

# Small Business Export Finance Solutions in the Global Economy Workshop

## Identifying Risks and Tools to Mitigate Risk

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# Risks in International Trade

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Risk	Examples
Commercial	Insolvency, unscrupulous
Product	Quality, quantity
Foreign Exchange	Convertibility of currency
Political	Government restrictions on payment (both U.S. and foreign), economic stability, war, embargo
Documentary	Wrong documents, improperly prepared documents, incomplete documents
Transportation	Timeliness of delivery, piracy, pilferage, unions, etc.

# Terms of Sale/Methods of Payment

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- Open Account
- Collection
- Letters of Credit
- Cash-in-Advance

## Notice to Exporters

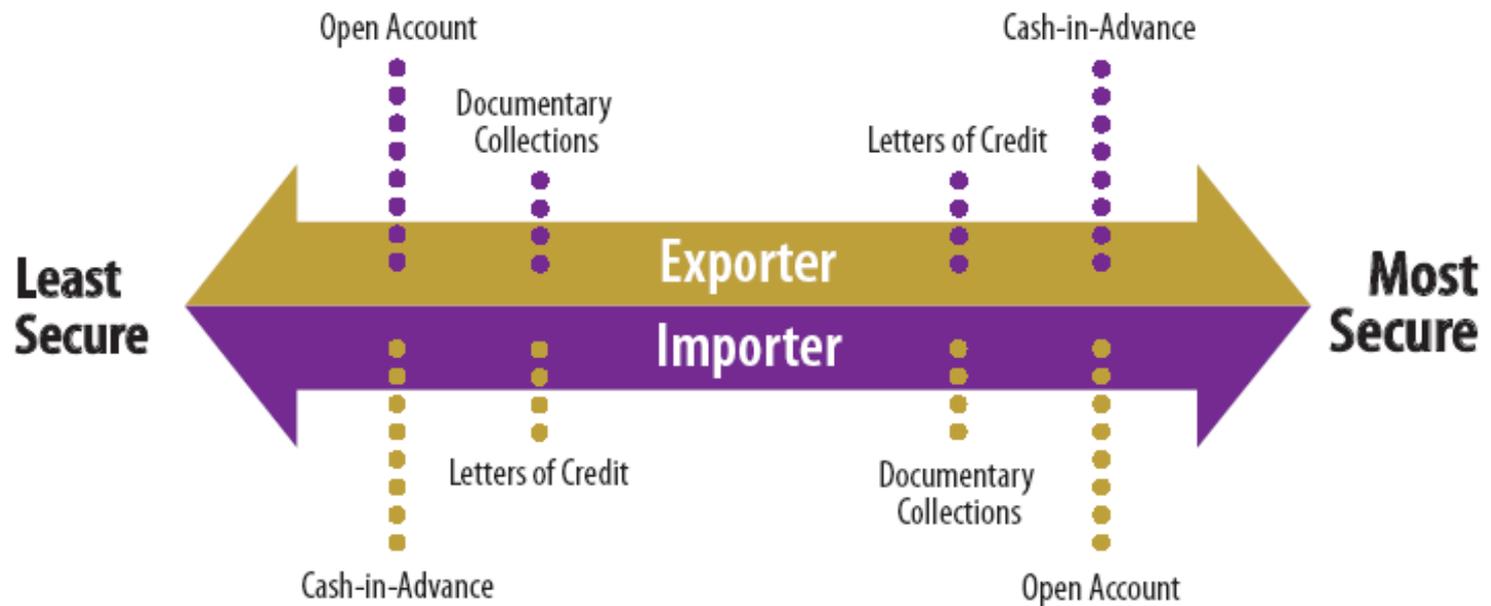
Hours upon hours are spent working on contractual details concerning the manufacturing process, delivery, etc.

Incredibly enough, very little time and effort is spent on “HOW DO I GET PAID?” To say by wire transfer, collection, letter of credit, or cash-in-advance is not enough.

Be clear, concise, but fully describe “HOW WILL YOU GET PAID” in detail.

# Risks vs. Method of Payment

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# Open Account/Cash-in-Advance

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## Open Account

- The goods are shipped directly to the buyer who has agreed to pay at a specified future date; i.e., 30 to 90 days.
- Significant risk to seller if buyer delays or defaults on payment.
- Commercial banks may not be willing to finance foreign accounts receivable.

