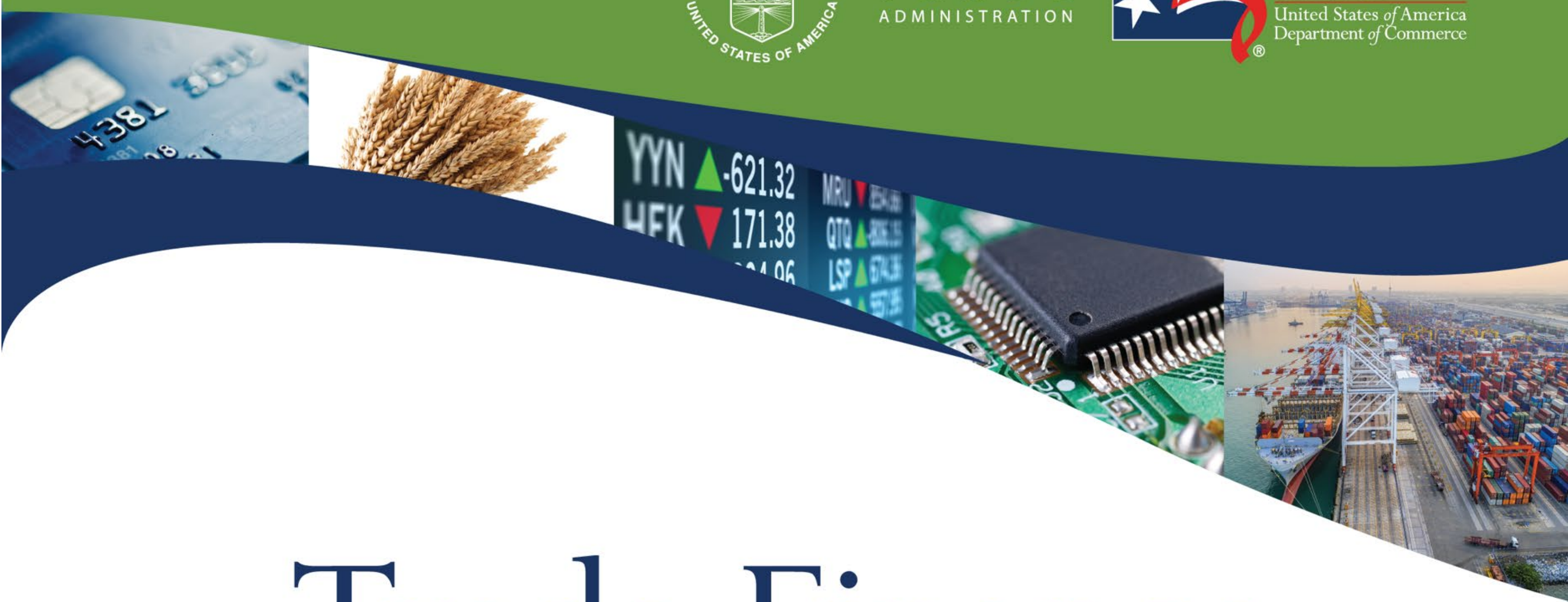
U.S. Department of Commerce
International Trade Administration

INTERNATIONAL TRADE ADMINISTRATION

U.S. COMMERCIAL SERVICE
United States of America Department of Commerce



Trade Finance Guide

A Quick Reference for U.S. Exporters

2022

Table of Contents

Published July 2022

The International Trade Administration's mission is to create prosperity by strengthening the international competitiveness of U.S. industry, promoting trade and investment, and ensuring fair trade and compliance with trade laws and agreements. To learn more about ITA, contact the Office of Public Affairs at publicaffairs@trade.gov or (202) 482-3809 or visit www.trade.gov.

Acknowledgments

The International Trade Administration (ITA) of the U.S. Department of Commerce would like to acknowledge and extend sincere appreciation to the following organizations for their support and contributions in making the 2022 edition of *The Trade Finance Guide* possible.

