseas buyers.

(i) Sources of Credit Reports

Credit reports on companies are available from credit reporting agencies in many countries. These agencies are known as “credit bureaus” in the US and by similar names in other countries – e.g., “credit reference agencies” (UK), “credit reporting bodies” (Australia), “credit information companies” (India), “special accessing entities (Philippines). Credit reports focus primarily on a company’s “financials” (e.g., capitalization, credit-worthiness, cash flow, and ability to pay on time). Most of the agencies are only able to report on domestic companies, but a few, including those listed below, have extensive global coverage and can produce credit reports on virtually any company in any country.

- Equifax International Credit Reports
- Experian International Business Credit Reports
- FCIB Worldwide Credit Reports
- Coface Analyze my Customers and Prospects and Debtor Risk Assessments
- Dun & Bradstreet (D&B) Credit Evaluator Plus
- Graydon’s International Credit Reports

In addition to these sources for international credit reports, the U.S. Department of Commerce’s International Company Profile (ICP) program goes beyond financials to also assess the foreign company’s overall “suitability” as a potential partner (buyer or distributor) for a US firm. The ICP investigation is conducted by a commercial specialist at a US Embassy or Consulate who is familiar with the industry.

(ii) Costs, Usage, and Value of Credit Reports

Credit reports are a vital due diligence tool for companies looking for reputable foreign buyers, distributors, licensees, or other partners. Credit reports are particularly needed to verify a prospective foreign partner’s financials. (e.g., capitalization, creditworthiness, cash flow, ability to pay on time). Costs typically range from $35 to $400, depending on the target country, the depth of company detail wanted (e.g., standard vs. comprehensive), and the turnaround time needed (e.g., next day vs. 2 weeks).

A company credit report would typically cover:
For examples of the level of detail in standard vs. in-depth reports, the following sample is illustrative –

- FCIB standard, a next-day credit report for Hong Kong, and
- FCIB in-depth credit report for Mexico

Although in-depth credit reports provide extensive financial and operational details, they generally do not address other key issues needed to assess the foreign company's "suitability" as a potential distributor in the country; topics such as product expertise, country-wide coverage, and ability to produce, stock, market, train users, and provide after-sales service as needed. For this type of assessment, US exporters can order an International Company Profile (ICP) from the U.S. Department of Commerce. The ICP, with a roughly 15-day turnaround, provides:

- A detailed credit report on a prospective overseas sales representative or partner
- A listing of the company's key officers and senior management
- Banking and other financial information about the company
- Market information, including sales and profit figures, and potential liabilities
- An opinion as to the viability and reliability of the overseas company, as well as an opinion on the relative strength of that company's industry sector in the target market

The fee for a "full" ICP is ~$700 for small companies, $1,200 for medium companies, and $2,000 for large companies. The fee for a "partial" ICP is ~$150 for small companies, $350 for medium companies, and $450 for large companies.

(iii) Commercial Risks of Late and/or non-payment from Overseas Buyers

Although credit reports and credit checks are used extensively in the US to determine whether or not to offer open account payment terms to other companies, it is much riskier in international businesses to offer open account terms without credit insurance as a backstop against losses associated with payment default. Without adequate precautions, exporters are at risk that their foreign buyers will default altogether or not pay on time. In many instances, the amount of money at stake (e.g., when 1-2 containers of the product have been shipped to another country) is not enough to warrant the time and money associated with an international lawsuit. Depending on the country, alternative collection options may not be available either.

Commercial risks relate to the buyer's inability or unwillingness to pay at all or on time. For example:

- Insolvency/bankruptcy could make it impossible for the buyer to pay anything (default).
- Cash flow problems could necessitate a late payment by the buyer.
- Disagreements about the terms of the sale could hold up the payment until resolved.
- Currency depreciation could make the purchase unaffordable to the buyer

Exporters are therefore advised to assess commercial risk carefully and use traditional export payment risk reduction techniques to mitigate these risks (for an introduction to some of these tools, read this quick summary).

(iv) Methods of Payment

Many potential exporters resist exporting out of fear that they will not get paid. However, there are several available payment methods to protect against buyer default. These methods can reduce the risk of nonpayment considerably for export sales. The options include cash in advance, documentary collections, Letters of Credit, and even open accounts when backed by very inexpensive export credit insurance.

No matter what the payment method, exporters should verify the reputability and creditworthiness of the potential customers, especially those less well-known or established in the industry. Check out the company's website, ask for bank and trade references, and consider credit and background checks from organizations providing these services.

Selecting an export payment method. Export payment terms and methods – when and how to get paid -- are negotiable between the exporter and importer. Both parties have interests and risks at stake, and each approaches the payment issue from somewhat opposite ends. These differences must be mutually understood and accommodated in a successful negotiation.

For exporters, the key payment issues are:

- How soon can I get paid (before or after shipment)?
- How will I get paid (what currency and what payment method and process)?
- How do I protect against non-payment (risk mitigation)?

For importers, the converse issues are:

- How soon do I have to pay (the more time the better)?
- How do I make certain I get what I paid for?
- How do I ensure the goods have been shipped to me?

There are several options for payment and each method has strengths and weaknesses that are important to both the exporter and importer (for different reasons):

Cash in advance is best for exporters, particularly by wire transfer, because there is no cash-flow burden and no risk of a buyer default. Advance payment by credit card offers the same benefit, but it carries the risk of credit card fraud. For importers, however, advance payment is the worst option. It not only shifts the cash-flow burden to them but forces them to pay before they can even see what they are getting.

Therefore, unless this is a "must" buy situation (with no other supplier options/sources), the buyer will likely say no to cash in advance. Otherwise, most buyers can usually find a competing supplier willing to offer better terms. If faced with this resistance, some exporters will try for an up-front installment payment, say 25-50% of the total amount, with the balance to be paid on delivery or at a specified later time. If a buyer still says no, some exporters will consider other payment options that also greatly reduce the payment risk, such as documentary collections, Letters of Credit, or even open account terms backed by export credit insurance (these options are explained below).

Factoring - If an importer is unwilling to agree to an advance payment, another possible option is to discount or "factor" the receivable. Factoring companies will need to be found in the buyers' country, but it may be possible to arrange in advance to have the Factoring company buy an export receivable from an exporter for a fee. After paying the exporter up front, the Factor takes on the responsibility of collecting from the importer and ideally, this can be arranged on a "non-recourse" basis (which means that the Factor will assume the risk of non-payment). Factors may charge a relatively high premium for this service, but it's a risk-free, up-front payment for exporters if they can afford to accept the discounted amount.

Documentary Collections are a commonly used payment method for export sales. Timing-wise, the payment in a documentary collection is similar to cash on delivery (COD) or cash at a mutually agreed date after delivery. These payment tools are routinely handled by banks, and the service is not particularly expensive (i.e., usually a few hundred dollars per transaction). A documentary collection involves the transfer of two documents – as follows:

i. **The Bill of Lading** –This document is usually issued by the carrier and provided to the exporter as a receipt for the goods. Original copies of the Bill of Lading can also serve as the "Title" to the Goods (a sample can be found here).

ii. **The Bill of Exchange** (also known as a "Draft") is a document that is prepared by the exporter with the assistance of the exporter's bank. This is like a personal check in reverse. Instead of the draft indicating that the exporter owes the importer money (like a check), it is the opposite – the draft indicates that the importer owes the exporter money and indicates when payment is due.

There are two types of documentary collections – as follows:

1. **Documents Against Payment (D/P)** also known as a "**Sight Draft**" – In this type of documentary collection, the importer's bank in the importing country receives the title to the goods (in the form of the Bill of Lading), along with a Bill of Exchange from the exporter. The Bill of Exchange indicates how much the importer owes and specifies that payment is due from the importer "at sight" (i.e., at the sight of the documents). The importer must therefore pay the bank the full amount owed immediately. If the payment is made, the bank releases the Bill of Lading to the importer. This will allow the importer to get access to the goods (specifically, the original copy/copies of the Bill of Lading can be presented to the carrier or the receiving port, and the goods will then be released to the importer).

   Exporters Risk – In this arrangement, if the buyer decides not to go to the bank to pay (a potential risk), the exporter still retains the title to the goods and will be able to bring the goods back or sell them to someone else. So, this is less risky than an open account, but it is not entirely risk-free.

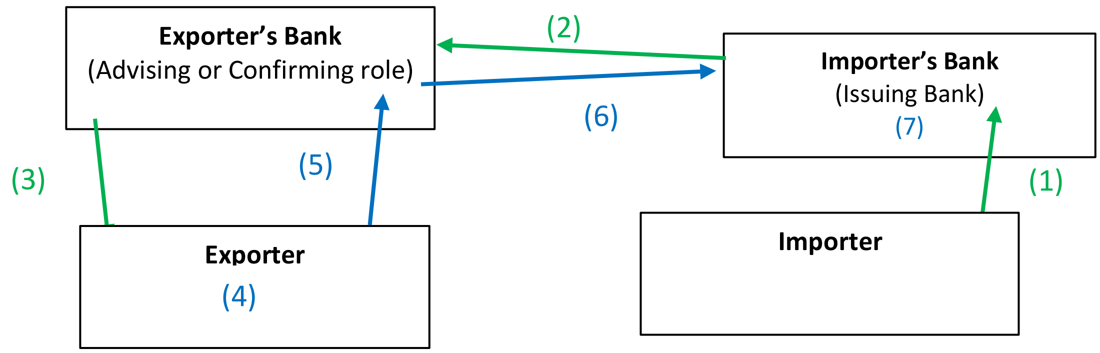
   Importers Risk- In this arrangement, if the buyer pays to get the Bill of lading released and uses it to access the goods, the importer will not have 100% certainty that the goods that have been shipped are exactly what was ordered and exactly the quality demanded. Something has been shipped, so this is less risky for the importer than cash-in-advance, but it is not entirely risk-free.

2. **Documents against Acceptance (D/A)** also known as a "**Time/Term Draft" -** In this type of documentary collection, the same documents are used and the same steps are involved as described for Documents Against Payment, but the Bill of Exchange does not indicate that payment is due at sight. Instead, the Bill of Exchange indicates that there will be a specified term for repayment (e.g., 30 days, 60 days, 90 days). When this approach is used, the exporter will usually pre-arrange Factoring (see above) and ask the importer's bank to buy the Bill of Exchange/Draft from the exporter for an amount that is a discount of full value.

