

# TRADE FINANCE GUIDE

*A Quick Reference for U.S. Exporters*

Export Working Capital Programs

Export Factoring

Forfaiting

Export Credit Insurance

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The International Trade Administration's mission is to create prosperity by strengthening the competitiveness of U.S. industry, promoting trade and investment, and ensuring fair trade and compliance with trade laws and agreements. To learn more about the ITA write to: International Trade Administration, Office of Public Affairs, U.S. Department of Commerce, Washington, DC 20230, or visit the ITA's Internet site at [www.trade.gov](http://www.trade.gov).

# Introduction

## Opportunities, Risks, and Trade Finance

Welcome to the first edition of the *Trade Finance Guide: A Quick Reference for U.S. Exporters*. This guide is designed to help U.S. companies, especially small and medium-sized enterprises (SMEs), learn the basic fundamentals of trade finance to turn their export opportunities into actual sales and to achieve the ultimate goal: to get paid for their export sales, especially on time. This guide provides general information about common techniques of export financing. Accordingly, you are advised to assess each technique in light of your specific situation or needs. The *Trade Finance Guide* will be revised and updated annually. Future editions may include new chapters discussing other trade finance techniques and related topics.

### Benefits of Exporting

Ninety five percent of the world's consumers live outside of the United States, so if you are only selling domestically, you are reaching just a small share of potential customers. Exporting enables SMEs to diversify their portfolios and insulates them against periods of slower growth. Free trade agreements have opened in markets such as Australia, Canada, Central America, Chile, Israel, Jordan, Mexico, and Singapore, creating more opportunities for U.S. businesses. The *Trade Finance Guide* is designed to provide U.S. SMEs with the knowledge necessary to grow and become competitive in overseas markets.

### Key Players in the Creation of the *Trade Finance Guide*

The International Trade Administration (ITA) is an agency within the U.S. Department of Commerce whose mission is to foster economic growth and prosperity through global trade. ITA provides practical information to help you select your markets and products, ensures that you have access to international markets as required by our trade agreements, and safeguards you from unfair competition in the form of dumped and subsidized imports. ITA is made up of the following four units: (1) The **Commercial Service**—the trade promotion unit that helps U.S. businesses at every stage of the exporting process; (2) **Manufacturing and Services**—the industry analysis unit that supports U.S. industry's domestic and global competitiveness; (3) **Market Access and Compliance**—the country-specific policy unit that keeps world markets open to U.S. products and helps U.S. businesses benefit from our trade agreements with other countries; and (4) **Import Administration**—the trade law enforcement unit that ensures that U.S. businesses face a level playing field in the domestic marketplace. Visit [www.trade.gov](http://www.trade.gov) for more information.

### A QUICK GLANCE

#### **Trade Finance Guide**

A comprehensive but easy-to-understand elementary guide for trade finance, designed especially for U.S. SME exporters.

#### **Trade Finance**

A means to turn export opportunities into actual sales by effectively managing the risks associated with doing business internationally—the risks of getting paid, especially on time.

#### **Opportunities**

- Reaching the 95 percent of customers worldwide who live outside the United States
- Diversifying customer portfolios

#### **Risks**

- Nonpayment or delayed payment by foreign buyers
- Political and commercial risks; cultural influences

## **For More Information about the Guide**

The *Trade Finance Guide* was created by ITA's Office of Finance. A part of ITA's Manufacturing and Services unit, the Office of Finance is dedicated to enhancing the domestic and international competitiveness of U.S. financial services industries and providing internal policy recommendations on U.S. exports and overseas investment supported by official finance. For more information about the guide, contact Yuki Fujiyama, tel. (202) 482-3277; e-mail [Yuki.Fujiyama@mail.doc.gov](mailto:Yuki.Fujiyama@mail.doc.gov).

## **How to Obtain the Trade Finance Guide**

The *Trade Finance Guide* is available online at [Export.gov](http://Export.gov), the U.S. government's export portal. Printed copies will be available from the Trade Information Center, 1-800-USA-TRADE, and from the Commercial Service's global network of domestic Export Assistance Centers and overseas posts. To find the nearest Export Assistance Center or overseas Commercial Service office, visit [www.export.gov](http://www.export.gov) or call the Trade Information Center at 1-800-USA-TRADE.

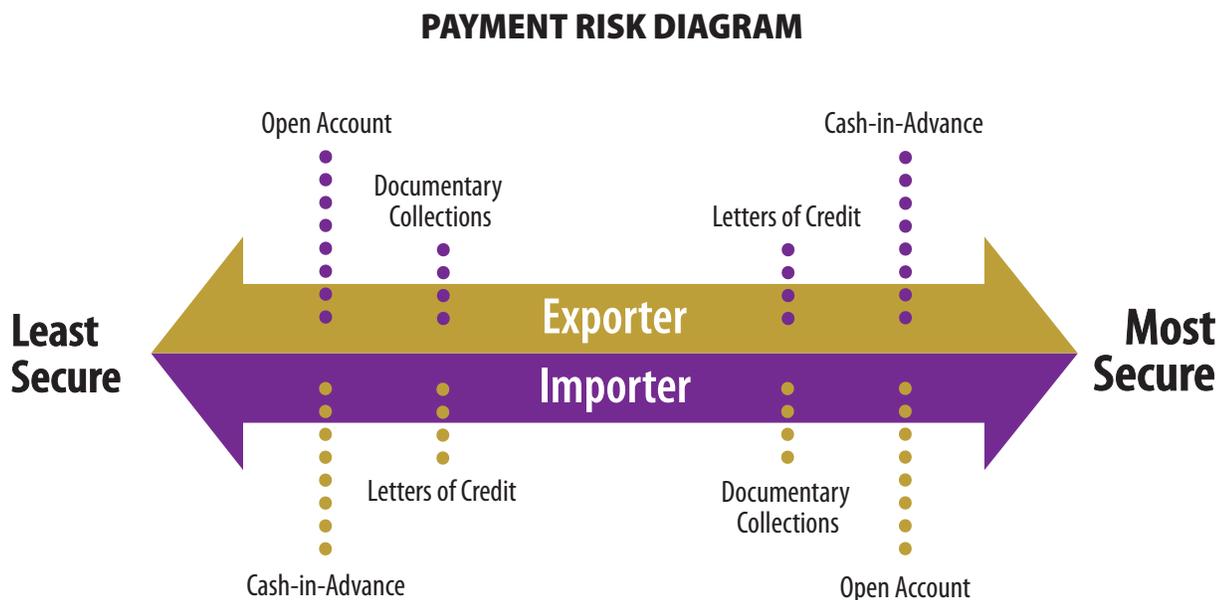
## **Private-Sector Partner**

The *Trade Finance Guide* was created in cooperation with FCIB, an Association of Executives in Finance, Credit, and International Business. Headquartered in Columbia, Maryland, FCIB is a prominent not-for-profit business educator of credit and risk management to exporting companies of every size. For more information on FCIB, visit its Web site at [www.fcibglobal.com](http://www.fcibglobal.com).