- **Private Sector Organizations**:
  - **BAFT:** Bankers Association for Finance and Trade
  - **FCIB:** Finance, Credit, and International Business Association
  - **ICTF:** Association of International Credit & Trade Finance Professionals
  - **IFA:** International Factoring Association
  - **ITFA:** International Trade and Forfaiting Association – Americas Regional Chapter
  - **NASBITE:** NASBITE International
  - **Thunderbird:** Thunderbird School of Global Management at Arizona State University
- **U.S. Government Export Finance Agencies**:
  - **EXIM:** Export-Import Bank of the United States – Office of Small Business
  - **SBA:** U.S. Small Business Administration – Office of International Trade
  - **USDA:** U.S. Department of Agriculture – Foreign Agricultural Service's Credit Programs Division

Special acknowledgements go to the following experts and professionals who provided valuable input and assistance in updating *The Trade Finance Guide*: BAFT Secretary/Treasurer Amy Sahm; former BAFT Innovation Council Co-Chair Alisa DiCaprio; BAFT Member Louis Tierno; BAFT Senior Vice President of Trade Scott Stevenson; FCIB Membership Relations Director David Anderson; FCIB/NACM Editor in Chief Diana Mota; FCIB Membership & Business Development Director Ron Shepherd; FCIB Online Course Instructor Valerie Venable; ICTF President Aneta Spilman; ICTF Member Buddy Baker; ICTF Business Development Manager Marta Chacon; IFA Executive Director Tania Daniel; IFA Co-Counsel Michael Ullman; IFA Co-Counsel Jared Ullman; ITFA Americas Chair Lynn Galkoski; ITFA Americas Board Member Harpreet Mann; ITFA Member Gregory Bernardi; ITFA Member Brendan Herley; NASBITE President Jackie Rasmussen; NASBITE Vice President Gabriel Shweiri; NASBITE Secretary/Treasurer Mike Seibert; NASBITE Board Member Tammy Marquez-Oldham; NASBITE Board Member Jim Foley; NASBITE Board Member Leroy Lowe; Thunderbird Senior Associate Dean & Finance Professor Lena Booth; EXIM Vice President for Education & Outreach Elizabeth Thomas; EXIM Business Development Specialist Jane Lemons; EXIM Vice President for Business Credit Insurance Steve Freshour; EXIM Commercial Account Manager Ursula Wegrzynowicz; EXIM Public Affairs Specialist Courteney Bush; EXIM Senior Loan Officer Jacob Bakst; SBA National Director of Trade Finance Daniel Pische; SBA Export Finance Director, North, Patrick Hayes; and USDA Agricultural Marketing Specialist Maria Dorsett.

Credit for developing a new "startups" chapter goes to NASBITE Secretary/Treasurer Mike Seibert, who is the Statewide Programs & Services Director at the North Carolina Small Business & Technology Development Center. And credit for developing a new "digitalization" chapter goes to former BAFT Innovation Council Co-Chair Alisa DiCaprio, who is the Chief Economist at R3 in New York City, and John Harkness, an international trade specialist in ITA's Office of Finance & Insurance Industries (OFII).

Deep gratitude is expressed to ITA's Web Content Manager Amanda Draper for developing a new webpage for *The Trade Finance Guide*.

Sincere appreciation is extended to ITA's Graphic Design Team Members Jan Guastaferro and Marcus Johnson for assisting with the art and design work for the 2022 edition of *The Trade Finance Guide*.

Finally, a special thanks to Erik Lenz, ITA/OFII's Banking, Trade & Project Finance Team Leader, for making a significant editorial contribution to the 2022 edition of *The Trade Finance Guide*.

Yuki Fujiyama, Author & Project Manager
Washington, D.C. • 2022

Introduction

Opportunities, Risks, and Trade Finance

Welcome to the 2022 edition of *The Trade Finance Guide: A Quick Reference for U.S. Exporters*. This online guide explains the basics of trade finance so that U.S. companies, especially small- and medium-sized enterprises (SMEs), can evaluate appropriate financing options to help ensure they get paid for their export sales. This update of *The Trade Finance Guide* supports the Administration's initiative to expand the number and diversity of U.S. businesses competing in global markets as outlined in the federal inter-agency Trade Promotion Coordinating Committee's *2022 National Export Strategy*. The updated *Guide* includes a new chapter addressing the recent surge in business startups and potential sources of capital that can help these new companies consider exporting and compete in niche markets globally. You will also find information on how digitalization is helping to transform trade finance, with the prospect of increasing access, streamlining processes, and reducing costs. We have also included introductions to each of the three U.S. government export finance agencies in their respective chapters and have updated other chapters, as appropriate, in collaboration with experts from relevant fields. We will be continuously updating the online *Trade Finance Guide* on an as-needed basis, with a revised PDF (Portable Document Format) version available for download on an annual basis.

A Quick Glance

Trade Finance Guide: A concise and easy-to-understand guide that explains the basics of trade finance so that U.S. exporters can evaluate financing options to help ensure they get paid for their export sales.

Trade Finance: A set of techniques or financial instruments used to mitigate the risks inherent in international trade to ensure payment to exporters while assuring the delivery of goods and services to importers.