In general, banks and other factoring companies prefer to purchase Bills of Exchange because the document is an unequivocal statement of the debt that is widely recognized and easily enforced by a court in the event of non-payment. This means that the bank or Factoring company will usually factor on a "non-recourse" basis (which means that the Factor will assume the risk of non-payment completely).

Letters of Credit (L/Cs) are the most secure payment method after cash in advance and are much more open to use by importers.

The Letters of Credit involve four different parties (see the boxes below):



The initial steps involved are best remembered as a sequence – as follows:

SEE THE GREEN ARROWS ABOVE –

1) The importer opens the L/C at his/her bank by putting up (a) the money owed, (b) a list of documentary evidence that the exporter will need to produce to get the bank to release the money, and (c) a deadline
2) The importer's bank (the issuing bank) informs the exporter's bank (the advising bank) that an L/C has been opened in favor of the exporter. The details of the documentary evidence requested, and the deadline are also shared.
3) The exporter's bank (the advising bank) notifies the exporter that an L/C has been opened in favor of the exporter. The details of the documentary evidence requested, and the deadline are also shared with the exporter.

SEE THE BLUE ARROWS ABOVE –

4) The exporter does whatever is required to gather the documentary evidence that was requested by the issuing bank. The types of documentation that are often requested are as follows:
    a. Commercial invoice
    b. Packing list
    c. Certificate of Origin
    d. Proof of shipping insurance
    e. Original copies of the Bill of Lading
    f. Evidence of 3rd Party Inspection, etc.
5) The exporter submits the documentary evidence to the advising bank for review.
6) The advising bank forwards the documentary evidence to the issuing bank and demands payment.
7) Provided that the documentary evidence submitted is "letter perfect" (exactly as requested), the issuing bank releases payment to the exporter's bank for the exporter. If there are any "discrepancies" among the documents, the buyer's bank is not obliged to release the payment. Thus, compliance with all the L/C documentary terms is crucial.

L/Cs are designed to protect both the exporter and the importer. The exporter gets a guarantee of payment by a bank; the importer gets a guarantee that the exporter will deliver exactly the evidence requested, as specified in the L/C. To assure this is to their mutual benefit, the L/C evidence requested should align perfectly with the purchase order and all related shipping documents. The exporter's bank and freight forwarder can help the exporter make sure that the requested documents are exactly as requested by the issuing bank, but if an unexpected problem arises with the documents, it can usually be resolved amicably. When an issue occurs, the exporter should contact the buyer immediately and ask for an amendment to the L/C to allow for a fully compliant documentary submission.

Despite their fairly wide use and mutual benefit, the costs associated with an L/C are quite high and bank fees are charged to both the importer and exporter, so the cost exceeds the fees associated with most other payment methods. For this reason, companies often prefer less costly payment methods that still offer reasonable protection against buyer default, such as "documentary collections."

Confirmed Letter of Credit

One of the main risks in an L/C is the risk of nonpayment by the issuing bank. Although this is rarely an issue with well-established banks, when dealing with unknown foreign banks, the exporter can get the L/C "confirmed", which protects the exporter from that risk. To do this, the exporter asks his/her bank to "confirm the Letter of Credit". If the exporter's bank agrees to take on the role of the **confirming bank**, the exporter's bank will take over the obligation to pay upon receipt of a fully compliant set of documentary evidence (as requested in the L/C). The resulting payment instrument is known as an "irrevocable, confirmed L/C."

Open account is the payment method most favored by importers because they do not have to pay until some agreed-upon time after they get the goods (typically 30-120 days). Inexperienced exporters generally avoid open accounts and lose many deals for fear that they will not get paid in the end. However, savvy exporters know how to protect against buyer default, even for open account sales. They also know that they can be much more competitive if willing to sell on an open account, especially if their prices are higher than other suppliers. The risk can be mitigated almost entirely with an export credit insurance policy from the U.S. Export-Import Bank. Under these very inexpensive policies, the exporter is guaranteed nearly full payment if the buyer later defaults. Without export insurance for open account terms, the exporter should be especially vigilant in due diligence or reserve this option only for buyers that are well established, have solid payment records, or have been thoroughly checked for creditworthiness.

(v) Risk Mitigating Techniques

Trade and investment risks can best be mitigated by, first, trying to avoid them altogether (**risk avoidance**) and, if unavoidable, by using techniques to limit the damage (**risk mitigation**).

- **Risk Avoidance Techniques**. The two main risks to avoid are a) poor partner selection and b) poor country selection. Both risks can be avoided, or at least minimized, with appropriate risk assessments (due diligence). To assess partner risks, use credit and background reporting services to verify that any potential trade or investment partners are reputable, credit-worthy, and capable of performing as needed. To assess country risks, research to verify that the target country has a relatively stable economic, business, currency, political, and regulatory environment.
- **Risk Mitigation techniques**. If opportunities dictate that partner and country risks are worth taking, know that techniques and programs are available to protect the sale or investment.

Exporters can protect against non-or-late payment by requesting buyers to pay fully or partially in advance, discounting the receivable (factoring), using L/Cs or other relatively secure methods of payment (e.g., cash on delivery), or by insuring the shipment against buyer default (export credit insurance). Export credit insurance is available from the **U.S. Export-Import Bank** (Ex-Im), as well as from commercial sources, such as Meridian, Coface, and Allianz (formerly Euler-Hermes). For a relatively low premium (e.g., only about half of 1% of the transaction value from EXIM), the policies guarantee near total payment (e.g., 95% from EXIM) if the buyer defaults for any economic, commercial, or political reason.

For U.S. **investors**, protection against risks is available from the U.S. International Development Finance Corporation (FDC) for investments in more than 160 developing and post-conflict countries. FDC offers political risk insurance guarantees against losses from:

- War, civil strife, coups, and other acts of politically motivated violence, including terrorism.
- Expropriation, including abrogation, repudiation, and/or impairment of contract and other improper host government interference
- Restrictions on the conversion and transfer of local-currency earnings (e.g., ability to repatriate capital or remit profits)

Task 4.4 - Establish the most appropriate methods and terms of payment and required documentation to ensure timely payment for the sale of goods and/or services and to facilitate external financing

Knowledge of:

(i) Methods and costs of payment (e.g., Letters of Credit, documentary collections, cash in advance, time draft, banker's acceptance)
(ii) Commercial, economic, and political risks of the buyer and buyer's country
(iii) International regulations published by the International Chamber of Commerce (Paris) governing international transactions and methods of payment (e.g., Incoterms, Uniform Customs & Practices for Documentary Credits [UCP], arbitration, Uniform Rules for Collection [URC])
(iv) Methods of funds remittance (e.g., checks, banker's draft, SWIFT transfer)
(v) Types of Letters of Credit (e.g., confirmed/unconfirmed, irrevocable, transferable, standby, with a time draft)
(vi) Types of payment (e.g., sight, deferred, acceptance)
(vii) Documentation requirements (e.g., commercial invoices, transport documents and documents relating to services, inspection certificate)
(viii) Related financial and legal costs (e.g., bank charges, insurance premiums, legal fees)
(ix) Communication of Letters of Credit, collections, and associated documents electronically via the Internet (e.g., the Uniform Customs & Practices for Documentary Credits (Supplement for Electronic Presentation [eUCP], SWIFT)

This topic will discuss methods and costs of payment, commercial, economic, and political risks of the buyer and buyer's country, international regulations governing international transactions and methods of payment, and methods of funds remittance.

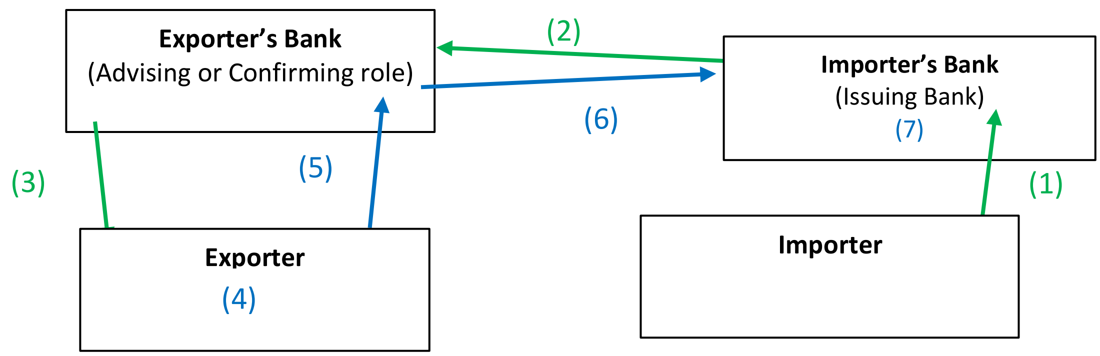
(i) Methods and Costs of Payment

Several options are available to get paid for export sales. Some favor one party over the other in cash flow impact, payment security, processing fees, and other costs. The most appropriate payment method is not necessarily the one that favors one party over the other, but a compromise that each can mutually agree to. This is generally sorted out in the negotiations between exporter and importer leading up to a deal (e.g., on price, payment method, transport mode, and delivery date). The traditional payment options include one form or other of **cash in advance**, **payment on delivery**, and **payment after delivery**. The payment documents and procedures vary with each option, as do costs and fees.

Cash in advance, either 100% or a first installment, is most beneficial for the exporter, as it virtually guarantees payment with little or no drain on cash flow. Cash in advance is the least beneficial for the buyer, both in cash flow impact while waiting for the goods to arrive and the risk that the goods on arrival will not be as ordered or expected. With cash in advance, the buyer typically transfers ("wires") the funds electronically to the seller's bank account. Bank rates for wire transfers usually range from 1% to 3% of the transaction value, or could also be a mutually agreeable flat fee, Credit card payments might instead be used for smaller purchases but run the risk of credit card fraud.
Letters of Credit (L/Cs) are the most secure payment method after cash in advance and are much more open to use by importers.

