IMPORT FORUM

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University of Southern Maine, Portland

International Trade

Global Trade Risks

KeyBank

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International Trade Risks

Risks that companies face doing business globally that do not exist when buying and selling domestically

Commercial	Compliance	Currency	Documentary	Economic	Political
Product quality and quantity issues or insolvency problems.	Non-adherence to government trade agreements and restrictions on countries subject to trade and economic sanctions.	Unanticipated changes in currency exchange rates, diminished access to currencies, and government actions that affect currency convertibility.	Discrepancies in documents or non-conformance with contract or agreement requirements.	Unfavorable economic conditions that impact a buyer's ability to accept receipt of goods or a seller's ability to deliver goods.	Political developments that impact transactions, including war, riots, terrorism, and embargoes.

International Trade

International Trade Payment Methods

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Four Methods of Payment for International Trade

2 Documentary collection:

- A bank intermediates to exchange a payment, or promise of payment, for title to the goods being shipped.
- Does not provides seller payment protection.

4 Cash-in-advance:

- Buyer pays in advance of shipment of goods.
- Buyers don't prefer this option because they are out of cash well before their receive goods or services.

More Secure Importer ←→ *More Secure Exporter*

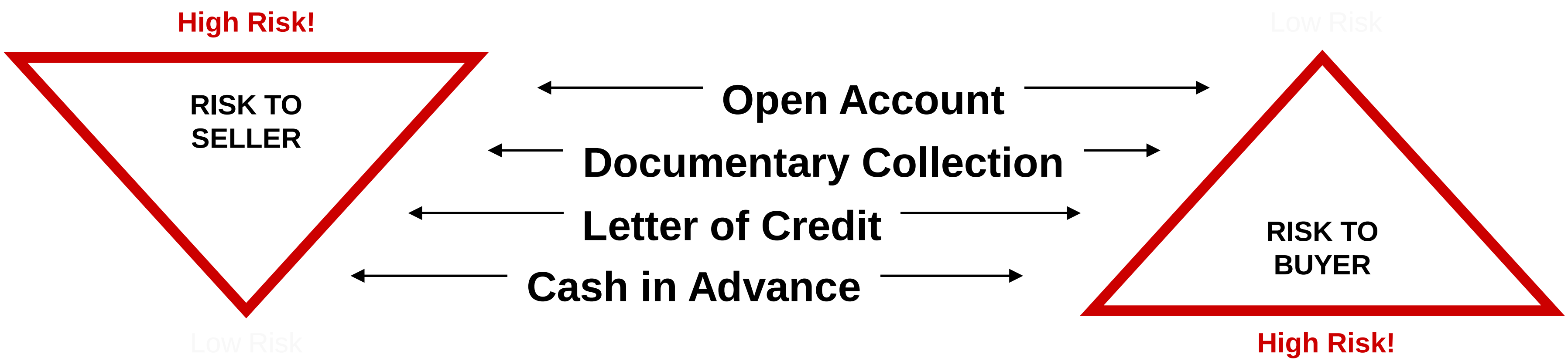
1 Open account:

- Seller ships the goods in advance of payment and relies on buyer paying after goods are received. Riskiest payment method for exporters.

3 Letter of Credit (L/C):

- A trade finance instrument issued by a buyer's bank in favor of their supplier.
- An L/C substitutes a bank's creditworthiness for the buyer's.
- L/Cs are specialized instruments that guarantee payment for a shipment of goods or services from one party to another.

KeyBank Payment Methods: Exporters and Importers – Mars / Venus?



Objectives

Exporter's	Importer's
• Shorten payment terms • Ship on time • Reduce foreign risk & buyer risk • Reduce days sales outstanding (DSO) • Receive payment for merchandise prior to shipment – best outcome	• Extend payment terms • Receive merchandise on time • Reduce transportation costs • Pay for goods after they are delivered and sold – best outcome

What determines choice of payment method?