Opportunities: (1) Reaching the 95 percent of potential customers who live outside the United States; (2) Diversifying customer portfolios.

Challenges: (1) Non-payment or delayed payment by foreign buyers; (2) Country, commercial, and foreign exchange risks as well as cultural influences.

Benefits of Exporting

The United States is the world's second largest exporter, with $2.5 trillion in goods and services exports in 2021, according to the U.S. Census Bureau and the U.S. Bureau of Economic Analysis. However, less than one percent of America's 32 million companies export; and of those do, about 60 percent sell to just one or two markets—Canada and Mexico, for example. And SMEs, which account for 98 percent of the nearly 280,000 American exporters, are even less likely to export to more than one market. With 95 percent of the world's consumers living outside of the United States, beginning to export-- or expanding to additional export markets—can help SMEs expand their sales, diversify their portfolios, and insulate them against periods of slower growth in the domestic economy.

Trade Finance

Trade finance is a set of techniques or financial instruments used to mitigate the risks inherent in international trade to ensure payment to exporters while assuring the delivery of goods and services to importers. In other words, trade finance is a means to turn cross-border trade opportunities into real transactions by effectively managing the competing risks as well as the inherent risks facing both exporters and importers. The WTO estimates that trade finance plays a key role in facilitating and supporting as much as 80 to 90 percent of international trade. However, the availability of trade finance and the risk of non-payment are among the most often cited obstacles by U.S. SMEs considering selling in global markets.

Types of Risks Facing Exporters

Below are the major types of risks facing exporters.

- **Country risk** is the risk of exposure to financial loss caused by political, economic, and social conditions and events in a foreign country.
- **Commercial risk** is the risk of non- and delayed payment caused by the importer's insolvency or cash-flow problems.
- **Foreign exchange risk** is the risk of exposure to financial loss due to the fluctuation of an exchange rate change when trading with countries that have a different currency.
- **Cultural influences** are an additional risk factor that can negatively affect all aspects of international business.

Trade Finance Providers

Below are the three major types of U.S. trade finance providers.

- **Commercial and corporate banks** offer a relatively low cost of finance to exporters by taking deposits, compared to non-bank lenders. In general, commercial banks service a wider range of SMEs, whereas corporate banks service large corporations. Because banks are tightly regulated, they are less flexible and slow in making a lending decision.
- **Alternative finance providers (AFPs)** have been leveraging new technologies to try to fill a SME lending service gap created by traditional banks after the 2008 global financial crisis. Because AFPs do not take deposits but obtain funding from public markets and private investments, the cost of finance they offer can be higher than a bank. However, since AFPs are generally lightly regulated or unregulated, they are more flexible in serving SMEs with faster processes driven by technology.
- **U.S. government export finance agencies** provide financing to support U.S. exports and jobs when private-sector lenders are unable or unwilling to assume commercial and country risks. These agencies include: (1) Export-Import Bank of the United States; (2) U.S. Small Business Administration; and (3) U.S. Department of Agriculture's Commodity Credit Corporation.

International Trade Administration

The Trade Finance Guide is developed and published by the International Trade Administration (ITA) of the U.S. Department of Commerce. ITA strengthens the competitiveness of U.S. industry, promotes trade and investment, and ensures fair trade through the rigorous enforcement of our trade laws and agreements. ITA is organized into three distinct but complementary business units: (1) *Global Markets (GM)*; (2) *Industry and Analysis (I&A)*; and (3) *Enforcement and Compliance (E&C)*. *GM* combines ITA's country and regional experts, a network of 100 U.S. Commercial Service offices nationwide and in more than 75 countries, and specific trade promotion programs to provide U.S. firms with the full suite of country-specific export promotion services and market access advocacy, while promoting the United States as an investment destination. *I&A* brings together ITA's industry, trade, and economic experts to advance the competitiveness of U.S. industries through the development and execution of international trade and investment policies and promotion strategies. *E&C* enhances ITA's responsibilities to enforce U.S. trade laws and ensure compliance with trade agreements negotiated on behalf of U.S. industry.

For More Information

For more information about *The Trade Finance Guide*, contact, via email at yuki.fujiyama@trade.gov, the author and project manager of the *Guide*, Yuki Fujiyama in ITA/I&A's Office of Finance and Insurance Industries.