The Letters of Credit involve four different parties (see the boxes below):

The initial steps involved are best remembered as a sequence – as follows:



SEE THE GREEN ARROWS ABOVE –

1) The importer opens the L/C at his/her bank by putting up (a) the money owed, (b) a list of documentary evidence that the exporter will need to produce to get the bank to release the money, and (c) a deadline
2) The importer's bank (the issuing bank) informs the exporter's bank (the advising bank) that an L/C has been opened in favor of the exporter. The details of the documentary evidence requested, and the deadline are also shared.
3) The exporter's bank (the advising bank) notifies the exporter that an L/C has been opened in favor of the exporter. The details of the documentary evidence requested, and the deadline are also shared with the exporter.

SEE THE BLUE ARROWS ABOVE –

4) The exporter does whatever is required to gather the documentary evidence that was requested by the issuing bank. The types of documentation that are often requested are as follows:
    a. Commercial invoice
    b. Packing list
    c. Certificate of Origin
    d. Proof of shipping insurance
    e. Original copies of the Bill of Lading
    f. Evidence of 3rd Party Inspection, etc.
5) The exporter submits the documentary evidence to the advising bank for review.
6) The advising bank forwards the documentary evidence to the issuing bank and demands payment.
7) Provided that the documentary evidence submitted is "letter perfect" (exactly as requested), the issuing bank releases payment to the exporter's bank for the exporter. If there are any "discrepancies" among the documents, the buyer's bank is not obliged to release the payment. Thus, compliance with all the L/C documentary terms is crucial.

L/Cs are designed to protect both the exporter and the importer. The exporter gets a guarantee of payment by a bank; the importer gets a guarantee that the exporter will deliver exactly the evidence requested, as specified in the L/C. To assure this is to their mutual benefit, the L/C evidence requested should align perfectly with the purchase order and all related shipping documents. The mutual terms are spelled out in the L/C's Letter of Instructions.

While L/Cs offer the exporter a guaranteed payment (upon receipt of the requested documentation), they are more costly than other payment methods for the buyer because the buyer usually has to advance the funds to get the L/C opened or secure the L/C with credit at the bank. Either way, this can be a significant financial burden for the buyer.

Another cost disadvantage of L/Cs for both parties is that fees are much higher, reflecting the greater interbank processing involved. Both banks typically charge $25 to $150 for postage, courier services, bank-to-bank reimbursements, authenticating the LC, and other services. These charges average about 1% of the face amount of the L/C and a fixed percentage fee may be established as a base charge for larger amounts.

Documentary Collections are a commonly used payment method for export sales. Timing-wise, the payment in a documentary collection is similar to cash on delivery (COD) or cash at a mutually agreed date after delivery. These payment tools are routinely handled by banks, and the service is not particularly expensive (i.e., usually a few hundred dollars per transaction). A documentary collection involves the transfer of two documents – as follows:

iii. **The Bill of Lading** –This document is usually issued by the carrier and provided to the exporter as a receipt for the goods. Original copies of the Bill of Lading can also serve as the "Title" to the Goods (a sample can be found here).

iv. **The Bill of Exchange** (also known as a "Draft") is a document that is prepared by the exporter with the assistance of the exporter's bank. This is like a personal check in reverse. Instead of the draft indicating that the exporter owes the importer money (like a check), it is the opposite – the draft indicates that the importer owes the exporter money and indicates when payment is due (a sample can be found here).

There are two types of documentary collections – as follows:

3. **Documents Against Payment (D/P)** also known as a "**Sight Draft**" – In this type of documentary collection, the importer's bank in the importing country receives the title to the goods (in the form of the Bill of Lading), along with a Bill of Exchange from the exporter. The Bill of Exchange indicates how much the importer owes and specifies that payment is due from the importer "at sight" (i.e., at the sight of the documents). The importer must therefore pay the bank the full amount owed immediately. If the payment is made, the bank releases the Bill of Lading to the importer. This will allow the importer to get access to the goods (specifically, the original copy/copies of the Bill of Lading can be presented to the carrier or the receiving port, and the goods will then be released to the importer).

   Exporter's Risk – In this arrangement, if the buyer decides not to go to the bank to pay (a potential risk), the exporter still retains the title to the goods and will be able to bring the goods back or sell them to someone else. So, this is less risky than an open account, but it is not entirely risk-free.

   Importer's Risk- In this arrangement, if the buyer pays to get the Bill of lading released and uses it to access the goods, the importer will not have 100% certainty that the goods that have been shipped are exactly what were ordered and exactly the quality demanded. Something has been shipped, so this is less risky for the importer than cash-in-advance, but it is not entirely risk-free.

4. **Documents against Acceptance (D/A)** also known as a "**Time/Term Draft" -** In this type of documentary collection, the same documents are used and the same steps are involved as described for Documents Against Payment, but the Bill of Exchange does not indicate that payment is due at sight. Instead, the Bill of Exchange indicates that there will be a specified term for repayment (e.g., 30 days, 60 days, 90 days). When this approach is used, the exporter will usually pre-arrange Factoring (see above) and ask the importer's bank to buy the Bill of Exchange/Draft from the exporter for an amount that is a discount of full value.

In general, banks and other Factoring companies prefer to purchase Bills of Exchange because the document is an unequivocal statement of the debt that is widely recognized and easily enforced by a court in the event of non-

payment. This means that the bank or Factoring company will usually factor on a "non-recourse" basis (which means that Factoring companies will assume the risk of non-payment completely).
The bank fees for D/Cs are much lower than for L/Cs because neither bank takes on any risk of non-payment. D/C fees cover costs to transmit funds, issue banker's sight or time drafts, receive transfers and clear checks in foreign currencies.

(ii) Commercial, Economic, and Political Risks of Buyer's Country

Any payment is at some risk unless the buyer pays the entire amount up front. Risks can be **buyer-related** (e.g., cannot afford to pay or unwilling to pay) and/or **country-related** (e.g., deteriorating commercial, economic, or political conditions that limit or prevent payment).

- **Company-related risks**. Buyers can appear to be good risks when a deal is struck but suffer financial losses thereafter (e.g., insolvency) that leave them unable to pay when the bill is due. They could also just refuse to pay (e.g., found fault with the goods, got a better deal elsewhere, or try to take the goods without paying). Exporters should not rely on the good faith of buyers, but make every effort to vet them before closing the deal. This can be done by asking questions about their finances and experience, checking bank and trade references, and ordering credit and background reports. However, even honest, well-meaning buyers can default if deprived of means of payment by government actions (e.g., denial of foreign exchange or import permits). Exporters can still protect against such possible company default by using more secure methods of payment (e.g., Letters of Credit, cash on delivery) or with export credit insurance for open account sales.

- **Country-related risks.** Most industrialized countries have stable economic and political environments that pose no intrinsic threat to the ability of buyers to afford or pay for imports. The greatest risks are in developing countries, especially the least-developed, with more volatile economies, political structures, and endemic corruption. Buyers in these countries are much more likely to face hurdles in conducting everyday business (e.g., bureaucratic delays, demands for payoffs) or more impactful economic or political government actions that raise the cost of imports (e.g., currency devaluation, high new tariffs) or limit access to needed import permits or foreign exchange. Exporters may conclude that the potential rewards are greater than the risks, but they should take steps, in any case, to assess each target market for potential commercial, economic, and political risks and take precautionary steps to mitigate them, most notably with export credit insurance that protects against all such risks.

(iii) International Regulations Published by the International Chamber of Commerce (Paris) Governing International Transactions and Methods of Payment

Exporters and importers need to agree amongst themselves on the price, payment terms and method, transport mode, and delivery date for each transaction. To aid in this process, the International Chamber of Commerce has developed regulations to standardize terms and methods of payment for international trade transactions – specifically International Commercial Terms (Incoterms), Uniform Customs & Practices for Documentary Credits (UCP600), Uniform Rules for Collection (URC), and arbitration/mediation procedures for resolving disputes.

- **Incoterms** are a set of 3-letter acronyms, published by the ICC, that standardize terms for quoting export prices and determining liability for goods if lost or damaged in transit. The process typically starts with the buyer asking the exporter for a price quote from a specified starting point (e.g., the price at the factory or from any named point further along the way to the final destination). Each named point has its own Incoterm. The ICC revises Incoterms every 10 years. Incoterms 2020 came into effect in January 2020, and include 11 different Incoterms, ranging from the price at the factory (EXW for Ex Works) to the price delivered to the importer's door (DDP for Delivered Duty Paid).

INCOTERMS 202

EXW - Ex Works (Named place of delivery)	The seller makes the goods available to the buyer at the seller's premises or at another named place (i.e., works, factory, warehouse, etc.). The buyer loads and transports the goods from that point to their destination and is liable. for any loss of or damage to the goods up to the destination.
FCA - Free Carrier (Named place of delivery)	The seller delivers the goods to the carrier. The buyer assumes liability thereafter and arranges transport to the destination.
FAS - Free Alongside Ship (Named port of shipment)	The seller delivers the goods alongside the vessel at the named exit port. The buyer loads the goods onto to the vessel and bears all further costs and liability thereafter.
FOB - Free on Board (Named port of shipment)	The seller delivers and loads the goods on board the vessel at the named exit port. The buyer bears all further costs and liability thereafter.
CPT - Carriage Paid to (Named place of destination)	The seller delivers the goods to the carrier and contracts for and pays the costs of carriage to bring the goods to the named place of destination.
CIP - Carriage and Insurance Paid to (Named place of destination)	In addition to CPT conditions, the seller also contracts for minimum insurance. cover against the buyer's risk of loss or damage to the goods in transit. The buyer would need to obtain extra insurance for any added protection.
CFR - Cost and Freight (Named port of destination)	The seller pays all costs except cargo insurance to deliver the goods to the named entry port. The buyer is liable for any loss or damage to the goods. in transit and is expected to obtain cargo insurance.
CIF - Cost, Insurance and Freight (Named port of destination)	The seller pays all costs, including cargo insurance, to deliver the goods to the named entry port. The buyer may opt to purchase additional cargo. insurance for protection beyond the seller's minimum cover policy.
DAP - Delivered at Place (Named place of destination)	The seller delivers the goods to a named destination place. The seller bears all risks involved up to that point. The buyer pays any duties to release the goods from customs.
DPU - Delivered at Place Unloaded (Named place of destination)	The seller delivers the goods to a named destination place and is responsible for unloading the goods at the detination. The seller bears all risks involved up to that point. The buyer pays any duties to release the goods from customs.
DDP - Delivered Duty Paid (Named place of destination)	The seller delivers the goods to the buyer's door. The seller is responsible for clearing the goods and pay any applicable duties for export as well as for import. The seller bears all the costs and risks involved to bring the goods to the named place of destination.