# Chapter 1

## Methods of Payment in International Trade

To succeed in today's global marketplace, exporters must offer their customers attractive sales terms supported by the appropriate payment method to win sales against foreign competitors. As getting paid in full and on time is the primary goal for each export sale, an appropriate payment method must be chosen carefully to minimize the payment risk while also accommodating the needs of the buyer. As shown below, there are four primary methods of payment for international transactions. During or before contract negotiations, it is advisable to consider which method in the diagram below is mutually desirable for you and your customer.



### Key Points

- International trade presents a spectrum of risk, causing uncertainty over the timing of payments between the exporter (seller) and importer (foreign buyer).
- To exporters, any sale is a gift until payment is received.
- Therefore, the exporter wants payment as soon as possible, preferably as soon as an order is placed or before the goods are sent to the importer.
- To importers, any payment is a donation until the goods are received.
- Therefore, the importer wants to receive the goods as soon as possible, but to delay payment as long as possible, preferably until after the goods are resold to generate enough income to make payment to the exporter.

## Cash-in-Advance

With this payment method, the exporter can avoid credit risk, since payment is received prior to the transfer of ownership of the goods. Wire transfers and credit cards are the most commonly used cash-in-advance options available to exporters. However, requiring payment in advance is the least attractive option for the buyer, as this method creates cash flow problems. Foreign buyers are also concerned that the goods may not be sent if payment is made in advance. Thus, exporters that insist on this method of payment as their sole method of doing business may find themselves losing out to competitors who may be willing to offer more attractive payment terms.

## Letters of Credit

Letters of credit (LCs) are among the most secure instruments available to international traders. An LC is a commitment by a bank on behalf of the buyer that payment will be made to the exporter provided that the terms and conditions have been met, as verified through the presentation of all required documents. The buyer pays its bank to render this service. An LC is useful when reliable credit information about a foreign buyer is difficult to obtain, but you are satisfied with the creditworthiness of your buyer's foreign bank. An LC also protects the buyer since no payment obligation arises until the goods have been shipped or delivered as promised.

## Documentary Collections

A documentary collection is a transaction whereby the exporter entrusts the collection of a payment to the remitting bank (exporter's bank), which sends documents to a collecting bank (importer's bank), along with instructions for payment. Funds are received from the importer and remitted to the exporter through the banks involved in the collection in exchange for those documents. Documentary collections involve the use of a draft that requires the importer to pay the face amount either on sight (document against payment—D/P) or on a specified date in the future (document against acceptance—D/A). The draft lists instructions that specify the documents required for the transfer of title to the goods. Although banks do act as facilitators for their clients under collections, documentary collections offer no verification process and limited recourse in the event of nonpayment. Drafts are generally less expensive than letters of credit.

## Open Account

An open account transaction means that the goods are shipped and delivered before payment is due, usually in 30 to 90 days. Obviously, this is the most advantageous option to the importer in cash flow and cost terms, but it is consequently the highest risk option for an exporter. Due to the intense competition for export markets, foreign buyers often press exporters for open account terms since the extension of credit by the seller to the buyer is more common abroad. Therefore, exporters who are reluctant to extend credit may face the possibility of the loss of the sale to their competitors. However, with the use of one or more of the appropriate trade finance techniques, such as export credit insurance, the exporter can offer open competitive account terms in the global market while substantially mitigating the risk of nonpayment by the foreign buyer.

## Chapter 2

# Cash-in-Advance

**W**ith the cash-in-advance payment method, the exporter can avoid credit risk or the risk of nonpayment, since payment is received prior to the transfer of ownership of the goods. Wire transfers and credit cards are the most commonly used cash-in-advance options available to exporters. However, requiring payment in advance is the least attractive option for the buyer, as this method tends to create cash flow problems, and unless the seller sees no other option or the buyer has other vendors to choose from, it often is not a competitive option. In addition, foreign buyers are often concerned that the goods may not be sent if payment is made in advance. Exporters that insist on this method of payment as their sole method of doing business may find themselves losing out to competitors who may be willing to offer more attractive payment terms.

### Key Points

- Full or significant partial payment is required, usually via credit card or bank/wire transfer, prior to the transfer of ownership of the goods.
- Cash-in-advance, especially a wire transfer, is the most secure and favorable method of international trading for exporters and, consequently, the least secure and attractive option for importers. However, both the credit risk and the competitive landscape must be considered.
- Insisting on these terms ultimately could cause exporters to lose customers to competitors who are willing offer more favorable payment terms to foreign buyers in the global market.
- Creditworthy foreign buyers, who prefer greater security and better cash utilization, may find cash-in-advance terms unacceptable and may simply walk away from the deal.

### CHARACTERISTICS OF A CASH-IN-ADVANCE PAYMENT METHOD

#### Applicability

Recommended for use in high-risk trade relationships or export markets, and ideal for Internet-based businesses.

#### Risk

Exporter is exposed to virtually no risk as the burden of risk is placed nearly completely on the importer.

#### Pros

- Payment before shipment
- Eliminates risk of nonpayment

#### Cons

- May lose customers to competitors over payment terms
- No additional earnings through financing operations

### Wire Transfer—Most Secure and Preferred Cash-in-Advance Method

An international wire transfer is commonly used and has the advantage of being almost immediate. Exporters should provide clear routing instructions to the importer when using this method, including the name and address of the receiving bank, the bank's SWIFT, Telex, and ABA numbers, and the seller's name and address, bank account title, and account number. This option is more costly to the importer than other options of cash-in-advance method, as the fee for an international wire transfer is usually paid by the sender.

## **Credit Card—A Viable Cash-in-Advance Method**

Exporters who sell directly to the importer may select credit cards as a viable method of cash-in-advance payment, especially for consumer goods or small transactions. Exporters should check with their credit card company(s) for specific rules on international use of credit cards as the rules governing international credit card transactions differ from those for domestic use. As international credit card transactions are typically placed via online, telephone, or fax methods that facilitate fraudulent transactions, proper precautions should be taken to determine the validity of transactions before the goods are shipped. Although exporters must endure the fees charged by credit card companies, this option may help the business grow because of its convenience.