Chapter 1
Access to Capital for Startups in Global Markets

The United States has witnessed a surge in new business startups over the past few years despite the global health pandemic and an economic downturn. According to U.S. Census Bureau data on the number of new business applications reported, American startups grew from 3.5 million in 2019 to 4.4 million in 2020, an impressive 24 percent increase[1]. As a critical part of the backbone of the American economy, startups create jobs, spur innovation, and foster the entrepreneurial spirit. The main strength of startups is flexibility and creativity because of their ability to shift gears constantly to adapt to the changing needs of markets and customers. New businesses also offer fast growth potential and high return on invested capital for results-driven global-minded entrepreneurs. With the advancement of information technology, startups today can easily reach the 95 percent of the world's customers who live outside of the United States. Thus, startups are well-positioned to compete and succeed in niche markets globally. Nevertheless, many talented and innovative entrepreneurs face serious challenges in launching a startup due to lack of access to capital. In addition, startups often struggle in the early stages of business development because their lack of operating history can make it difficult to obtain a business loan.

A Quick Glance

Startups in Global Markets: A startup is a new business that aims to sell a unique product or service in niche markets both at home and abroad.

Startup Capital: Startup capital, also referred to as seed money, is money raised by an entrepreneur or an organization to launch and run a new business from the ground up.

Opportunities: (1) Potential for succeeding in niche markets globally; (2) Fast growth potential and high return on invested capital.

Challenges: (1) Lack of access to capital is often cited as one of the primary barriers facing entrepreneurs in launching a new business; (2) Obtaining a business loan is also challenging for early-stage startups due to lack of operating history.

Key Points

- American startups, with their flexibility and creativity combined with the utilization of modern information technology, are well-positioned to compete and succeed in niche markets both in the United States and internationally.
- Exporting enables American startups to reach the 95 percent of the world's customers who live outside of the United States, diversify their customer bases, and protect them against periodic domestic economic downturns.
- Without access to capital, even the talented and innovative entrepreneurs face serious challenges in launching a new business and keeping it going long enough to start making a profit.
- There are four major sources of capital for American startups: (1) Personal Assets, (2) Debt Financing, (3) Equity Financing, and (4) Government Programs. The details will be discussed in the next section of this chapter.

Potential Sources of Capital for American Startups

Source 1: Personal assets must be considered as the first source of capital because most commercial lenders do not offer financing for a startup enterprise with no track record on which the business can be judged.

- **Pro:** The entrepreneur can retain complete control over the business by leveraging personal financial resources.
- **Con:** The entrepreneur must assume all the financial risk.

[1] (1) https://www.piie.com/blogs/realtime-economic-issues-watch/startups-boom-united-states-during-covid-19; (2) https://www.census.gov/econ/bfs/data.html

- **Personal Savings:** Cash, cash equivalents, and liquid investments held in non-retirement accounts.
- **Home Equity:** Cash from refinancing, home equity loans, and home equity lines of credit.
- **Retirement Accounts:** 401(k) loans as well as 401(k) and IRA distributions, which are subject to tax and possibly penalty.

Source 2: Debt financing is a method of raising capital for a business by borrowing money from an external source that must be paid back with interest over time.

➢ **Pro:** The entrepreneur retains business ownership while minimizing the cost of financing, which is generally far less than the return that an equity investor will require.
➢ **Con:** The entrepreneur is generally required to provide a personal guarantee and/or collateral that can be used to assure repayment of the loan, even if the business fails.

- **Family and Friends:** Financial support may be available from relatives and friends in exchange for signing a legal promissory note with agreed upon interest and repayment terms.
- **Credit Cards and Short-Term Loans:** Unsecured credit cards provide a quick revolving line of credit while unsecured short-term loans provide a fixed lump sum of money repayable in fixed payments over a set period of time.
- **Asset-Backed Loans:** Financing may be available based on the value of the company's equipment, inventory, or accounts receivable, thereby using the borrower's assets as collateral.

Source 3: Equity financing is a method of raising capital for a business by selling ownership shares (equity) to investors such as venture capital firms or angel investors.

➢ **Pro:** The entrepreneur obtains capital on a permanent basis with no requirement of repayment of principal or interest while increasing the company's net worth, hence improving its ability for other debt financing.
➢ **Con:** The entrepreneur faces a higher cost of capital compared to debt financing, while diluting ownership control of the business with shared profits.

- **Crowdfunding:** The practice of funding a project or venture by raising small amounts of money from a large number of people, typically via the Internet. Crowdfunding can be either (1) donation-based or (2) investment-based.
- **Angel Investors:** Wealthy private investors who use their own net worth to provide capital for startups and early-stage businesses in exchange for convertible debt or ownership equity.
- **Venture Capital:** A form of financing provided by firms or funds to startups or small businesses with high growth potential, in exchange for equity or an ownership stake.