Uniform Customs & Practices for Documentary Credits [UCP] is a set of standardized rules published by the International Chamber of Commerce (ICC) specifically relating to Letters of Credit (L/Cs). ICC periodically updates the UCP – the current version is UCP600. The UCP 600 rules are voluntary but become applicable when specifically incorporated in trade finance contracts. An accompaniment to the UCP 600 (the International Standard Banking Practice for the Examination of Documents under Documentary Credits (ISBP), helps clarify whether a document complies with the L/C terms. UCP600 is used throughout the world by international commercial banks. Key elements of UCP 600 include:

- How L/Cs can be signed and acknowledged by all parties
- Differences between documents, goods and services, and responsible parties
- Which parts of L/Cs are negotiable and non-negotiable

- How credit works, and how payment is made
- How banks can communicate the confirmation of goods
- Transportation of the goods, modes of transport, and who bears responsibility
- How to deal with discrepancies, waivers, and giving notice
- The provision of original documents or electronic copies
- Bills of Lading
- Insurance and covering the cost of goods
- Loss of shipping documents in transit

- **Uniform Rules for Collection (URC)** are a set of rules developed by the International Chamber of Commerce (ICC) that standardize the process of collecting debts arising from international trade transactions. The latest version, URC 522, provides rules for businesses, banks, buyers, and sellers to follow to initiate a collections process, particularly for transactions using either Document Against Payment (D/P) or Documents Against Acceptance (D/A) as the method of payment. Under URC 522, D/P terms are to specify that the importer can take immediate title to and possession of the goods only by signing a sight draft issued by the importer's bank and making a full up-front payment. D/A terms under URC522 must specify that the importer can also take immediate title and possession of the goods, but only by signing a time draft issued by the importer's bank agreeing to pay the exporter at a future time.

- **Arbitration** is a process for resolving payment and other commercial disputes without going to court. ICC is a pioneer in the development of global Rules of Arbitration that define and regulate the management of cases submitted to its International Court of Arbitration. Payment disputes can still arise, despite ICC rules to standardize payments by Letters of Credit (L/Cs) and Documentary Collections (D/Cs). Arbitration essentially involves using a mutually agreed third party (an arbitrator) to hear the evidence and reach a decision that both parties are obliged to accept. If arbitration is agreed to as the dispute resolution mechanism, an arbitration clause must be inserted in the sales contract. Although arbitration is not always best in every situation, it has several advantages over court litigation. Court cases often must take place in unfriendly jurisdictions, such as the adversary's country. They usually take longer and cost more than arbitration, due mostly to the extra time needed for pre-trial legal discovery (document production, witness depositions, etc.) and the possibility of lengthy appeals. By contrast, arbitration awards are final and binding (no appeals) and the cases are conducted in a neutral setting with little or no need for discovery. Also, arbitration is conducted in private, with no official court record that could damage reputations.

(iv) Methods of Funds Remittance

Exporters commonly receive funds (remittances) from buyers either by check, credit card, wire transfer, or banker's drafts. Each method has relative benefits for one party or the other (e.g., speed, ease of use, security), but also may have risks (e.g., buyer default, fraud). As with any transaction that relies on either party to make good, each should verify the other's bona fides to the extent possible (e.g., with credit and background reports, bank, and trade references, etc.).

- **Checks** are written by the buyer to the credit of the seller but must go through a check-clearing process before they can be cashed. Check clearing moves the money from the buyer's "issuing" bank to the seller's "paying" bank, either in the traditional paper form or digitally. The risk with checks is that they could bounce, in which case the check would be marked as non-sufficient funds and returned.

- **Credit Cards** are an inexpensive, widely accessible, and speedy method of payment for exports, especially for smaller-value transactions. They are increasingly popular as the primary payment method for surging E-Commerce export sales. Credit cards are also relatively safe since they guarantee payment collection for the exporter and ensure security for the importer. Also, credit cards include an extended payment cycle for the importer (varying based on the payment date and the closing date for the monthly payment cycle on the card). Because credit cards do run the risk of fraud, exporters need to take reasonable precautions to protect themselves. For example:

- Verify that the buyer's billing address matches the shipping address, especially if the addresses are in different countries. Also, use the **Address-Verification System (AVS)** of the credit card processing company to assure that the buyer's credit card is valid. The AVS can verify the identity of the person claiming to own a credit card and can determine whether the address on a buyer's credit card account matches the address the buyer typed into the online order form.

- Require the online buyer to enter the 3-or 4-digit **Card Verification Number** (CVN) on the back of the card, in addition to the credit card number. The CVN is supposedly only known by the cardholder.

- Use **IP Geolocation**, a service that enables a seller to identify a prospective buyer's geographic location (country, region, ZIP/postal code), based on the IP address of the computer being used. If the country or region of the buyer's credit card address doesn't match that of the IP address, the seller can flag the order and then investigate further or reject the order outright. This method is increasing in popularity, particularly among larger exporters.

- **Bank/Wire Transfers** are payments by the buyer directly into the exporter's bank account. To initiate the transfer, the exporter provides the buyer with the relevant account information – the name of the exporter's bank, account name and number, routing number, Swift code, branch name and address, and telephone number (for international callers). Exporters should consider setting up a separate bank account just to receive wired funds for export orders.

- **Banker's Drafts** are the form of payment used by banks for Documentary Collection (DC) transactions. Once the export shipment arrives with documents holding title to the goods, the importer's bank issues either a "sight draft" – the importer pays on sight to gain access to the goods – or a "time draft" – the importer gains access to the goods upon acceptance to pay at a specified later "time." In a typical DC payment, the exporter is the drawer, the buyer is the drawee, and the exporter is the payee. Bankers' drafts are relatively secure and routinely handled by banks. The only risk to the exporter is if the buyer decides not to buy the goods after they arrive. In this situation, the exporter still owns the goods but must find another buyer or bring them back.

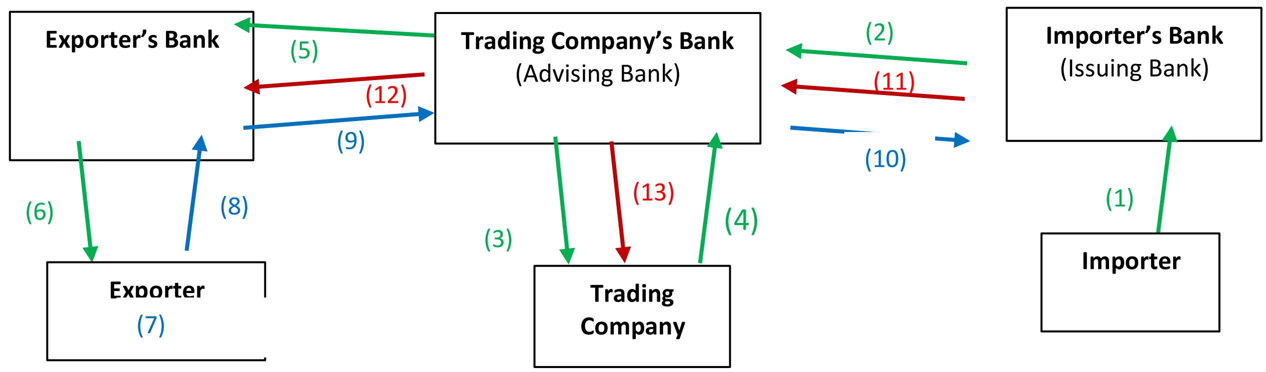
Because banks are involved in virtually all international trade transactions, they recognized the need to simplify and systematize the process of transferring funds from buyer to seller. The Society for Worldwide Interbank Financial Telecommunications (SWIFT) network was established for this purpose. The SWIFT international payment network is one of the largest financial messaging systems in the world. To illustrate the process, assume a Mexican buyer wants its Mexican bank to transfer a payment to the exporter's bank in New York. The Mexican importer can provide the U.S. exporter with its Mexican bank account number and the bank's unique SWIFT code. The Mexican bank will send a payment transfer SWIFT message to the New York bank over the secure SWIFT network. Once the New York bank receives the SWIFT message about the incoming payment, it will clear and credit the money to the exporter. SWIFT payments average about 2–5 working days to reach their destination. Banks typically charge a fee for SWIFT transfers.

(v) Types of Letters of Credit

Transferable Letters of Credit

A Transferable Letter of Credit is similar to a normal Letter of Credit (L/C), but it allows the recipient of the funds to extend the irrevocable offer to a third party. In other words, a person or a company that is working as an intermediary (e.g., a trading company) can act on behalf of a buyer and use the buyer's Transferable Letter of Credit to pay for goods for a supplier that is not known to the buyer. The steps to make this happen are as follows:

The Letters of Credit involve six different parties (see the boxes below):



The steps involved in a Transferable Letter of Credit *are best remembered as a sequence – as follows:*

SEE THE GREEN ARROWS ABOVE –

1) At the request of the trading company, the importer opens the Transferable L/C at his/her bank by putting up (a) the money owed, (b) a list of documentary evidence that the exporter will need to produce to get the bank to release the money, and (c) a deadline
2) The importer's bank (the issuing bank) informs the trading company's bank (the advising bank) that a Transferable L/C has been opened in favor of the Trading Company. The details of the documentary evidence requested, and the deadline are also shared with the trading company.
3) The trading company's bank (the advising bank) notifies the trading company that a Transferable L/C has been opened in favor of the trading company.
4) The trading company provides their bank with (a) the contact details of the exporter's bank, (b) the name and address of the exporter, and the amount (portion) of the Importers Transferable L/C that is going to be extended to the exporter.
5) The trading company's bank informs the exporter's bank that an L/C has been opened in favor of the exporter. The documentary evidence that is requested and the deadline that will need to be met are identical to the original requirements set out in the Importers Transferable L/C. The only difference between this offer and the original offer is the amount of money being extended. The offer is always less than the full amount. This allows the trading company to pay the exporter a portion of the funds that have been promised by the issuing bank.
6) The exporter's bank informs the exporter of the L/C that has been opened in their favor. However, this irrevocable offer that has been extended to the exporter can only be acted on by the exporter (i.e., it is not transferable again to another party, because a transferable L/C can only be transferred once).