## **Payment by Check—A Less-Attractive Cash-in-Advance Method**

Advance payment using an international check may result in a lengthy collection delay of several weeks to months. Therefore, this method may defeat the original intention of receiving payment before shipment. If the check is in U.S. dollars or drawn on a U.S. bank, the collection process is the same as any U.S. check. However, funds deposited by non-local check may not become available for withdrawal for up to 11 business days due to Regulation CC of the Federal Reserve. In addition, if the check is in a foreign currency or drawn on a foreign bank, the collection process is likely to become more complicated and can significantly delay the availability of funds. Moreover, there is always a risk that a check may be returned due to insufficient funds in the buyer's account.

## **When to Use Cash-in-Advance Terms**

- The importer is a new customer and/or has a less-established operating history.
- The importer's creditworthiness is doubtful, unsatisfactory, or unverifiable.
- The political and commercial risks of the importer's home country are very high.
- The exporter's product is unique, not available elsewhere, or in heavy demand.
- The exporter operates an Internet-based business where the use of convenient payment methods is a must to remain competitive.

## Chapter 3

# Letters of Credit

Letters of credit (LCs) are among the most secure instruments available to international traders. An LC is a commitment by a bank on behalf of the buyer that payment will be made to the beneficiary (exporter) provided that the terms and conditions have been met, as verified through the presentation of all required documents. The buyer pays its bank to render this service. An LC is useful when reliable credit information about a foreign buyer is difficult to obtain, but you are satisfied with the creditworthiness of your buyer's foreign bank. This method also protects the buyer, since no payment obligation arises until the documents proving that the goods have been shipped or delivered as promised are presented. However, since LCs have many opportunities for discrepancies, they should be prepared by well-trained documenters or the function may need to be outsourced. Discrepant documents, literally not having an "I-dotted and T-crossed," can negate payment.

### Key Points

- An LC, also referred to as a documentary credit, is a contractual agreement whereby a bank in the buyer's country, known as the issuing bank, acting on behalf of its customer (the buyer or importer), authorizes a bank in the seller's country, known as the advising bank, to make payment to the beneficiary (the seller or exporter) against the receipt of stipulated documents.
- The LC is a separate contract from the sales contract on which it is based and, therefore, the bank is not concerned whether each party fulfills the terms of the sales contract.
- The bank's obligation to pay is solely conditional upon the seller's compliance with the terms and conditions of the LC. In LC transactions, banks deal in documents only, not goods.

### Illustrative Letter of Credit Transaction

1. The importer arranges for the issuing bank to open an LC in favor of the exporter.
2. The issuing bank transmits the LC to the advising bank, which forwards it to the exporter.
3. The exporter forwards the goods and documents to a freight forwarder.
4. The freight forwarder dispatches the goods and submits documents to the advising bank.
5. The advising bank checks documents for compliance with the LC and pays the exporter.
6. The importer's account at the issuing bank is debited.
7. The issuing bank releases documents to the importer to claim the goods from the carrier.

### CHARACTERISTICS OF A LETTER OF CREDIT

#### Applicability

Recommended for use in new or less-established trade relationships when you are satisfied with the creditworthiness of the buyer's bank.

#### Risk

Risk is evenly spread between seller and buyer provided all terms and conditions are adhered to.

#### Pros

- Payment after shipment
- A variety of payment, financing and risk mitigation options

#### Cons

- Process is complex and labor intensive
- Relatively expensive in terms of transaction costs

## **Irrevocable Letter of Credit**

LCs can be issued as revocable or irrevocable. Most LCs are irrevocable, which means they may not be changed or cancelled unless both the buyer and seller agree. If the LC does not mention whether it is revocable or irrevocable, it automatically defaults to irrevocable. Revocable LCs are occasionally used between parent companies and their subsidiaries conducting business across borders.

## **Confirmed Letter of Credit**

A greater degree of protection is afforded to the exporter when a LC issued by a foreign bank (the importer's issuing bank) is confirmed by a U.S. bank (the exporter's advising bank). This confirmation means that the U.S. bank adds its guarantee to pay the exporter to that of the foreign bank. If an LC is not confirmed, the exporter is subject to the payment risk of the foreign bank and the political risk of the importing country. Exporters should consider confirming LCs if they are concerned about the credit standing of the foreign bank or when they are operating in a high-risk market, where political upheaval, economic collapse, devaluation or exchange controls could put the payment at risk.

## **Special Letters of Credit**

LCs can take many forms. When an LC is issued as transferable, the payment obligation under the original LC can be transferred to one or more "second beneficiaries." With a revolving LC, the issuing bank restores the credit to its original amount once it has been drawn down. Standby LCs can be used in lieu of security or cash deposits as a secondary payment mechanism.

## **Tips for Exporters**

- Consult with your bank before the importer applies for an LC.
- Consider whether a confirmed LC is needed.
- Negotiate with the importer and agree upon detailed terms to be incorporated into the LC.
- Determine if all LC terms can be compiled within the prescribed time limits.
- Ensure that all the documents are consistent with the terms and conditions of the LC.
- Beware of many discrepancy opportunities that may cause nonpayment or delayed payment.

## Chapter 4

# Documentary Collections

A documentary collection (D/C) is a transaction whereby the exporter entrusts the collection of payment to the remitting bank (exporter's bank), which sends documents to a collecting bank (importer's bank), along with instructions for payment. Funds are received from the importer and remitted to the exporter through the banks involved in the collection in exchange for those documents. D/Cs involve the use of a draft that requires the importer to pay the face amount either on sight (document against payment—D/P) or on a specified date in the future (document against acceptance—D/A). The draft lists instructions that specify the documents required for the transfer of title to the goods. Although banks do act as facilitators for their clients under collections, documentary collections offer no verification process and limited recourse in the event of nonpayment. Drafts are generally less expensive than letters of credit (LCs).

### Key Points

- D/Cs are less complicated and less expensive than LCs.
- Under a D/C transaction, the importer is not obligated to pay for goods prior to shipment.
- The exporter retains title to the goods until the importer either pays the face amount on sight or accepts the draft to incur a legal obligation to pay at a specified later date.
- Banks that play essential roles in transactions utilizing D/Cs are the remitting bank (exporter's bank) and the collecting bank (importer's bank).
- While the banks control the flow of documents, they do not verify the documents nor take any risks, but can influence the mutually satisfactory settlement of a D/C transaction.