## Cash-in-Advance

- Payment is received prior to the transfer of ownership of goods.
- Least attractive option for buyer.
- May lose customers to competition who are willing to offer more favorable payment terms.

# Open Account/Cash-in-Advance

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Bank's Role: To provide foreign exchange and funds transfer systems to buyers and sellers engaged in trade.

- Wire Transfer
- SWIFT
- Bank Draft
- International Buyer's Check

Note: Commercial documents flow between buyer and seller.

# Open Account Foreign Receivable Insurance

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## Allows Exporter to:

- Borrow against foreign receivables. (Bank takes assignment of policy).
- Can offer foreign buyer financing up to 180 days.
- May be able to relax method of payment from letter of credit to open account (based on country terms).
- Various insurance options available through Ex-Im Bank and private insurers.

# Documentary Collections

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- The seller ships the goods to the buyer but sends the documents through the banking system for collection.
- Seller retains title to goods until buyer pays or agrees to pay at specific future date.
- Most effective using ocean shipment compared to air or overland shipment.

# Documentary Collections

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## Bank's Role:

- The handling of documents on instructions received from the seller for payment, acceptance of delivery to the buyer.
- A bank service offered worldwide that assures the seller and buyer of control over shipping and financial documents that will result in more efficient, predictable payment.
- There is no bank obligation or undertaking to pay. This is still an open account transaction.

# Documentary Collections Risk

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- Unscrupulous buyer
- Insolvent buyer
- Buyer changes mind
- Buyer's country is in turmoil
- Foreign exchange may not be available
- Seller may have to pay return freight
- Buyer may not honor promise to pay

# Today's Letter of Credit

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- Instrument issued by a bank on behalf of its client (the buyer) whereby the bank substitutes its own creditworthiness for that of its client.
- Bank unconditionally undertakes to pay for goods or services supplied by seller provided seller is in compliance with terms and conditions stated in the instrument.
- Bank's obligation to pay must arise only upon the presentation of draft or other specified documents and bank must not be called upon to determine questions of fact or law.

# Types of Letters of Credit

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- Standby letter of credit
- Commercial letter of credit (documentary)

# Standby Letters of Credit

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Defined as a letter written by a bank to support a financial or performance contractual obligation.

## Financial:

A bank's irrevocable undertaking to support a financial contractual obligation

- Unpaid invoices to vendors
- Advanced payments to vendors
- Lease agreements

## Performance:

A bank's irrevocable undertaking to support a performance contractual obligation

- Bid
- Development of land
- Requirement of insurance policies

# Commercial Letters of Credit

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- Commonly known as trade letters of credit.
- A trade letter of credit is considered the “mechanism” for payment in a trade transaction. These credits are meant to be drawn on.
- Typically issued after the buyer (applicant) and seller (beneficiary) have completed a sales agreement (contract).
- Terms found in the letter of credit are based on the sales agreement (contract).

# Advantages

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## Advantages for Applicant

- Payment to supplier only after compliance with letter of credit terms and conditions
- Expert examination of documents by buyer's bank
- Expanded sources of supply, better prices and terms
- Usually no tie-up of cash

## Advantages for Beneficiary

- Mitigates credit risk, reduces FX and political risks
- Knows all requirements for payment
- Facilitates financing
- Prompt payment upon compliance with documentation requirements

# Responsibility of Beneficiary

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To carefully examine letter of credit to ensure:

- Letter of credit has been opened in accordance with the sales or other agreements
- Ability to comply with all terms and conditions
- All documents stipulated in the letter of credit can be obtained

# How to Reduce Letter of Credit Fees

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- Minimize partial shipments
- Minimize number of letter of credit amendments
- Clearly communicate letter of credit terms *prior* to issuance
- Provide a specimen letter of credit or term sheet with letter of credit requirements
- Prepare accurate documents
- Identify fees up front to build into pricing
- Determine which party pays for what fees
- Maintain DDA account with your *global trade* bank

# A Letter of Credit is Not . . .

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- Absolute assurance of payment. It is only as good as the bank that issues it.
- Absolute assurance that merchandise ordered is the merchandise Applicant (buyer) will receive.

# Your Bank is Your Partner Make Your Bank Work for You

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- Global trade cycle solutions
- Export financing options
- Import and export solutions
- Foreign exchange solutions
- Public and private insurance programs
- Training
- Creative thinking

# Questions?

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