Source 4: Government programs that may be of beneficial to American entrepreneurs aspiring to succeed in global niche markets are offered by the U.S. Small Business Administration (SBA) and potentially by state and local economic development organizations.

➢ **Pro:** The entrepreneur may qualify for an SBA loan targeted to startups and seek a grant that generally requires no repayment of principal or interest.
➢ **Con:** The entrepreneur may need more than the maximum SBA loan amount and government grants given to startups are rare.

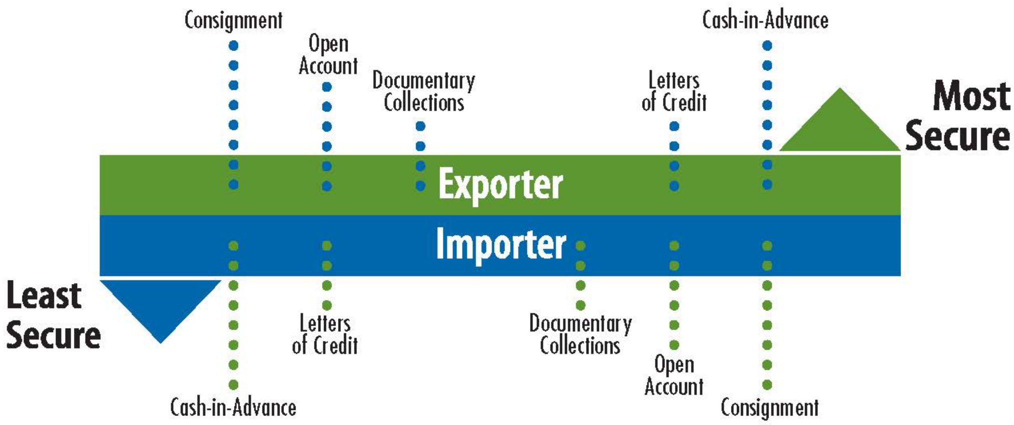
- **SBA Microloan:** Smaller-scale loans targeted specifically to startups, as well as existing small businesses, seeking to borrow from under $500 to up to $50,000.
- **SBA State Trade Expansion Program (STEP):** U.S. small businesses can overcome obstacles to exporting through STEP grants that cover the costs associated with entering and expanding into international markets.
- **State and Local Grants:** Special grants targeted to startups may be available from state and local governments.

Chapter 2

Methods of Payment in International Trade

To succeed in today's global marketplace and win sales against foreign competitors, exporters must offer their customers attractive sales terms supported by the appropriate payment methods. Because getting paid in full and on time is the ultimate 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 in the below *Payment Risk Diagram*, there are five primary methods of payment for international transactions. During or before contract negotiations, you should consider as an exporter which payment method is mutually desirable for you and the importer. In addition, the exporter should become familiar with shipping documents that are required by the importer to take possession of goods upon shipment arrival at the destination country. Examples of such documents include a commercial invoice, a packing and/or weight certificate, an insurance certificate, a certificate of origin and bills of lading. No matter which payment method is used, the exporter and importer must understand what shipping documents will be required to avoid potential problems with their transaction.

Payment Risk Diagram



Key Points

- International trade presents a spectrum of risk, which causes uncertainty over the timing of payments between the exporter (seller) and importer (foreign buyer).
- For exporters, any sale is a gift until payment is received.
- Therefore, exporters want to receive payment as soon as possible, preferably as soon as an order is placed or before the goods are sent to the importer.
- For importers, any payment is a donation until the goods are received.
- Therefore, importers want 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 pay the exporter.
- No matter which payment method is used, the exporter must understand what shipping documents will be required by the importer to take possession of goods upon shipment arrival at the destination country.

Cash-in-Advance

With cash-in-advance payment terms, an exporter can avoid credit risk because payment is received before the goods are shipped. For international sales, wire transfers and credit cards are the most commonly used cash-in-advance options available to exporters. Cross-border escrow services may be a cash-in-advance alternative for exporters and their importers who demand assurance that the goods will be sent in exchange for advance payment. However, requiring payment in advance is the least attractive option for the importer because it creates unfavorable cash flow for their business. Importers are also concerned that the goods may not be sent if payment is made in advance. Thus, exporters who insist on this payment method as their sole manner of doing business may lose to competitors who offer more attractive payment terms.

Letters of Credit

Letters of credit (LCs) are one of the most secure instruments available to international traders. An LC is a commitment by a bank on behalf of the importer that payment will be made to the exporter, provided that the terms and conditions stated in the LC have been met, as verified through the presentation of all required documents. The importer establishes credit and pays their bank to render this service. An LC is useful when reliable credit information about an importer is difficult to obtain, but the exporter is satisfied with the creditworthiness of the importer's bank and, if not, the exporter can ask for the LC to be confirmed by a second bank is satisfied with. An LC also protects the importer since no payment obligation arises until documents evidencing that the goods have been shipped as promised are presented.