### Typical Simplified D/C Transaction Flow

1. The exporter ships the goods to the importer and receives in exchange the documents.
2. The exporter presents the documents with instructions for obtaining payment to its bank.
3. The exporter's remitting bank sends the documents to the importer's collecting bank.
4. The collecting bank releases the documents to the importer upon receipt of payment.
5. Or the collecting bank releases the documents on acceptance of draft from the importer.
6. The importer then presents the documents to the carrier in exchange for the goods.

## CHARACTERISTICS OF A DOCUMENTARY COLLECTION

### Applicability

Recommended for use in established trade relationships and in stable export markets.

### Risk

Exporter is exposed to more risk as D/C terms are more convenient and cheaper than an LC to the importer.

### Pros

- Bank assistance in obtaining payment
- The process is simple, fast, and less costly than LCs

### Cons

- Banks' role is limited and they do not guarantee payment
- Banks do not verify the accuracy of the documents

7. Having received payment, the collecting bank forwards proceeds to the remitting bank.
8. Once payment is received, the remitting bank credits the exporter's account.

### Documents Against Payment (D/P) Collection

Under a D/P collection, the exporter ships the goods, and then gives the documents to his bank, which will forward them to the importer's collecting bank, along with instructions on how to collect the money from the importer. In this arrangement, the collecting bank releases the documents to the importer only on payment for the goods. Upon receipt of payment, the collecting bank transmits the funds to the remitting bank for payment to the exporter.

**Time of Payment:** After shipment, but before documents are released

**Transfer of Goods:** After payment is made on sight

**Exporter Risk:** If draft is unpaid, goods may need to be disposed

### Documents Against Acceptance (D/A) Collection

Under a D/A collection, the exporter extends credit to the importer by using a time draft. In this case, the documents are released to the importer to receive the goods upon acceptance of the time draft. By accepting the draft, the importer becomes legally obligated to pay at a future date. At maturity, the collecting bank contacts the importer for payment. Upon receipt of payment, the collecting bank transmits the funds to the remitting bank for payment to the exporter.

**Time of Payment:** On maturity of draft at a specified future date

**Transfer of Goods:** Before payment, but upon acceptance of draft

**Exporter Risk:** Has no control of goods and may not get paid at due date

### When to Use Documentary Collections

Under D/C transactions, the exporter has little recourse against the importer in case of nonpayment. Thus, the D/C mechanism should only be used under the following conditions:

- The exporter and importer have a well-established relationship.
- The exporter is confident that the importing country is stable politically and economically.
- An open account sale is considered too risky, but an LC is also too expensive for the importer.

## Chapter 5

# Open Account

An open account transaction means that the goods are shipped and delivered before payment is due, usually in 30 to 90 days. Obviously, this is the most advantageous option to the importer in cash flow and cost terms, but it is consequently the highest risk option for an exporter. Because of the intense competition for export markets, foreign buyers often press exporters for open account terms. In addition, the extension of credit by the seller to the buyer is more common abroad. Therefore, exporters who are reluctant to extend credit may face the possibility of the loss of the sale to their competitors. However, while this method of payment will definitely enhance export competitiveness, exporters should thoroughly examine the political, economic, and commercial risks, as well as cultural influences to ensure that payment will be received in full and on time. It is possible to substantially mitigate the risk of nonpayment associated with open account trade by using such trade finance techniques as export credit insurance and factoring. Exporters may also wish to seek export working capital financing to ensure that they have access to financing for both the production for export and for any credit while waiting to be paid.

### Key Points

- The goods, along with all the necessary documents, are shipped directly to the importer who agrees to pay the exporter's invoice at a future date, usually in 30 to 90 days.
- Exporter should be absolutely confident that the importer will accept shipment and pay at agreed time and that the importing country is commercially and politically secure.
- Open account terms may help win customers in competitive markets, if used with one or more of the appropriate trade finance techniques that mitigate the risk of nonpayment.

### How to Offer Open Account Terms in Competitive Markets

Open account terms may be offered in competitive markets with the use of one or more of the following trade finance techniques: (1) Export Working Capital Financing, (2) Government-Guaranteed Export Working Capital Programs, (3) Export Credit Insurance, (4) Export Factoring, and (5) Forfaiting. More detailed information on each trade finance technique is provided in other sections of the *Trade Finance Guide*.

### CHARACTERISTICS OF AN OPEN ACCOUNT

#### Applicability

Recommended for use (1) in secure trading relationships or markets or (2) in competitive markets to win customers with the use of one or more appropriate trade finance techniques.

#### Risk

Exporter faces significant risk as the buyer could default on payment obligation after shipment of the goods.

#### Pros

- Boost competitiveness in the global market
- Establish and maintain a successful trade relationship

#### Cons

- Exposed significantly to the risk of nonpayment
- Additional costs associated with risk mitigation measures

## **Export Working Capital Financing**

To extend open account terms in the global market, the exporter who lacks sufficient liquidity needs export working capital financing that covers the entire cash cycle from purchase of raw materials through the ultimate collection of the sales proceeds. Export working capital facilities can be provided to support export sales in the form of a loan or revolving line of credit.

## **Government-Guaranteed Export Working Capital Programs**

The Export-Import Bank of the United States and the U.S. Small Business Administration offer programs that guarantee export working capital facilities to U.S. exporters. With these programs, U.S. exporters are able to obtain needed facilities from commercial lenders when financing is otherwise not available or when their borrowing capacity needs to be increased.

## **Export Credit Insurance**

Export credit insurance provides protection against commercial losses—default, insolvency, bankruptcy, and political losses—war, nationalization, currency inconvertibility, etc. It allows exporters to increase sales by offering liberal open account terms to new and existing customers. Insurance also provides security for banks providing working capital and financing exports.

## **Export Factoring**

Factoring in international trade is the discounting of a short-term receivable (up to 180 days). The exporter transfers title to its short-term foreign accounts receivable to a factoring house for cash at a discount from the face value. It allows an exporter to ship on open account as the factor assumes the financial ability of the importer to pay and handles collections on the receivables. The factoring house usually works with consumer goods.