- Buyer's credit standing
- Buyer-Seller Relationship
- Cash flow considerations
- What are Competitors offering?
- Country conditions (political, economic)
- Risk tolerance of buyer and seller
- Transaction costs
- Uniqueness of product (custom made?)
- Other

What determines choice of payment method?

(cont'd.)

	Cash in Advance	Letter of Credit	Documentary Collection	Open Account
Relationship	New	New	Established	Established
Type of Goods	Custom Made	Custom Made	Stock Items	Stock Items
Political	Unstable	Unstable*	Stable	Stable
Economic	Unstable	Unstable *	Stable	Stable
Timing of Cash Flow	Certain	Certain	Reliable	Reliable
Timing of Delivery	Uncertain	Reliable	Reliable	Reliable

**Confirmation by a creditworthy US bank is recommended*

Cash-in-Advance

With a Cash-in-Advance payment, exporters can avoid credit risk or the risk of nonpayment, since payment is received prior to the transfer of ownership of the goods.

Applicability	Risk
Recommended for use in high-risk trade relationships or high-risk export markets, and ideal for internet-based businesses.	Exporter is exposed to virtually no risk as the burden or risk is placed nearly completely on the importer.

Pros	Cons
• Payment before shipment • Eliminates risk of nonpayment	• May lose customers to competitors over payment terms • Banks do not intermediate; no trade finance opportunities

Cash-in-Advance: Key points

- Full or 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 trade for exporters and, consequently, the least secure and least attractive option for importers. However, both the credit risk and the competitive landscape must be considered.
- Insisting on these terms could ultimately cause exporters to lose customers to competitors who 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.

KeyBank Cash-in-Advance: When clients should use it

- 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.

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Open Account

Open Account transaction means that the goods are shipped and delivered before payment is due, usually in 30-90 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.

Applicability

Recommended for use: (1) in secure trading relationships or markets or (2) in competitive markets to win customers; can be coupled 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