SEE THE BLUE ARROWS ABOVE –

7) The exporter does whatever is required to gather the documentary evidence that was requested by the issuing bank. The types of documentation that are often requested are as follows:
    a. Commercial invoice
    b. Packing list
    c. Certificate of Origin
    d. Proof of shipping insurance
    e. Original copies of the Bill of Lading
    f. Evidence of 3rd Party Inspection, etc.
8) The exporter submits the documentary evidence to the exporter's bank for review.
9) The exporter's bank forwards the documentary evidence to the trading company's bank and demands payment.
10) Provided that the documentary evidence submitted is "letter perfect" (exactly as requested), the trading company's bank pulls the Commercial Invoice from the exporter and replaces it with a Commercial Invoice from the Trading Company (for the full amount of the Transferable L/C) and this is forwarded along with the rest of the documentary evidence to the issuing bank along with a demand for full payment.

SEE THE RED ARROWS ABOVE –

11) Finally, the issuing bank reviews the documentary evidence to ensure it is "letter perfect" (exactly as requested) and in advance of the stated deadline. As long as these requirements have been met, the full amount of the Transferable L/C is released as payment to the Trading Company's Bank.
12) The Trading Company's bank then releases the promised portion of the money to the Exporter's bank as payment for the submitted documents.
13) Any money remaining from the Transferable L/C (i.e., the portion that was not paid to the exporter's bank) is then released to the Trading Company. In this way, the trading company can work as an intermediary and essentially use the buyer's Transferable Letter of Credit to pay for goods from an exporter that is not known to the buyer.

Note that in most cases, the trading company will also ask either the buyer or the exporter to sign a Non-circumvention Agreement as well to ensure that the two parties do not circumvent the trading company (by dealing directly with each other) in future transactions. This agreement is generally signed with the party that is geographically closest to the trading company to reduce travel costs in the event of future litigation (for a breach of the agreement).

Standby Letters of Credit

A Standby Letter of Credit is a normal Letter of Credit (L/C) that is put in place with a long expiry date to provide guaranteed funds to a recipient if something happens that would warrant the release of those funds.

For example, in some large government tenders, a foreign government that is accepting bids on a large project will ask the bidders for a bid bond to ensure they are serious about the bid and willing to follow through if selected. The method of payment for a bid bond can vary, but in some instances, an acceptable approach would be for the exporter to open a Letter of Credit in favor of the government that is evaluating the bids. Typically, the amount of the bid is only 5-10% of the value of the contract, and documentary evidence requirement may be as simple as a "Letter of Demand" from the government if they believe that they should be compensated (e.g., in a situation where they awarded the bid to the exporter, but the exporter declined to accept the contract and refused to go ahead). In essence, this sort of requirement ensures the government doesn't waste its time on a frivolous bid.

Similarly, a Standby Letter of Credit might be used as a payment mechanism for a Performance Bond requirement. But there are no real restrictions on what a Standby Letter of Credit can be used for. It is a tool that can be used to provide another party with the assurance that money is available and can be accessed in a contingency scenario where a guaranteed payment would be warranted.

(vi) Types of payment

Letters of Credit have several variations but there are mainly two types of payment that are commonly used:

A "Sight" Letter of Credit (Sight L/C) or Letter of Credit that pays on sight is the most common type of payment form used for a Letter of Credit. As described above, once the required documents have been submitted, reviewed, and approved by the issuing bank, the bank releases the money immediately. Since most L/Cs pay in this manner, the term "Sight" L/C is rarely used. Instead, most L/Cs are assumed to pay on sight unless a deferred payment is stipulated.

A "Deferred Payment" Letter of Credit (Deferred Payment L/C) operates like a normal L/C (i.e., one that pays on sight), and it still guarantees payment when the correct documents have been submitted, reviewed, and approved by the issuing bank. However, in a Deferred L/C, the L/C that is initially issued stipulates that the payment will be delayed/deferred for a predetermined period of time (e.g., 30, 60, 90 days) and after the correct documents have been submitted, reviewed, and approved, the issuing bank delays releasing the money to the beneficiary for the agreed upon period of time.

(vii) Documentation Requirements

Some common documents that are involved in an international trade transaction are as follows:

- **Commercial invoice** - A bill for the goods, produced by the seller/exporter (from the seller to the buyer).
- **Packing list** – A detailed document created by the seller/exporter that lists all of the packages and goods contained in a shipment
- **Certificate of Origin** - A signed statement as to the origin of the export item (frequently obtained by the manufacturer from a local Chamber of Commerce)
- **The Bill of Lading** –This document is usually issued by the carrier and provided to the exporter as a receipt for the goods. Original copies of the Bill of Lading can also serve as the "Title" to the Goods (a sample can be found here).
- **The Bill of Exchange** (also known as a "Draft") and used in Documentary Collections. The draft is a document that is prepared by the exporter with the assistance of the exporter's bank. This is like a personal check in reverse. Instead of the draft indicating that the exporter owes the importer money (like a check), it is the opposite – the draft indicates that the importer owes the exporter money and indicates when payment is due (a sample can be found here).
- **Shipping Insurance** - This insurance is used to cover losses due to damage or delays when goods are in transit to a buyer. It can be purchased by the seller/exporter or the buyer depending on the terms of the agreement and the Incoterms used for the shipment.
- **Inspection Certificate** - Required by some purchasers and countries to attest to the specifications of the goods shipped, its export packaging, or both. The inspection is usually performed by a third party, often an independent testing organization.

Additional documents involved in exporting transactions can be found here

(viii) Related Financial and Legal Costs

Letters of Credit are generally seen to be quite expensive, with a variety of fees being charged by both the issuing bank and the advising or confirming bank. In a single export transaction involving a shipment of less than $100,000 USD, the combined fees charged by the exporter's bank and the importer's bank could easily total $1000 USD. For transactions valued at more than $100,000, many banks will charge a percentage of the value of the transaction (typically ranging from 0.75%-3%). For this reason, it is worthwhile looking at more than one bank and also considering different payment options, depending on the risks involved. There are no legal fees to consider for a Letter of Credit.

(ix) Communication of Letters of Credit, collections, and associated documents electronically via the 'Internet

Most communications in international business are now electronic. For example, **The Uniform Customs and Practice for Documentary Credits (UCP)** is a set of rules that are used by the banks in most countries to ensure that Letters of Credit communications have been standardized. This allows for seamless L/C transactions between banks. Banks also reference the Supplement for Electronic Presentation (***eUCP)*** *which* provides additional guidance for the *presentation* of the *electronic* equivalents of paper documents under documentary Letters of Credit.

Funds can also be sent directly from one party to another (or exchanged between banks) using a wire transfer, which is an electronic payment service that typically relies on the **SWIFT** network (The Society for Worldwide Interbank Financial Telecommunication = SWIFT). This system allows financial institutions around the globe to send and receive financial transactions in a secure and standardized format.

Task 4.5 – Select appropriate methods, terms, and currency of payment to agents, sales representatives, distributors, suppliers, and international joint ventures.

Knowledge of:

(i) Terms and conditions of purchase or sale (e.g., countertrade, consignment, payment terms)
(ii) Resources (e.g., banks, U.S. government agencies, International Chamber of Commerce)

This study topic focuses solely on countertrade and consignment as two trade payment options that have not yet been discussed and several financial resources that may be helpful for companies involved in international trade transactions.

(i) Terms and Conditions of Purchase or Sale

Countertrade

Countertrade is a unique way of organizing an international sale. Although it is not often used in North American trade, it is used extensively in some parts of the world and has certain advantages when traditional methods of payment aren't suitable for certain circumstances.

A countertrade transaction involves two parties trading goods and/or services of equal value (i.e., no cash payment involved). Countertrade has several advantages:

- It can make trade possible in countries where foreign exchange conversions have been restricted (making traditional payment impossible)
- It can make trade possible in countries where credit is not available to a company that needs financing
- It can be beneficial in situations where a prospective customer in another country has a product to trade but no cash or credit to enable a transaction

At the same time, countertrade has several disadvantages:

- It can create uncertainties because the exact value of goods being traded may fluctuate
- It can be difficult to simultaneously secure title transfer of the goods in a manner that is low risk for both parties
- It can be difficult for both parties to simultaneously ensure the quality of the goods that are being exchanged
- When accepting goods as payment that are not of immediate use to the company in the transaction, the resale of those goods can create additional challenges that add time and cost to the transaction

Consignment

Consignment in international trade is similar to consignment in domestic business. An importer/buyer receiving shipped goods on consignment only makes payment to the exporter/seller after the goods have been re-sold. In this arrangement, the exporter retains title to the goods while the foreign buyer receives, warehouses, and resells the goods on behalf of the exporter. Payment is then sent to the exporter after the goods have been sold.

Consignment is commonly used in exporting for the sale of very expensive heavy machinery and equipment. This is a cost-effective way for an importer/distributor to hold inventory without the investment that would normally be required.

Exporting on consignment can be very risky for the exporter because the retrieval of goods held in another country may not be straightforward (even though the title to the goods has been retained). Moreover, when payment is received by the importer for goods that are sold, the payment to the exporter is also not guaranteed.

This type of transaction is therefore usually only used when an exporting company has:

(a) a longstanding relationship with an importer; or
(b) great trust in the importing company
(c) significant legal capacity in the importer's country and a willingness to use the legal system in that country as needed (to retrieve inventory or claim payments that are owed)

Consignment terms are ideal when importers cannot afford inventory but need inventory to attract customers. This approach also reduces storage/warehousing/inventory requirements for the exporter.

(ii) Resources

Exporters can protect against non-or-late payment by requesting buyers to pay fully or partially in advance, discounting the receivable (factoring), using L/Cs, or other relatively secure methods of payment (e.g., cash on delivery).

Banks

Globally, commercial banks provide a wide array of tools for international trade finance. Generally speaking, most banks can facilitate international wire transfers and many banks have specialist groups that can handle Documentary Collections, Letters of Credit, and other trade-related services. Rankings of banks in this specialized sector can be found here for 2018 and here for 2019.