## **Forfaiting**

Forfaiting is a method of trade financing that allows the exporter to sell its medium-term receivables (180 days to 7 years) to the forfaiter at a discount, in exchange for cash. With this method, the forfaiter assumes all the risks, enabling the exporter to extend open account terms and incorporate the discount into the selling price. Forfaiters usually work with capital goods, commodities, and large projects.

## Chapter 6

# Export Working Capital Financing

**E**xport working capital (EWC) financing allows exporters to purchase the goods and services they need to support their export sales. More specifically, EWC facilities extended by commercial banks can provide a means for exporters who lack sufficient internal liquidity to process and acquire goods and services to fulfill export orders and extend open account terms to their foreign buyers. EWC funds are commonly used to finance three different areas: (1) materials, (2) labor, and (3) inventory, but they can also be used to finance receivables generated from export sales and/or standby letters of credit used as performance bonds or payment guarantees to foreign buyers. An unexpected large export order or many incremental export orders can often place challenging demands on working capital. EWC financing helps to ease and stabilize the cash flow problems of exporters while they fulfill export sales and grow competitively in the global market.

### Key Points

- Funds may be used to acquire materials, labor, inventory, goods and services for export.
- A facility can support a single export transaction (transaction specific short-term loan) or multiple export transactions (revolving line of credit) on open account terms.
- The term of a transaction specific loan is generally up to one year and a revolving line of credit may extend up to three years.
- A government guarantee may be needed to obtain a facility that can meet your export needs.
- Risk mitigation may be needed to offer open account terms confidently in the global market.

### Where and How to Obtain an Export Working Capital Facility

Commercial banks offer facilities for export activities. To qualify, exporters generally need to (1) be in business profitably for at least 12 months (not necessarily in exporting), (2) demonstrate a need for transaction-based financing, and (3) provide documents to demonstrate that a viable transaction exists. To ensure repayment of a loan, the lending bank may place a lien on the assets of the exporter, such as inventory and accounts receivable. In addition, all export sale proceeds will usually be collected by the lending bank before the balance is passed on to the exporter. Fees and interest rates are usually negotiable between the lender and the exporter.

### CHARACTERISTICS OF AN EXPORT WORKING CAPITAL FACILITY

#### Applicability

To purchase raw materials, supplies, and equipment to fulfill a large export sales order or many small export sales orders.

#### Risk

Without the use of proper risk mitigation measures, the exporter is exposed to significant risk of nonpayment.

#### Pros

- Can fulfill export sales orders
- Can offer open account terms to remain competitive

#### Cons

- Cost of financing a facility
- Risk mitigation may be needed, incurring additional costs

## **Short-term Loans or Revolving Lines of Credit**

There are basically two types of export working capital facilities: transaction specific short-term loans and revolving lines of credit. Short-term loans, which are appropriate for large and periodic export orders, are typically used in situations where the outflows and inflows of funds are accurately predictable in time. These loans can be contracted for 3, 6, 9, or 12 months and the interest rates are usually fixed over the requested tenors. Revolving lines of credit, on the other hand, are appropriate for a series of small fractional export orders as they are designed to cover the temporary funding needs that cannot always be predictable. These revolving lines of credit have a very flexible structure so that you can draw funds against your current account at any time and up to a specified limit.

## **Why a Government Guarantee May Be Needed**

The Export-Import Bank of the United States and the U.S. Small Business Administration offer programs that guarantee export working capital facilities to U.S. exporters. With these programs, U.S. exporters are able to obtain needed facilities from commercial lenders when financing is otherwise not available or when their borrowing capacity needs to be increased. Advance rates offered by commercial banks on export inventory and foreign accounts receivables are not always sufficient to meet the needs of exporters. In addition, some lenders do not lend to exporters without a government guarantee due to repayment risk associated with export sales. More detailed information is provided in Chapter 7.

## **Why Risk Mitigation May Be Needed**

While export working capital financing will certainly make it possible for exporters to offer open account terms in today's highly competitive global markets, the use of such financing itself does not necessarily eliminate the risk of nonpayment by foreign customers. In order to offer open credit terms more confidently in the global market, the use of some forms of risk mitigation may be needed. In addition, the use of risk mitigation may be necessary for exporters to obtain export working capital financing. For example, the bank may require the exporter to obtain export credit insurance as a condition of providing working capital and financing exports. Forms of risk mitigation will be discussed in other chapters of the *Trade Finance Guide*.

## Chapter 7

# Government-Guaranteed Export Working Capital Programs

Financing rates offered by commercial banks on export inventory and foreign accounts receivables are not always sufficient to meet the needs of U.S. exporters. In addition, some banks are reluctant to extend credit due to the repayment risk associated with export sales. In such cases, government-guaranteed export working capital facilities can provide the exporter with the liquidity to accept new business, help grow export sales, and compete more effectively in the global marketplace. Two U.S. government agencies—the Export-Import Bank of the United States (Ex-Im Bank) and the U.S. Small Business Administration (SBA)—work together to offer such programs to U.S. firms through participating lenders. By completing one standardized application form, exporters are directed to the agency best able to assist them, with SBA typically handling facilities below \$2 million and Ex-Im Bank processing larger requests. Additionally, SBA financing is limited to small businesses. Through these government-guaranteed export working capital programs (EWCP), U.S. exporters are able to obtain needed facilities from commercial lenders when financing is otherwise not available or when their borrowing capacity needs to be increased.

### Key Points

- Fulfill export sales orders by expanding access to export working capital financing.
- Maximize the borrowing base by turning export inventory and accounts receivable into cash.
- Risk mitigation may be needed to offer open account terms confidently in the global market.

### Comparison: Commercial Facility vs. Guaranteed Facility

See the table below for examples of how the EWCP can increase your borrowing base against your total collateral value.<sup>1</sup>

#### CHARACTERISTICS OF AN EWCP

##### Applicability

When commercial financing is otherwise not available or when pre-approved borrowing capacity is not sufficient.

##### Risk

Without the use of proper risk mitigation measures, the exporter is exposed significantly to the risk of nonpayment.

##### Pros

- Encourage lenders to make financing to exporters
- Enable lenders to offer generous advance rates

##### Cons

- Cost of obtaining and maintaining a guaranteed facility
- Risk mitigation may be needed, incurring additional costs

<sup>1</sup> EWCP advance rates may vary depending on the quality of the collateral offered.