Documentary Collections

A documentary collection (D/C) is a transaction whereby the exporter entrusts the collection of the payment for a sale to the exporter's bank, which sends the required shipping documents to the importer's bank, with instructions to release the documents to the importer in exchange for payment or the importer's signed promise to pay on a specified future date. Funds are received from the importer and remitted to the exporter through the banks involved in the collection. D/Cs involve using a draft that requires the importer to pay the face amount either at sight or on a specified date. Although banks do act as facilitators for their clients, D/Cs offer no verification process and limited recourse in the event of non-payment. D/Cs are generally less expensive than LCs.

Open Account

An open account transaction is a sale where the goods are shipped and delivered before payment is due, which in international sales is typically in 30, 60 or 90 days. Obviously, this is one of the most advantageous options to the importer in terms of cash flow and cost, but it is consequently one of the highest risk options for an exporter. Because of intense competition in export markets, importers 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 lose sales to their competitors. Exporters can offer competitive open account terms while substantially mitigating the risk of non-payment by using one or more of the appropriate trade finance techniques covered later in this Guide.

Consignment

Consignment in international trade is a variation of open account in which payment is sent to the exporter only after the goods have been sold by the foreign distributor to the end customer. An international consignment transaction is based on a contractual arrangement in which the foreign distributor receives, manages, and sells the goods for the exporter who retains title to the goods until they are sold. Clearly, exporting on consignment is very risky as the exporter is not guaranteed any payment and its goods are in a foreign country in the hands of an independent distributor or agent. However, consignment helps exporters become more competitive on the basis of better availability and faster delivery of goods. Selling on consignment can also help exporters outsource the burden of storing and managing inventory. The key to success in exporting on consignment is to partner with a reputable and trustworthy foreign distributor or a third-party logistics provider. Appropriate insurance should be in place to cover consigned goods in transit or in possession of a foreign distributor as well as to mitigate potential financial losses. In addition, all details should be spelled out in the contract, and be enforceable in the country of both exporter and importer.

Chapter 3
Cash-in-Advance

With the cash-in-advance payment method, the exporter can eliminate credit risk or the risk of non-payment since payment is received before the goods are shipped. For international sales, wire transfers are the most secure and commonly used cash-in-advance option available to exporters. For small international consumer transactions, credit cards are a viable cash-in-advance option. Advance payment by check is a less attractive option for exporters because of the potentially lengthy and complicated collection process. For exporters and their importers who demand assurance that the goods will be sent in exchange for advance payment, cross-border escrow services may be a mutually agreeable cash-in-advance alternative. However, cash-in-advance is the least attractive option for the importer because it tends to create cash-flow problems for their business. Importers are also concerned that the goods may not be sent if payment is made in advance. Moreover, cash-in-advance is not often a competitive option for the exporter especially when the importer has other vendors to choose from. Thus, exporters who insist on cash-in-advance as their sole payment method for doing business may lose out to competitors who are willing to offer more attractive payment terms.

Characteristics of Cash-in-Advance

Applicability: Recommended for use in high-risk trade relationships or export markets, and appropriate for small export transactions.

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

Pros: (1) Payment before shipment and improved cash flow; (2) Eliminates risk of non-payment.

Cons: (1) May lose customers to competitors over payment terms; (2) No additional earnings through financing operations.

Key Points

- Full or significant partial payment is required, usually via credit card or wire transfer before the goods are shipped.
- Cash-in-advance, especially a wire transfer, is the most secure and least risky method of international trading for exporters and, consequently, the least secure and most unattractive method for importers.
- Credit cards are a viable cash-in-advance option, especially for small consumer transactions.
- Payment by check is a less attractive cash-in-advance option because the collection process can be lengthy and complicated.
- Exporters may pursue cross-border escrow services as a mutually agreeable cash-in-advance alternative for transactions with importers who demand assurance that the goods will be sent in exchange for advance payment.
- Insisting on cash-in-advance could, ultimately, cause exporters to lose customers to competitors who are willing to offer more favorable payment terms.
- Creditworthy importers, who prefer greater security and better cash utilization, may find cash-in-advance unacceptable and simply walk away from the deal.