U.S. Government Agencies

Exporters can insure their shipments against buyer default using export credit insurance. Export credit insurance is available from the **U.S. Export-Import Bank** (EXIM), as well as from commercial sources, such as Meridian, Coface, and Allianz (formerly Euler-Hermes). For a relatively low premium (e.g., only about half of 1% of the transaction value from EXIM), the policies guarantee near total payment (e.g., 95% from EXIM) if the buyer defaults for any economic, commercial, or political reason.

For U.S. **investors**, protection against risks is available from the U.S. International Development Finance Corporation (FDC) for investments in more than 160 developing and post-conflict countries. FDC offers political risk insurance guarantees against losses from:

- War, civil strife, coups, and other acts of politically-motivated violence, including terrorism
- Expropriation, including abrogation, repudiation, and/or impairment of contract and other improper host government interference
- Restrictions on the conversion and transfer of local-currency earnings (e.g., ability to repatriate capital or remit profits)

International Chamber of Commerce (ICC)

Exporters and importers need to agree amongst themselves on the price, payment terms and method, transport mode, and delivery date for each transaction. To aid in this process, the International Chamber of Commerce (ICC) has developed regulations to standardize terms and methods of payment for international trade transactions – specifically International Commercial Terms (Incoterms), Uniform Customs & Practices for Documentary Credits (UCP600), Uniform Rules for Collection (URC), and arbitration/mediation procedures for resolving disputes.

- **Incoterms** are a set of 3-letter acronyms, published by the ICC, that standardize terms for quoting export prices and determining liability for goods if lost or damaged in transit. The process typically starts with the buyer asking the exporter for a price quote from a specified starting point (e.g., the price at the factory or from any named point further along the way to the final destination). Each named point has its own Incoterm. The ICC revises

Incoterms every 10 years. Incoterms 2020 came into effect in January 2020, and include 11 different Incoterms, ranging from the price at the factory (EXW for Ex Works) to the price delivered to the importer's door (DDP for Delivered Duty Paid).

- **Uniform Customs & Practices for Documentary Credits [UCP]** is a set of standardized rules published by the International Chamber of Commerce (ICC) specifically relating to Letters of Credit (L/Cs). ICC periodically updates the UCP – the current version is UCP600. The UCP 600 rules are voluntary but become applicable when specifically incorporated in trade finance contracts. An accompaniment to the UCP 600, the International Standard Banking Practice for the Examination of Documents under Documentary Credits (ISBP), helps clarify whether a document complies with the L/C terms. UCP600 is used throughout the world by international commercial banks.

  Key elements of UCP 600 include:
    - How L/Cs can be signed and acknowledged by all parties
    - Differences between documents, goods and services, and responsible parties
    - Which parts of L/Cs are negotiable and non-negotiable
    - How credit works, and how payment is made
    - How banks can communicate the confirmation of goods
    - Transportation of the goods, modes of transport, and who bears responsibility.
    - How to deal with discrepancies, waivers, and giving notice
    - The provision of original documents or electronic copies
    - Bills of Lading
    - Insurance and covering the cost of goods.
    - Loss of shipping documents in transit

- **Uniform Rules for Collection (URC)** are a set of rules developed by the International Chamber of Commerce (ICC) that standardize the process of collecting debts arising from international trade transactions. The latest version, URC 522, provides rules for businesses, banks, buyers, and sellers to follow to initiate a collections process, particularly for transactions using either Document Against Payment (D/P) or Documents Against Acceptance (D/A) as the method of payment. Under URC 522, D/P terms are to specify that the importer can take immediate title to and possession of the goods only by signing a sight draft issued by the importer's bank and making a full up-front payment. D/A terms under URC522 must specify that the importer can also take immediate title and possession of the goods, but only by signing a time draft issued by the importer's bank agreeing to pay the exporter at a future time.

Task 4.6 – Develop a financial plan to establish whether internal/external international trade financing is required

Knowledge of:

(i) Resources (e.g., Export-Import [Ex-Im] Bank, Small Business Administration [SBA], U.S. Department of Agriculture (USDA), U.S. International Development Finance Corporation (FDC), private banks, non-bank private sector lenders)

(i) Resources

A key decision for exporters during the sales or purchase process is to decide how payment will be financed. A U.S. company that sells to a foreign buyer incurs costs to produce the orders. The availability of capital to the seller for production poses a limit on how much can be produced and sold. On the buyer's side, the constraint is how much capital is available in the company to pay for purchases.

Export financing is a tool that can assist both sellers and buyers increase the quantities of exports and imports by providing the capital needed to accomplish market transactions. The World Trade Organization (WTO) estimates that between 80% to 90% of the world's trade relies on trade finance. As international firms have become more competitive, national governments have implemented lending programs for their firms to encourage greater participation in the trade game. Quality has been consistently improving and the U.S. encounters several competitors from around the world in selling their products overseas.

Because trade is so important to a country's financial health, banks, and governments have created many financing tools to facilitate export and import transactions, reducing the risk of financial hardship for their firms. Understanding and using trade financing tools facilitates the growth of businesses by supplying capital to expedite the sales and/or production processes. Financial resources obtained through trade financing mitigate risks, ease pressure on the production cycle and provide opportunities for exporters to sell bigger orders. Pressure for both the exporter and importer is reduced. By using the relevant finance tools, the exporter can obtain capital to produce more when the demand is high, offer better payment terms to customers, and increase their sales. The buyers can be better assured that the goods will arrive on time and they also can buy more goods if financing is available at a reasonable cost.

Previous topics have discussed Letters of Credit, international payment methods, foreign currency exchange risks, international banking transactions, and trade terms. All these tools are excellent facilitators in assisting firms to transact foreign sales. This topic focuses on the available instruments for U.S. firms to obtain capital to facilitate the export/import of products or services.

Developing a Financial Plan for Exporting

A business needs to develop a plan for export which includes both sales projections and costs. Since exporting is known to be riskier than selling domestically (due to the various political, economic, and commercial risks), firms often times tread cautiously. Many firms specify they want "payment up front" which guarantees they get paid. This approach, however, can be very limiting. Payment upfront is typically not desirable for the importer/customer because they are undertaking the risk of whether they will ever get the products they have paid for delivered—either on time or at all. Also, it ties up their cash flow. If a U.S. firm cannot offer better payment terms (open order, 30, 60, 90-day payment terms, etc.), it often loses sales to a foreign competitor who can offer better terms. Sales for the exporter are foregone or reduced. Also, cash for production is limited to whatever the exporting firm can afford, and their bank may not lend to businesses for exporting. This occurs because banks oftentimes perceive the same risks of non-payment and delivery delays.

Recognizing these realities, financial institutions and government agencies offer a variety of products that can assist both buyers and sellers. Firms that decide to utilize these tools can expand their export sales more rapidly, resulting in faster growth of revenues and profits and better cash flow. Also, the right financing tools limit the risk of financial difficulties in the future.

For these reasons, firms need to understand the various financial tools for international trade and incorporate them into their plan, if the firm decides they are valuable. Oftentimes small businesses, seeking to avoid risk, do not investigate these tools. Those who successfully incorporate them into their plan, have better opportunities to increase their sales and profitability. A major benefit of seeking trade financing is that it is typically short-term and transaction-based, in contrast to traditional bank loans that tend to be longer-term.

A major deciding factor the business owner needs to consider is the firm's goals and objectives for growth and sales distribution. If further growth is not an objective and the firm desires to have only a minimal percentage of business be dedicated to exports, then payment upfront or using in-house funds to finance production can work. If the business wishes to grow, export sales can be a critical element in fulfilling this goal. Understanding and utilizing export financing tools can play a major role in having the company achieve this growth goal.

Export financing tools consist of an array of financial products and approaches that work together to provide the exporter with various options to attain success. Previous and following units describe tools such as Letters of Credit, currency hedging options, forfeiting, and credit risk insurance—all designed to mitigate risks to the exporter and to expedite a smooth transition between seller and buyer.

Typically, private banks avoid export lending due to higher risks involved in export sales ranging from non-payment, lost shipments, possible instability in governments, language barriers, etc. To handle these situations, the bank must devote resources to understanding the various available tools to alleviate these risks. Therefore, there are few traditional bank products available to support a U.S. exporter to success in growing export sales. Banks can utilize traditional lending tools (i.e., SBA-guaranteed loans, or commercial bank loans) to assist a customer with exports, but other tools focus on exports and offer better options to assist the seller in minimizing or eliminating risks. The remaining section of this topic focuses on these programs.

Several U.S. government agencies provide export finance programs designed to provide capital to advance the trade transactions between seller and buyer by mitigating constraints and risks. Each program targets specific needs that arise during the export process. Some programs target working capital needs (cash to support the transaction); provide capital to the overseas/international buyer; lend to the exporter for trade transactions; enable investment projects in developing countries (that buy from the U.S) and ensure payment. The purpose is to ensure U.S. firms can compete with firms from countries that provide these tools. Data shows that companies that export grow faster than their counterparts and have more employees and revenues, positively contributing to economic growth for the U.S. Of course, all of the agencies, as well as the banks, thoroughly scrutinize both the buyer (credit history and capability to pay) and the seller (credit history and production capacity) as well as the transactions to assure capability to pay and produce/deliver before financing.

U.S. government agencies offering export financing programs include The U.S. Small Business Administration (SBA), the U.S. Export-Import Bank (EXIM), the U.S. Department of Agriculture, and the U.S. International Development Finance Corporation (FDC). These programs provide lending tools to accommodate various needs, including specialized programs for agricultural exporters and overseas projects in developing countries. Most of the programs work in partnership with banks by offering guarantees for repayment. The goal is to encourage U.S. banks to finance trade by offering tools that are designed for them to be repaid by reducing risk.

Note: Some private financing firms also offer trade credit insurance, receivables financing, and other products, but this topic focuses on government entity programs. Special government programs targeted at improving exports are not unique to the U.S. Most of the major trading countries also have export finance and credit insurance programs that provide these tools and other incentives to their exporters. These programs enable competitors from other countries to offer very attractive payment terms to buyers. This reality provides an excellent incentive for U.S. firms to take advantage of financing programs that enable them to offer competitive terms of sale. These U.S. government export financing programs are discussed below, grouped by the agency. Additionally, many U.S. States have introduced lending programs to serve exporting businesses. Some offer similar programs to the EXIM Bank and the U.S. Small Business Administration and many have incentives for businesses in the State to sell overseas.