***Borrow up to \$1.65 million against your collateral value of \$2 million***

		<b>Commercial Facility Without an EWCP</b>		<b>Commercial Facility With an EWCP</b>	
<b>COLLATERAL</b>	<b>VALUE</b>	Advance Rate	Borrowing Base	Advance Rate	Borrowing Base
<b>Export Inventory</b>					
Raw Materials	\$200,000	20%	\$40,000	75%	\$150,000
Work-in-Process	\$200,000	0%	\$0	75%	\$150,000
Finished Goods	\$600,000	50%	\$300,000	75%	\$450,000
<b>Export Accounts Receivable</b>					
On Open Account	\$400,000	0%	\$0	90%	\$360,000
By Letter of Credit	\$600,000	70%	\$420,000	90%	\$540,000
<b>Totals</b>	<b>\$2,000,000</b>		<b>\$760,000</b>		<b>\$1,650,000</b>

**Key Features of Ex-Im Bank’s Export Working Capital Program**

- For U.S. exporters and credit lines of all sizes, usually \$2 million or more.
- Must adhere to the Bank’s requirements for content, non-military uses and country policy.
- Nonrefundable \$100 application fee.
- 1.5 percent upfront facility fee based on the total loan amount and a one-year loan.
- Fees and interest rate charged by the commercial lender are usually negotiable.
- Enhancements are available for minority- or woman-owned, rural and environmental firms.
- For more information, visit [www.exim.gov](http://www.exim.gov) or call **1-800-565-EXIM**.

**Key Features of the SBA’s Export Working Capital Program**

- For small businesses that meet the SBA’s guidelines and require credit lines up to \$2 million.
- No applications fee and no restrictions regarding foreign content or military sales.<sup>2</sup>
- 0.25 percent upfront facility fee based on the guaranteed portion and a loan up to 12 months.
- Fees and interest rate charged by the commercial lender are usually negotiable.
- For more information, visit [www.sba.gov/OIT](http://www.sba.gov/OIT) or call 1-800-U-ASK-SBA.

**Why Risk Mitigation May Be Needed**

The EWCP does not make exporters immune to the risk of nonpayment by foreign customers. The use of some forms of risk mitigation may be needed to offer open account terms more confidently in the global market. Possible risk mitigation measures recommended for use in conjunction with open account terms are (1) export credit insurance, (2) export factoring, and (3) forfaiting. More detailed information on each risk mitigation measures is respectively provided in chapters 8, 9, and 10.

<sup>2</sup> SBA encourages the use of American made products, if feasible. Borrowers must comply with all federal laws regulating military sales.

## Chapter 8

# Export Credit Insurance

**E**xport credit insurance (ECI) protects an exporter of products and/or services against the risk of nonpayment by a foreign buyer. In other words, ECI significantly reduces the payment risks associated with doing business internationally by giving the exporter conditional assurance that payment will be made in the event that the foreign buyer is unable to pay. Simply put, with an ECI policy, exporters can protect their foreign receivables against a variety of risks, which could result in nonpayment by foreign buyers. The policy generally covers commercial risks—insolvency of the buyer, bankruptcy or protracted defaults (slow payment), and certain political risks—war, terrorism, riots, and revolution, as well as currency inconvertibility, expropriation, and changes in import or export regulations. The insurance is offered either on a single-buyer or portfolio multi-buyer basis for short-term (up to one year) and medium-term (one to five years) repayment periods.

### Key Points

- ECI allows you to offer competitive open account terms to foreign buyers while minimizing the risk of nonpayment.
- Creditworthy buyers could default on payment due to circumstances beyond their control.
- With reduced nonpayment risk, you can increase your export sales, establish market share in emerging and developing countries, and compete more vigorously in the global market.
- With insured foreign account receivables, banks are more willing to increase your borrowing capacity and offer attractive financing terms.

### Coverage

Short-term ECI, which provides 90 to 95 percent coverage against buyer payment defaults, typically covers (1) consumer goods, materials, and services up to 180 days, and (2) small capital goods, consumer durables and bulk commodities up to 360 days. Medium-term ECI, which provides 85 percent coverage of the net contract value, usually covers large capital equipment up to five years.

### How Much Does It Cost?

Premiums are individually determined on the basis of risk factors such as country, buyer's creditworthiness, sales volume, seller's previous export experience, etc. Most multi-buyer policies cost less than 1 percent of insured sales while the prices of single-buyer policies vary widely due to presumed higher risk. However, the cost in most cases is significantly less than the fees charged for letters of credit. ECI, which is often incorporated into the

## CHARACTERISTICS OF EXPORT CREDIT INSURANCE

### Applicability

Recommended for use in conjunction with open account terms and export working capital financing.

### Risk

Exporters share the risk of the uncovered portion of the loss and their claims may be denied in case of non-compliance with requirements specified in the policy.

### Pros

- Reduce the risk of nonpayment by foreign buyers
- Offer open account terms safely in the global market

### Cons

- Cost of obtaining and maintaining an insurance policy
- Deductible—coverage is usually below 100 percent

selling price, should be a proactive purchase, in that you have coverage in place before a customer becomes a problem.

### **Where Can I Get Export Credit Insurance?**

ECI policies are offered by many private commercial risk insurance companies as well as the Export-Import Bank of the United States (Ex-Im Bank), the government agency that assists in financing the export of U.S. goods and services to international markets. U.S. exporters are strongly encouraged to shop for a good specialty insurance broker who can help them select the most cost-effective solution for their needs. Reputable, well-established companies that sell commercial ECI policies can be easily found on the Internet. You may also buy ECI policies directly from Ex-Im Bank. In addition, a list of active insurance brokers registered with Ex-Im Bank is available at [www.exim.gov](http://www.exim.gov) or you may call **1-800-565-EXIM** for more information.

### **Pros and Cons of Ex-Im Bank's Export Credit Insurance**

- Offers coverage in emerging foreign markets where private insurers may not operate.
- Exporters electing an Ex-Im Bank Working Capital Guarantee may receive a 25 percent premium discount on Multi-buyer Insurance Policies.
- Ex-Im Bank insurance policies are backed by the full faith and credit of the U.S. government.
- Offers enhanced support for environmentally beneficial exports.
- The products must be shipped from the United States and have at least 50 percent U.S. content.
- Unable to support military products or purchases made by foreign military entities.
- Support for exports may be closed or restricted in certain countries per U.S. foreign policy.