Wire Transfer: Most Secure and Preferred Cash-in-Advance Method

International wire transfers are common and almost immediate. Exporters should provide clear routing instructions to the importer when using this method, including the receiving bank's name and address, SWIFT (Society for Worldwide Interbank Financial Telecommunication) address, and ABA (American Bankers Association) number, as well as the seller's name and address, bank account title, and account number. The fees for an international wire transfer can be paid by the sender or they will be taken by the banks as deductions from the amount sent.

Credit Card: A Viable Cash-in-Advance Method

Exporters who sell directly to foreign customers may select credit cards as a viable cash-in-advance option, especially for small consumer transactions. Exporters should check with their credit card companies for specific rules on international use of credit cards because not all banks will accept cross-border credit card payments from all countries, and the rules governing international credit card transactions differ from those for domestic use. In addition, exporters may face significant fees, depending on size of the transaction and the countries involved. Furthermore, because international credit card transactions are typically placed using the Web, telephone, or fax, which facilitate fraudulent transactions, proper precautions should be taken to determine the validity of transactions before the goods are shipped. Although exporters must absorb the fees charged by credit card companies and take the risk of unfounded disputes, credit cards may help business grow because of their convenience.

Payment by Check: A Less-Attractive Cash-in-Advance Method

Advance payment by check mailed to the exporter 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 and drawn on a U.S. bank, the collection process is the same as for any U.S. check. However, as with domestic checks, funds deposited by non-local checks, especially those totaling more than $5,525 on any one day, may not become available for withdrawal for up to nine business days under Regulation CC of the Federal Reserve (12 CFR § 229.13(a)(1)(ii)). In addition, if the check is in a foreign currency or drawn on a foreign bank, the collection process can become more complicated and can significantly delay the availability of funds. Moreover, if shipment is made before the check is collected, there is a risk that the check may be returned due to insufficient funds in the buyer's account or even because of a stop-payment order.

Cross-border Escrow Service: A Mutually Agreeable Cash-in-Advance Alternative

Exporters may pursue cross-border escrow services as a mutually agreeable cash-in-advance alternative for small transactions with importers who demand assurance that the goods will be sent in exchange for advance payment. Escrow in international trade is a service that allows both exporter and importer to protect a transaction by placing the funds in the hands of a trusted third party until a specified set of conditions is met. Here's how it works: the importer sends the agreed amount to the cross-border escrow service provider. After payment is verified, the exporter is instructed to ship the goods. Upon delivery, the importer has a pre-determined amount of time to inspect and accept the goods. Once accepted, the funds are released by the cross-border escrow service provider to the exporter. The importer, if not satisfied with the goods, must return the goods in a satisfactory condition to the exporter in order to obtain a refund from the escrow agent. The cost can either be paid in full by one party or split evenly between the exporter and the importer. In the United States, cross-border escrow services are mostly offered by a small set of Internet-based non-bank financial services providers.

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 acceptance of credit card payments is a must to remain competitive.

Chapter 4
Letters of Credit

Letters of credit (LCs) are one of the most versatile and secure instruments available to international traders. An LC is a commitment by a bank on behalf of the applicant (importer) that payment will be made to the beneficiary (exporter) provided that the terms and conditions stated in the LC have been met, as evidenced by the presentation of specified documents. Since LCs are credit instruments, the importer's credit with their bank is used to obtain an LC. The importer pays their bank a fee to render this service. An LC is useful when reliable credit information about an importer is difficult to obtain or when the importer's credit is unacceptable, but the exporter is satisfied with the creditworthiness of the importer's bank. This method also protects the importer since the documents required to trigger payment provide evidence that goods have been shipped as agreed. However, because LCs have opportunities for discrepancies, which may negate payment to the exporter, documents should be prepared by trained professionals or outsourced.

Characteristics of a Letter of Credit

Applicability: Recommended for use in higher risk situations or new or less-established trade relationships when the exporter is satisfied with the creditworthiness of the importer's bank.

Risk: Risk is spread between exporter and importer, provided that all terms and conditions as specified in the LC are adhered to.

Pros: (1) Payment made after shipment; (2) A variety of payment, financing, and risk mitigation options available to receive payment quickly after shipment.

Cons: (1) Labor intensive process; (2) Relatively expensive method in terms of transaction costs.

Key Points

- An LC, also referred to as a documentary credit, is a contractual agreement whereby the issuing bank (importer's bank), acting on behalf of its customer (the applicant or importer), promises to make payment to the beneficiary or exporter against the receipt of "complying" stipulated shipping documents. The issuing bank will typically use intermediary banks to facilitate the transaction and make payment to the exporter.
- The LC is a separate contract from the sales contract on which it is based; therefore, the banks are not concerned with determining the quality of underlying goods or whether each party fulfills the terms of the sales contract.
- The bank's obligation to pay is solely conditioned upon the compliance of the exporter's documents with the terms and conditions of the LC. In LC transactions, banks deal in documents only, not goods.
- LCs can be arranged easily for one-time transactions between the exporter and importer or used for an ongoing series of transactions.
- Unless the conditions of the LC state otherwise, it is always irrevocable, which means the document may not be changed or cancelled unless the importer, banks, and exporter agree.