U.S. Small Business Administration Financing Programs

The role of the SBA in business financing is to provide guarantees to a bank to encourage lending to small businesses. Because the failure rate of startup businesses is greater than larger businesses, the SBA guarantees to provide an incentive to the bank to lend to the business. The lender is the bank, but if the business fails and there is an outstanding SBA-guaranteed loan, the SBA pays the loan back at the guaranteed rate (up to 75% for domestic business). Because exporting presents even greater risks, the guarantee percentage is higher for export loans.

The U.S. Small Business Administration offers three different export financing programs targeted at small businesses. A small business is defined in this program as a business with a tangible net worth of ≤ $15 million, and a 2-year average net income after taxes (excluding carryover losses) of ≤ $5 million. These SBA programs are **(1) International Trade loans, (2) Export Working Capital Programs, and (3) Export Express** for smaller loans of both working capital and business operations.

1) **SBA International Trade Loan (ITL)** "Positioning the firm for export" – provides financing for projects that improve the competitive position of a U.S. exporter at both the pre-export stage and for post-product shipment to increase exporting. The overall goal is to provide sufficient capital to businesses to pursue exporting. Uses include: paying for the pre-export manufacturing costs of goods for export (labor and materials); purchasing goods or services for export; supporting standby Letters of Credit to act as bid or performance bonds and financing foreign accounts receivable. The loan guarantee is 90% on loans up to $5 million including equipment, real estate, refinancing, and permanent working capital. It is a term loan. Repayment terms are up to 25 years for real estate and 10 years for working capital or equipment.

   Uses of this financing include pre-export financing of labor and materials; and post-shipment financing of the accounts receivable generated from transaction-specific overseas sales. A more detailed description of this program can be found here.

2) **SBA Export Working Capital Program (EWCP)** is a program that can advance up to $5 million to fund export transactions from purchase orders to collections to fulfill the export order. The EWCP provides 90% guarantees on loans up to $5 million. The availability of the EWCP provides many advantages including the following:

   - Provides export working capital during long payment cycles
   - Offers to finance for stand-by Letters of Credit used as bid or performance bonds or down payment guarantees.
   - Reserves domestic working capital for the company's sales within the U.S.
   - Permits increased global competitiveness by allowing the exporter to extend more liberal sales terms
   - Increases sales prospects in under-developed markets which have high capital costs for importers
   - Contributes to the growth of export sales
   - Charges low fees and has quick processing times
   - Offers to finance for suppliers, inventory, or production of export goods

3) **The SBA Export Express** program provides fast-track approvals for smaller export-related loans. It provides 90% guarantees on loans up to $350,000 and 75% guarantees on loans up to $500,000. Use of these funds includes any "export development activity" including funding for fixed assets; market development; refinancing; and working capital if the use is at least 70% export-related. It can be either a term loan or a revolving line. This is SBA's simplest, most flexible export program. Detailed descriptions of the SBA financing program can be found here.

U.S. Export & Import Bank (EXIM) Financing Programs

1) **EXIM Export Development and Working Capital Financing** enable U.S. businesses of any size to obtain loans that facilitate the export of goods or services by providing the liquidity needed to sell to new business customers, grow international sales, and compete more effectively in the international marketplace. This program arranges financing through a lender by using insured receivables as additional collateral. The EXIM working capital program lends to all sizes of businesses and issues credit limits of all sizes (in contrast with SBA's $5,000,000 credit limit). Through these government-guaranteed Export Working Capital (EWC) loans, U.S. exporters can obtain financing from participating lenders when commercial financing is otherwise not available or when their borrowing needs are greater than the lenders' credit standards would allow. Uses of this financing include purchasing finished products for export; paying for raw materials, equipment, supplies, labor, and overhead to produce goods and/or provide services for export; covering standby Letters of Credit serving as bid bonds, performance bonds, or payment guarantees; and financing foreign receivables. For a more detailed description of this program, link here.

2) **EXIM Bank's Financing for your International Buyers** program enables U.S. businesses to assist their international buyers in locating financing to purchase U.S. goods and services when financing is otherwise not available or there are no economically viable interest rates on terms over one-to-two years. This is a valuable program for U.S. exporters to enable them to be competitive vis a vis foreign competitor. Interest rates are exorbitantly high in several countries, posing difficulties in payment options. This causes a cash flow problem for the companies and they are less likely to purchase from U.S. companies without favorable options. This EXIM program provides a direct loan to credit-worthy international buyers, which is used to finance purchases of U.S. capital equipment and services. Financing may also be available for refurbished equipment, software, certain banking and legal fees, and certain local costs and expenses. This coverage is available for medium-term and long-term transactions. The total level of EXIM support will be the lesser of 85% of the value of all eligible goods and services in the U.S. supply contract or 100% of the U.S. content. The program provides coverage for 100% of commercial and political risks, and financing of up to 30% of local costs in addition to the U.S. exports as well as ancillary services and fees (legal, financial, bank, etc.). The terms of the loan are fixed-rate financing and repayment of up to 12 years in general and up to 18 years for renewable energy projects. A program is a tool for U.S. suppliers to recommend to their creditworthy international buyers in the private or public sector to obtain financing to support the transaction. With this direct loan, international buyers receive competitive term financing that may previously have been unavailable.
   Through the International Buyer lending program, EXIM also supports competitive medium-term financing structured as finance leases in addition to financing structured as installment loans. Support of lease financing is important since some foreign buyers of U.S. capital goods prefer lease financing as an alternative to traditional installment loans. EXIM will guarantee lease financing of U.S. goods and services to creditworthy international lessees, both private and public sector when financing is otherwise not available or applicable interest rates are not economically viable.
3) **EXIM Bank's Multi Buyer Export Credit Insurance** allows exporters to offer competitive open account terms to foreign buyers while minimizing the risk of non-payment. The policy covers both commercial (e.g., bankruptcy) and political risks (e.g., war or the inconvertibility of currency). When foreign accounts receivables are insured, lenders are more willing to increase the exporter's borrowing capacity and offer more attractive financing terms because insured receivables can act as additional capital. Policies ensure both commercial and political losses at 95%. There are no application fees or minimum premiums. The protection of having this policy equips businesses with the confidence necessary to enter new markets and chart a path forward with margins they can depend on. With this security in hand, U.S. companies can increase their global competitiveness by offering open account credit terms needed to win sales from credible buyers. Moreover, EXIM support empowers exporters to overcome cash flow obstacles by borrowing against their insured receivables. For success stories on how U.S. firms have utilized EXIM bank to grow sales, link here.

U.S. International Development Finance Corporation (DFC)

In 2018, the Better Utilization of Investments Leading to Development (BUILD) Act was signed into law to help address development challenges and foreign policy priorities of the United States. U.S. International Development Finance Corporation (DFC) is a modern, consolidated U.S. government agency that brings together the capabilities of OPIC and USAID's Development Credit Authority to better bring private capital to the developing world. DFC's investments focus on impactful global development, advancing U.S. foreign policy, and generating returns for American taxpayers.

DFC supports development in emerging markets with:

- **Debt Financing Direct** loans and guarantees of up to $1 billion for tenors as long as 25 years, with specific programs targeting small and medium U.S. businesses.

- **Equity Investments DFC** direct equity investments can provide critical support to companies committed to creating developmental impact.

- **Feasibility Studies Support** for the analysis of a potential DFC project

- **Investment Funds Support** emerging market private equity funds to help address the shortfall of investment capital.

- **Political Risk Insurance** Coverage of up to $1 billion against losses due to currency inconvertibility, government interference, and political violence including terrorism. DFC also offers reinsurance to increase underwriting capacity.

- **Technical Assistance Support** to increase the developmental impact or commercial sustainability of existing DFC projects or develop potential DFC projects privately.

U.S. Department of Agriculture (USDA) Foreign Agricultural Service Export Credit Guarantees

The USDA underwrites credit extended by the banking sector in the United States to approved foreign banks using dollar-denominated, irrevocable Letters of Credit to pay for food and agricultural products sold to foreign buyers. These programs encourage U.S. exports to buyers in countries where credit is necessary for the buyers to purchase the goods. The purpose of this program is to maintain or increase U.S. sales where financing may not be available without the guarantees. Letters of Credit are required for all USDA-supported export financing transactions. There are no loans that can be made to non-U.S. entities. Guarantees are transacted through USDA's **Commodity Credit Corporation** (CCC). U.S. exporters of agricultural commodities and products in demand are eligible for the guarantee. Manufactured goods that improve or establish agricultural-related facilities to accommodate the import of U.S. agricultural products in emerging markets are covered through the **Facilities Guarantee program**.

For more on USDA's Export Credit Guarantee Program link here
For more on USDA's Facilities Guarantee program link here

To download additional publications from U.S. agencies on trade finance, use this link and this link

Task 4.7 – Identify options for short-term (up to 180 days) pre-and/or post-shipment financing for the seller to ensure the lowest cost financing at acceptable levels of risk

Knowledge of:

(i) Forms and functions of short-term financing (e.g., credit insurance, government-supported finance, discounting, time draft Letters of Credit, Export Working Capital Program)

(i) Forms and Functions of Short-Term Financing

Exporters would not need short-term financing if their foreign buyers agree to pay in advance. However, most buyers will not pay upfront. They more typically will pay when the goods arrive (essentially "cash on delivery") or, more preferably, seek "open account" credit terms to pay well after they get the goods (e.g., 30-90 days). If the exporter can cover the lost cash flow for either duration, there is again no need for short-term financing. Instead, the parties agree to standard methods of payment through commercial banks, typically under (L/C) or a form of Documentary Collection, either Documents Against Payment (D/P) or Documents Against Acceptance (D/A**)**.