- Banks' role is limited and they do not guarantee payment

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Open Account: Key points

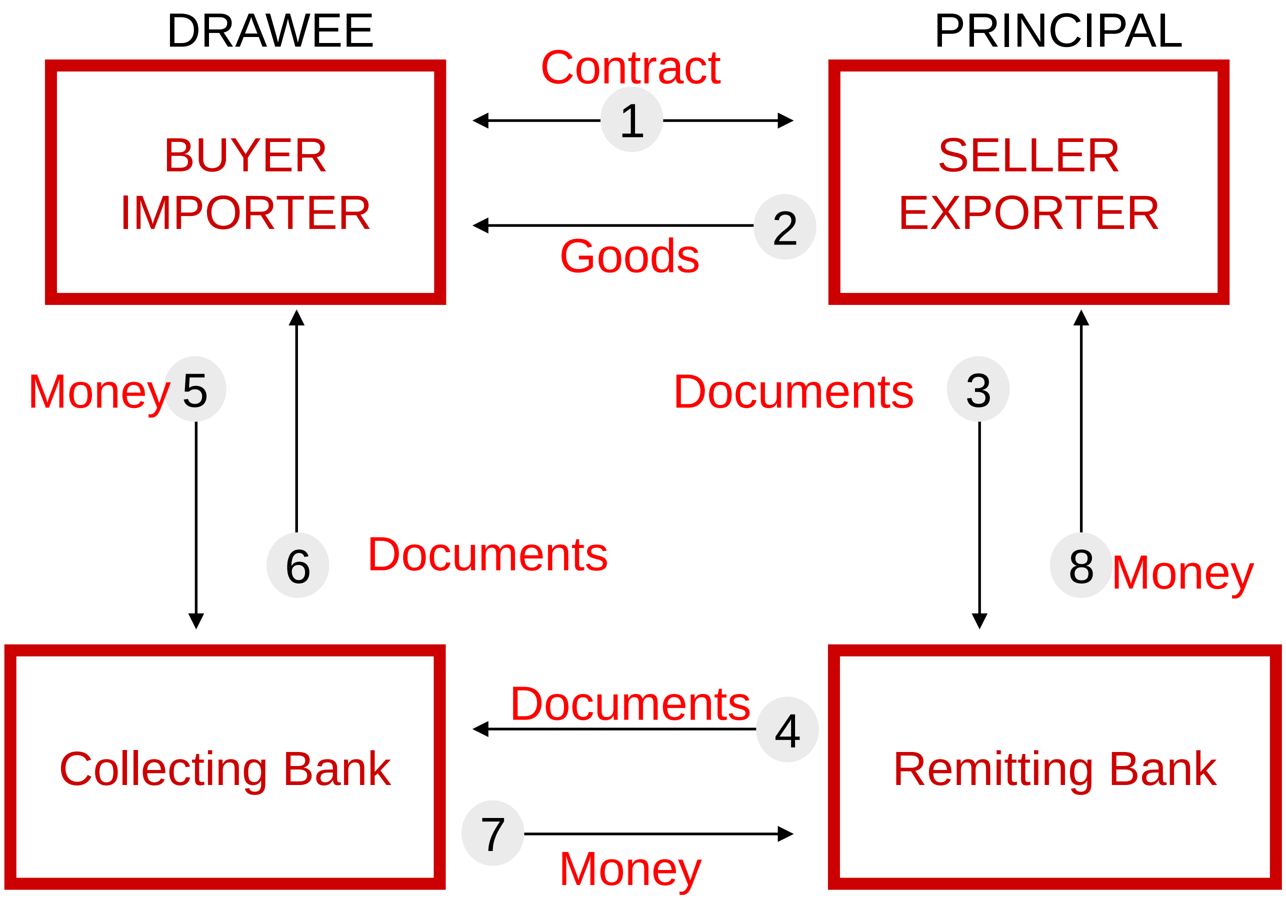
- The goods, along with all the necessary documents, are shipped directly to the importer who agrees to pay the exporter's invoice at a future date, usually in 30 to 90 days.

- 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 (for example export credit insurance).

Documentary Collection transaction flow

1. Seller and buyer negotiate a sales contract or purchase order providing for payment by documentary collection (documents against payment/acceptance).
2. Seller dispatches goods to buyer.
3. Seller delivers documents and draft to remitting bank.
4. Remitting bank forwards documents and draft to collecting bank along with collection instructions.
5. Buyer makes payment to collecting bank in case of sight draft, or accepts a time draft.
6. The collecting bank releases documents so that the buyer can take delivery of the goods.
7. The collecting bank transfers funds to the remitting bank.
8. The remitting bank transfers funds to the seller.



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Documentary Collections: Key points

- D/Cs are less complicated and less expensive than L/Cs.
- Under a D/C transaction, the buyer is not obligated to pay for goods prior to shipment.
- Seller retains title to the goods until the buyer either pays the face amount immediately (at sight) or accepts the draft to incur a legal obligation to pay at a specified later date.
- Banks that play an essential role in D/Cs are: remitting bank (exporter’s bank) and the collecting bank (importer’s bank).
- While 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.

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Documentary Collections: When clients should use it

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 L/C is also too expensive for the importer.

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Letters of Credit

Letters of Credit (L/Cs) are among the most secure instruments available to settle international trade transactions.

An L/C 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.

Applicability

Recommended for use in new or less-established trade relationships when exporter is comfortable with 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 are available

Cons

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

Letters of Credit: Key points

- An L/C, 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 L/C 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 conditioned upon the seller's compliance with the terms and conditions of the L/C. In L/C transactions, banks deal in documents only, not goods. If the seller ships rocks but meets all the L/C terms, the buyer's bank must pay.

Letters of Credit: Irrevocable letter of Credit

L/Cs can be issued as Revocable or Irrevocable.