## Chapter 9

# Export Factoring

**E**xport factoring is a complete financial package that combines export working capital financing, credit protection, foreign accounts receivable bookkeeping and collection services. A factor is a bank or a specialized financial firm that performs financing through the purchase of invoices or accounts receivable. Export factoring is offered under an agreement between the factor and exporter, in which the factor purchases the exporter's short-term foreign accounts receivable for cash at a discount from the face value, normally without recourse, and assumes the risk on the ability of the foreign buyer to pay, and handles collections on the receivables. Thus, by virtually eliminating the risk of nonpayment by foreign buyers, factoring allows the exporter to offer open accounts, improves liquidity position, and boosts competitiveness in the global marketplace. Factoring foreign accounts receivables can be a viable alternative to export credit insurance, long-term bank financing, expensive short-term bridge loans or other types of borrowing that will create debt on the balance sheet.

### Key Points

- Recommended for continuous short-term export sales of consumer goods on open account.
- 100 percent protection against the foreign buyer's inability to pay - no deductible/risk sharing.
- An attractive option for small- and medium-sized businesses, particularly during periods of rapid growth, because cash flow is preserved and risk is virtually eliminated.
- Unsuitable for the new-to-export company as factors generally (1) do not take on a client for a one-time deal and (2) require access to a certain volume of the exporter's yearly sales.

### How Does Export Factoring Work?

The exporter signs an agreement with the export factor who selects an import factor through an international correspondent factor network, who then investigates the foreign buyer's credit standing. Once credit is approved locally, the foreign buyer places orders for goods on open account. The exporter then ships the goods and submits the invoice to the export factor, who then passes it to the import factor who handles the local collection and payment of the accounts receivable. During all stages of the transaction, records are kept for the exporter's bookkeeping.

### CHARACTERISTICS OF EXPORT FACTORING

#### Applicability

Ideal for an established exporter who wants (1) the flexibility of selling on open account terms, (2) to avoid incurring any credit losses or (3) to outsource credit and collection functions.

#### Risk

Risk inherent in an export sale is virtually eliminated.

#### Pros

- Eliminate the risk of nonpayment by foreign buyers
- Maximize cash flows

#### Cons

- More costly than export credit insurance
- Generally not available in developing countries

## Two Common Export Factoring Financing Arrangements and Their Costs

1. In **discount factoring**, the factor issues an advance of funds against the exporter's receivables until money is collected from the importer. The cost is variable, depending on the time frame and the dollar amount advanced.
2. In **collection factoring**, the factor pays the exporter, less a commission charge, when receivables are at maturity, regardless of the importer's financial ability to pay. The cost is fixed, ranging generally between 1 and 4 percent, depending on the country, sales volume, and amount of paperwork involved. However, as a rule of thumb, export factoring usually costs about twice as much as export credit insurance.

## Limitations of Export Factoring

- Only exists in countries with laws that support the buying and selling of receivables.
- Generally does not work with foreign account receivables having greater than 180-day terms.
- May be cost prohibitive for exporters with tight profit margins.

## Export Factoring Industry Profile

While U.S. export factors have traditionally focused on specific market sectors such as textiles and apparel, footwear, and carpeting, they are now working with more diversified products. Today, U.S. exporters who factor are manufacturers, distributors, wholesalers, or service firms with sales ranging from \$5 million to \$200 million. Factoring is also used as a valuable financial tool for larger U.S. corporations to manage their balance sheets. International factoring volume in the U.S. is now over \$6 billion annually, greatly contributing to the growth in U.S. exports.

## Where to Find a Factor?

The international factoring business involves networks similar to the use of correspondents in the banking industry. **Factors Chain International (FCI)** is the largest of these global networks and can be useful in locating factors willing to finance your exports. Another useful source is the **International Factoring Association (IFA)**, an association of financial firms that offer factoring services. FCI has a Web site at [www.factors-chain.com](http://www.factors-chain.com) and is located in The Netherlands. The IFA also has a Web site at [www.ifa.org](http://www.ifa.org) and is located in California.

## Chapter 10

# Forfaiting

**F**orfaiting is a method of trade finance that allows exporters to obtain cash by selling their medium term foreign account receivables at a discount on a “without recourse” basis. A forfaiter is a specialized finance firm or a department in banks that performs non-recourse export financing through the purchase of medium-term trade receivables. Similar to factoring, forfaiting virtually eliminates the risk of nonpayment, once the goods have been delivered to the foreign buyer in accordance with the terms of sale. However, unlike factors, forfaiters typically work with the exporter who sells capital goods, commodities, or large projects and needs to offer periods of credit from 180 days to up to seven years. In forfaiting, receivables are normally guaranteed by the importer’s bank, allowing the exporter to take the transaction off the balance sheet to enhance its key financial ratios. The current going minimum transaction size for forfaiting is \$100,000. In the United States, most users of forfaiting have been large established corporations, although small- and medium-size companies are slowly embracing forfaiting as they become more aggressive in seeking financing solutions for countries considered high risk.

### Key Points

- Eliminates virtually all risk to the exporter with 100 percent financing of contract value.
- Allows offering open account in markets where the credit risk would otherwise be too high.
- Generally works with bills of exchange, promissory notes, or a letter of credit.
- Normally requires the exporter to obtain a bank guarantee for the foreign buyer.
- Financing can be arranged on a one-shot basis in any of the major currencies, usually on a fixed interest rate, but a floating rate option is also available.

### How Does Forfaiting Work?

The exporter approaches a forfaiter before finalizing a transaction’s structure. Once the forfaiter commits to the deal and sets the discount rate, the exporter can incorporate the discount into the selling price. The exporter then accepts a commitment issued by the forfaiter, signs the contract with the importer, and obtains, if required, a guarantee from the importer’s bank that provides the documents required to complete the forfaiting. The exporter delivers the goods to the importer and delivers the documents to the forfaiter who verifies them and pays for them as agreed in the commitment. Since this payment is without recourse, the exporter has no further interest in the transaction and it is the forfaiter who must collect the future payments due from the importer.

### CHARACTERISTICS OF FORFAITING

#### Applicability

Ideal for exports of capital goods, commodities, and large projects on medium-term credit (180 days to up to seven years).

#### Risk

Risk inherent in an export sale is virtually eliminated.

#### Pros

- Eliminate the risk of nonpayment by foreign buyers
- Strong capabilities in emerging and developing markets

#### Cons

- Cost can be higher than commercial bank financing
- Limited to medium-term and over \$100K transactions

## Cost of Forfaiting

The cost of forfaiting is determined by the rate of discount based on the aggregate of the LIBOR (London Inter Bank Offered Rate) rates for the tenor of the receivables and a margin reflecting the risk being sold. The degree of risk varies based on the importing country, the length of the loan, the currency of transaction, and the repayment structure – the higher the risk, the higher the margin and therefore the discount rate. However, forfaiting can be more cost-effective than traditional trade finance tools because of many attractive benefits it offers to the exporter.