A delayed payment scenario raises both a **risk of default issue** should the buyer fail to pay when due, and a **short-term financing issue** to cover lost cash flow for the specified time period. Inexperienced exporters lose many deals by refusing open account terms, mostly for fear that they won't get paid in the end. However, savvy exporters know how to protect against buyer default, even for open account sales. They also know that they can be much more competitive if willing to sell on an open account, especially if their prices are higher than other suppliers. The risk can be mitigated almost entirely with **Export Credit Insurance** from the U.S. Export-Import Bank (EXIM). For well under 1% of the transaction value, EXIM credit insurance guarantees that the exporter will be paid (95% of the transaction value) if, for any political or commercial reason, the buyer fails to pay at the specified due date. Credit insurance does not, however, help with the cash flow issues that arise while waiting to be paid.

Short-term Financing

When faced with the need to cover short-term cash flow needs, most exporters have several choices.

1) **Line of Credit -** Most companies have an established line of credit attached to their corporate bank account. This allows them to draw their account balance below zero. To the extent that money is borrowed on the corporate line of credit in any given month, interest is accrued. This works well for many companies, but much like a personal credit card has a limit, a corporate line of credit will have a limit as well, and it may not be adequate to fully address cash flow needs.

2) **Short-term Bank Loan** – When the corporate line of credit is inadequate, a short-term bank loan may be a good option. However, banks are not always receptive to requests for short-term loans, as these loans are often seen as being "too small" to bother with. Allowances may be possible if the exporting company has significant equity. When a business has owned assets of value, banks will often provide loans of any size as long as those loans can be secured by assets of greater value that can serve as collateral. Exporters can also apply for a standard SBA Small Business Loan, but these loans also are asset-based.

3. **Invoice Factoring -** Another option is to discount the export receivable (i.e., sell a receivable for immediate cash). This is typically done through a **Factor**, which is an organization that purchases the invoice at a discount (e.g., 10-25% of the invoice value). In this scenario, the factor normally takes on the obligation to collect from the buyer. So, the exporter gets cash up front (which resolves the cash flow problem), but the discount

offered to the Factor may need to be significant, and the exporter may only receive 75-90% of the invoice value, which is a fairly steep price.

4. **Factoring a Draft** – Documentary Collections are a commonly used payment method for export sales and these instruments are helpful when factoring is a preferred method for improving cash flow. A documentary collection involves the transfer of two documents – as follows:

    a. **The Bill of Lading** – This document is usually issued by the carrier and provided to the exporter as a receipt for the goods. Original copies of the Bill of Lading can also serve as the "Title" to the goods (a sample can be found here).

    b. **The Bill of Exchange** (also known as a "Draft") is a document that is prepared by the exporter with the assistance of the exporter's bank. This is like a personal check in reverse. Instead of the draft indicating that the exporter owes the importer money (like a check), it is the opposite – the draft indicates that the importer owes the exporter money and indicates when payment is due (a sample can be found here).

There are two types of documentary collections, one is known as a "**Sight Draft**" which requires the importer to make immediate payment, but the other is known as a "Term Draft" (or **Documents against Acceptance).** The Term Draft is particularly useful for factoring and in this arrangement, the importer's bank in the importing country receives the title to the goods (in the form of the Bill of Lading, along with a Bill of Exchange) from the exporter via the exporter's bank. The Bill of Exchange indicates how much the importer owes and specifies that payment is due from the importer based on the term provided (e.g., 30, 60, 90 days). The importer must then sign the Bill of Exchange accepting the terms offered and then the bank releases the Bill of Lading to the importer (which allows the importer to get access to the goods because the original copy/copies of the Bill of Lading can be presented to the carrier or the receiving port, and the goods will then be released to the importer).

In this type of documentary collection, the exporter can pre-arrange by asking the importer's bank in advance to buy the signed Bill of Exchange (Draft) from the exporter for an amount that is a discount of full value. In general, banks prefer to purchase Bills of Exchange because the document is an unequivocal statement of the debt that is widely recognized and easily enforced by a court in the event of non-payment. This means that the bank or factoring company will usually factor a Bill of Exchange on a "non-recourse" basis (i.e., the bank will assume the risk of non-payment completely) and the discount amount is usually much lower than a simple invoice that is factored, so the exporter may be able to receive as much as 90-95% of the face value of the Bill of Exchange.

For the bank, this is good business, because it might pay 95% of the face value of the Bill of Exchange and collect the full amount from the importer in 30 days, which is a high percentage gain for such a short period of time. At the same time, the exporter gets 95% of the invoiced amount and that money is available right away, even though the importer has been given time to pay.

Export Working Capital Program

Another need for short-term financing can arise when a foreign buyer places a very large order that requires a customized build, or an order for an amount of product that is much greater than the exporter has in stock. A significant investment in time/labor and materials may be needed to fill large orders or to create customized products, so the exporter may need money to buy more production equipment or materials, hire more workers, etc.

Banks rarely like to lend in these situations, even when the foreign purchase order is backed by a Letter of Credit unless the exporter/borrower's assets satisfy the bank's risk threshold. However, the U.S. **Small Business Administration** (SBA) and the U.S. **Export-Import Bank** (EXIM) both have similar Export Working Capital Guaranty Programs (EWCGP) to incentivize banks to make these loans. Both the SBA EWCGP and the EXIM EWCGP guarantee repayment to the bank (up to 90%) should a default occur. Most banks that work with SBA and EXIM are then willing to lend to the exporter with this assurance. The differences are that EXIM covers larger loan amounts (e.g., over $10 million), but does not cover military sales or products less than 51% U.S. made.

For more information on methods and sources of export financing, see USDOC/ITA's comprehensive Trade Finance Guide, Export.Gov's Methods of Export Payment, and EXIM's Video Gallery,

Task 4.8 – Identify options for medium- and long-term financing for the overseas buyer (internal/external) to allow the buyer extended terms while providing a cash payment to the seller without recourse

Knowledge of:

(i) Forms of medium- and long-term financing (e.g., government-supported finance, finance provided by banks and financial institutions, lease financing)

(i) Forms of Medium- and Long-Term Financing

Foreign buyers often need medium or long-term financing for fairly large procurements, such as for aircraft, a line of machine tools, or equipment for major infrastructure projects. Unless these large purchases can be financed by the local government, the World Bank, or one of the several Regional Development Banks, buyers may need to look elsewhere for financing.

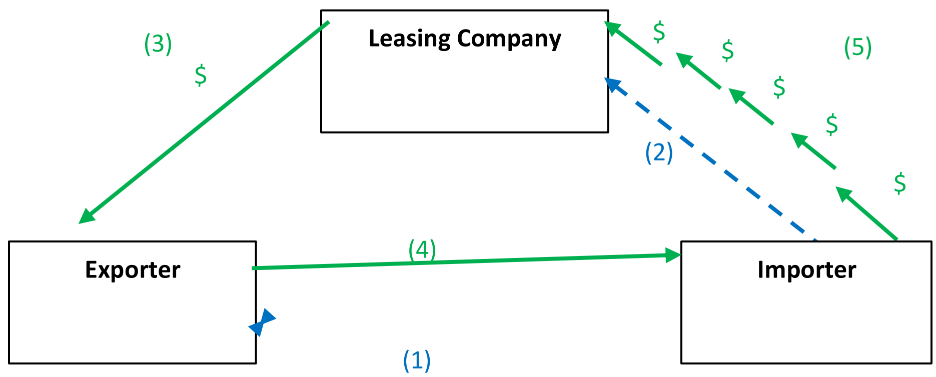
The U.S. Export-Import Bank (EXIM) is a primary source of foreign buyer financing for U.S. products. EXIM's **Medium-Term and Long-Term** buyer financing (insurance and guarantees) enable U.S. exporters or lenders to offer extended credit terms to their foreign buyers. The length of the repayment term depends on the dollar size of the transaction, the useful life of the items, and the country of the buyer. EXIM's **Medium-Term** financing allows repayment terms of 1-5 years, with 7-year terms for environmental projects over $350,000. In this arrangement, the buyer makes a 15% down payment to the exporter.

EXIM's L**ong-Term** financing is for transactions or projects valued at more than $10 million. Repayment terms are typically up to 10 years but can be up to 12 years for **large civil aircraft** and non-nuclear power plants, and up to 18 years for nuclear power plants and certain renewable energy and water sector exports.

Financing usually follows the steps outlined below:

1. The foreign buyer and US-based seller agree on a product or project that meets the buyer's needs.
2. The foreign buyer is referred to EXIM and will be asked to complete and submit a formal request for financing
3. If the buyer is approved for financing, EXIM pays the exporter the full purchase price for the product/project
4. The US-based seller delivers the agreed-upon product or project
5. The foreign seller makes a series of payments to EXIM over time until the full amount of the purchase has been paid off (plus whatever interest has been charged on the loan)

The steps involved are shown below – as follows:



Foreign lease financing is a similar arrangement and an alternative buyer financing option. This is particularly in countries where import restrictions prevent the buyer from purchasing foreign equipment outright, when the tax regime favors leasing over purchase, or when traditional buyer financing is not available or is too costly at prevailing interest rates.

Many private companies, such as Meridian Finance Group, specialize in lease financing, with programs designed for specific industries (e.g., motor vehicles, aircraft, and industrial equipment). EXIM's Finance Lease Guaranty Program also supports medium-term lease financing. EXIM lease guarantees are mostly for U.S. capital equipment and related services and in some cases for refurbished equipment and software.

Using the same diagram as shown above, leasing usually follows the steps outlined below:

1. The foreign buyer and US-based seller agree on a product or project that meets the buyer's needs.
2. The foreign buyer is referred to EXIM and will be asked to complete and submit a formal request for a lease
3. If the buyer is approved for a lease, EXIM pays the exporter the full purchase price for the product/project
4. The US-based seller delivers the agreed-upon product or project
5. The foreign seller makes a series of lease payments to EXIM over time, until the term of the lease is complete (plus whatever interest has been charged on the loan)

As you can see, the steps involved are nearly identical. The main difference between a lease and a loan is who owns the goods. In a finance arrangement, the buyer owns the goods and the organization that provides the financing may have a claim on the goods, if the buyer fails to make all payments. Whereas, in a lease agreement, the organization that provides the lease will own the goods and the foreign customer makes lease payments to EXIM which entitle them to use the goods, but if those payments stop before the term of the lease ends, the goods are already owned by the lessor.

For information contact NASBITE International at info@nasbite.org (website: www.nasbite.org).