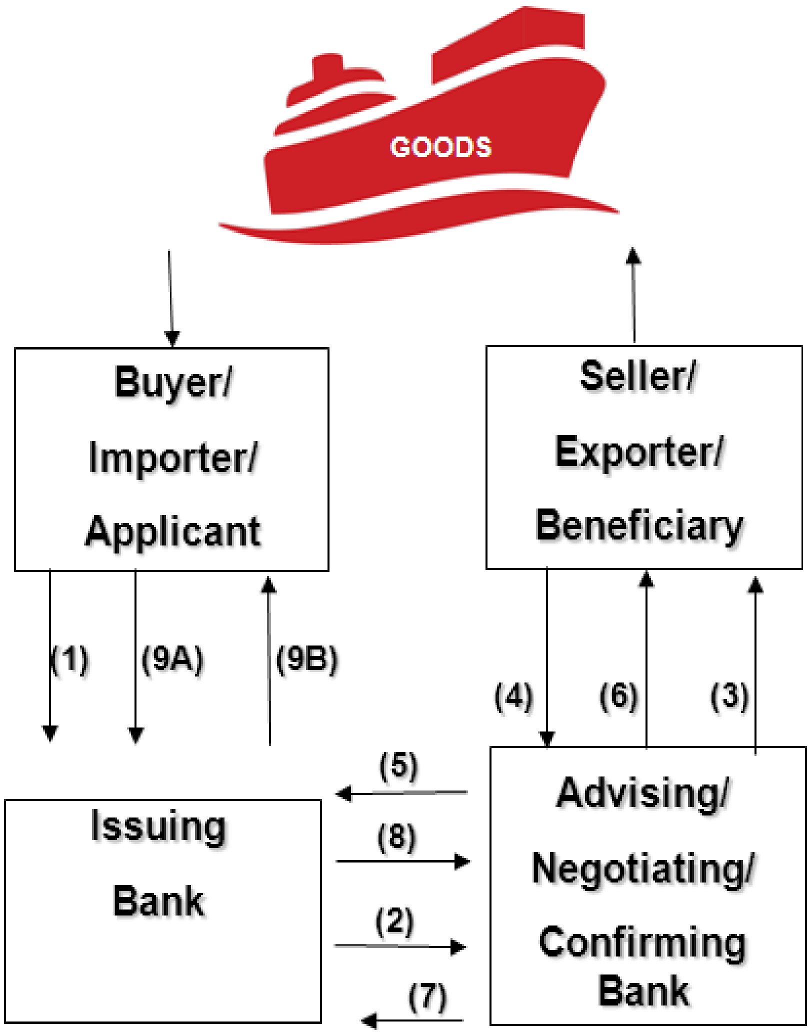
Revocable

- Revocable L/Cs are occasionally used between parent companies and their subsidiaries conducting business across borders.
- This type of L/C is not common.

Irrevocable

- Irrevocable means:
  - L/C may not be changed or cancelled unless **both** the buyer and seller agree.
  - If the L/C does not mention whether it is revocable or irrevocable, it automatically defaults to irrevocable.

Letter of Credit Transaction Flow



(1) L/C Application is completed by buyer/importer/applicant submitted to issuing bank

(2) Swift message sent to Advising/Negotiating/Confirming Bank by the issuing bank/reimbursing bank

(3) Original LC submitted to Seller/Exporter/Beneficiary from advising/negotiating/confirming bank. Seller agrees to LC terms

(4) Goods are shipped and documents are sent to advising /negotiating/ confirming bank

(5) Advising/negotiating/confirming bank sends documents to issuing bank/reimbursing bank once they are correct

(6) Advising/negotiating/ confirming bank releases payment to seller/exporter/beneficiary

(7) advising/negotiating/ confirming bank claims reimbursement from issuing/reimbursing bank

(8) Issuing Bank/reimbursing bank sends payment to advising/ negotiating/confirming bank

(9) Buyer/Importer/Applicant submits payment to issuing/reimbursing bank. Issuing/Reimbursing bank releases shipping documents to buyer/importer/applicant