## Three Additional Major Advantages of Forfaiting

**Volume:** Can work on a one-shot deal, without requiring an ongoing volume of business.

**Speed:** Commitments can be issued within hours/days depending on details and country.

**Simplicity:** Documentation is usually simple, concise, and straightforward.

## Forfaiting Industry Profile

While the number of forfaiting transactions is growing worldwide, industry sources estimate that only 2 percent of world trade is financed through forfaiting and that U.S. forfaiting transactions account for only 3 percent of that volume. Forfaiting firms have opened around the world, but the Europeans maintain a hold on the market, including in North America. While these firms remain few in number in the United States, the innovative financing they provide should not be overlooked as a viable means of export finance for U.S. exporters.

## Where to Find a Forfeiter?

The **Association of Trade & Forfaiting in the Americas, Inc. (ATFA)** and the **International Forfaiting Association (IFA)** may be useful in locating forfaiters willing to finance your exports. They are both associations of financial institutions dedicated to promoting international trade finance through forfaiting. ATFA has a Web site at <http://afia-forfaiting.org> and is located in New York. The IFA also has a Web site at [www.forfaiters.org](http://www.forfaiters.org) and is located in Switzerland.

## Chapter 11

# Government Assisted Foreign Buyer Financing

The international sales of high-value capital goods or services or exports to large-scale projects, which require medium- or long-term financing, often pose special challenges to exporters as commercial banks may be reluctant to lend large sums to foreign buyers, especially those in developing countries, for extended periods. One viable solution to these challenges is foreign buyer financing offered by the Export-Import Bank of the United States (Ex-Im Bank). As the official U.S. export credit agency, Ex-Im Bank supports the purchases of U.S. goods and services by creditworthy foreign buyers who are unable to obtain financing they need through traditional commercial sources. Ex-Im Bank does not compete with commercial banks but provides products that fill gaps in trade financing by assuming country and credit risks that the private sector is unable or unwilling to accept. With Ex-Im Bank's foreign buyer financing, U.S. exporters can turn their business opportunities into real transactions and get paid cash on delivery and acceptance of the goods or services.

### Key Points

- Helps turn business opportunities, especially in emerging markets, into real transactions for large U.S. exporters and their small business suppliers.
- Enables creditworthy foreign buyers to obtain loans needed for purchases of U.S. goods and services, especially high-value capital goods or services or exports to large-scale projects.
- Provides fixed-rate direct loans or guarantees term financing offered by commercial banks.
- Available for medium- (up to five years) and long-term (generally up to ten years) transactions.

### Key Common Features of Ex-Im Bank's Loan Guarantees and Direct Loans

Ex-Im Bank assists U.S. exporters by providing direct loans or guaranteeing commercial loans to creditworthy foreign buyers for purchases of U.S. goods and services. They are generally used to finance the purchase of high-value capital equipment or services or exports to large-scale projects that require medium- or long-term financing. Ex-Im Bank's foreign buyer financing is also used to finance the purchase of refurbished equipment, software, and certain banking and legal fees, as well as some local costs and expenses.

### CHARACTERISTICS OF GOVERNMENT ASSISTED FOREIGN BUYER FINANCING

#### Applicability

Suitable for the export of high-value capital goods or services or large-scale projects that require extended-term financing.

#### Risk

Commercial bank and/or Ex-Im Bank assume all risks.

#### Pros

- Buyer financing as part of an attractive sales package
- Cash payment upon shipment of the goods or services

#### Cons

- Subject to certain restrictions per U.S. foreign policy
- Possible lengthy process of approving financing

There is no minimum or maximum limit to the size of the export sale that may be supported by the Bank's foreign buyer financing. Ex-Im Bank requires the foreign buyer to make a cash payment to the exporter equal to at least 15 percent of the U.S. supply contract. Repayment terms up to five years are available for exports of capital goods and services. Transportation equipment and exports to large-scale projects may be eligible for repayment terms up to 10 years and for certain sectors up to 12-15 years. Military items are generally not eligible for Ex-Im Bank financing nor are sales to foreign military entities. In addition, goods must meet the Bank's foreign content requirements. Finally, Ex-Im Bank financing may not be available in certain countries and certain terms per U.S. foreign policy.

### **Key Features of Ex-Im Bank Loan Guarantees**

- Loans are made by commercial banks and guaranteed by Ex-Im Bank.
- 100 percent principal and interest cover for 85 percent of U.S. contract price.
- Negotiated interest rate, usually floating and lower than fixed rate.
- Fully transferable, can be securitized and available in certain foreign currencies.
- Faster documentation process with the assistance of commercial banks.
- Promotes cash payment financing.
- No U.S. vessel shipping regulations under \$20 million.

### **Key Features of Ex-Im Bank Direct Loans**

- Provides fixed-rate loans directly to creditworthy foreign buyers.
- Supports 85 percent of U.S. contract price.
- Exporter will be paid in full upon disbursement of a loan to the foreign buyer.
- Generally, the goods must be carried exclusively on U.S. vessels.
- Best used when the buyer insists on fixed rate.

### **Fees and Ex-Im Bank Contact Information**

**Letter of Interest:** \$100.

**Preliminary Commitment:** 0.1 of 1 percent of the financed amount up to \$25,000.

**Guarantee Commitment:** 0.125 percent per annum on the undisbursed balance of the loan.

**Direct Loan Commitment:** 0.5 percent per annum on the undisbursed balance of the loan.

**Exposure Fee:** Varies, depending upon tenor, country risk, and buyer credit risk.

**For more information:** Visit [www.exim.gov](http://www.exim.gov) or call **1-800-565-EXIM**.



*Trade Finance Guide, A Quick Reference for U.S. Exporters* has been written to help U.S. companies, especially small and medium-sized enterprises (SMEs), learn the fundamentals of trade finance to turn their export opportunities into actual sales and to achieve the ultimate goal: to get paid for their export sales. Eleven concise, two-page chapters offer the basics of numerous financing techniques, from open accounts, to forfeiting, to government assisted foreign buyer financing.

The International Trade Administration's mission is to create prosperity by strengthening the competitiveness of U.S. industry, promoting trade and investment, and ensuring fair trade and compliance with trade laws and agreements.



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