Confirmed Letter of Credit

The exporter can obtain a greater degree of protection when an LC issued by a foreign bank (the importer's issuing bank) is confirmed by a second bank (this bank is typically the advising bank, which then becomes the confirming bank). The exporter can do so by asking the importer to have the issuing bank authorize a bank in the exporter's country to add its confirmation to an LC. Confirmation means that the second bank adds its engagement to pay the exporter to that of the foreign bank. In other words, once the exporter presents the required shipping documents that strictly comply with the terms and conditions of the LC, the confirming bank will pay the exporter prior to receiving reimbursement by the issuing bank. If an LC is not confirmed, payment is made to the exporter only after the shipping documents are presented to the issuing bank. In this case, the exporter is subject to the payment risk of the foreign bank and the political risk of the importing country.

When to Consider Using Confirmed Letters of Credit

Exporters should consider using confirmed 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. Exporters should also consider using confirmed LCs when importers ask–for extended payment terms. Besides reducing risks, confirmation facilitates financing if the exporter desires payment prior to the due date.

Illustrative Letter of Credit Transaction

1. The importer applies for an LC to a local bank, which evaluates the importer's creditworthiness.
2. The importer's bank opens an LC in favor of the exporter.
3. The importer's bank transmits the LC to the exporter's bank for forwarding to the exporter.
4. The exporter forwards the goods and documents to a freight forwarder.
5. The freight forwarder dispatches the goods and either it or the exporter presents the documents required by the LC to the exporter's bank.
6. The exporter's bank checks documents for compliance with the LC and collects payment from the importer's bank for the exporter.
7. The importer's bank debits the payment for the goods from the importer's account.
8. The importer's bank releases documents to the importer to claim the goods from the carrier and to clear them at customs.

Key Letter of Credit Terminology

Below is terminology that helps understand who the key participants are in an LC transaction.

- **Applicant:** Importer (foreign buyer)
- **Beneficiary:** Exporter (seller)
- **Issuing Bank:** Importer's bank which opens the LC in favor of the exporter.
- **Nominated Bank:** Exporter's bank that facilitates the eventual payment from the importer's bank.
- **Advising Bank:** Exporter's bank that informs of the opening of the LC and verifies its authenticity.
- **Confirming Bank:** Exporter's bank that adds its own guarantee to pay if the importer's bank fails to do so.
- **Exporter's Banks:** Generally, the exporter will ask that their own bank be used by the importer's bank as (1) advising bank and (2) confirming bank. The advising bank is normally also given the nominated bank's role.

Special Letters of Credit

LCs can take many forms. When an LC is made 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 each time it is drawn down. A standby LC is an LC that is not intended to serve as the means of payment for goods but can be drawn in the event of a contractual default, including the failure of an importer to pay invoices when due. Standby LCs are often posted by exporters in favor of importers as well because they can serve as bid bonds, performance bonds, and advance payment guarantees.

Chapter 5
Documentary Collections

A documentary collection (D/C) is a transaction whereby the exporter entrusts the collection of payment to the exporter's bank (remitting bank), which sends documents to the importer's bank (collecting or presenting bank), along with payment and document release instructions. Funds received from the importer are remitted to the exporter through the banks in exchange for those documents. D/Cs involve using a bill of exchange (commonly known as a draft) that serves as a legal demand for the importer either to pay the face amount immediately or at sight (called "documents against payment" or "cash against documents") or to sign a promise to pay the draft on a specified future date (called "documents against acceptance" or "cash against acceptance"). The collection cover letter gives instructions that specify the documents required for the delivery of the goods to the importer. Although banks do act as facilitators for their clients under D/C transactions, D/Cs offer no verification process and limited recourse in the event of non-payment beyond return of the documents or the accepted draft. D/Cs are generally less expensive than letters of credit (LCs).

Characteristics of a Documentary Collection

Applicability: Recommended for use in established trade relationships, in stable export markets and only for transactions involving ocean shipments where documents control delivery of the goods.

Risk: Riskier for the exporter, though D/C terms are more convenient and cheaper than an LC to the importer.

Pros: (1) Bank assistance in obtaining payment; (2) The process is simple, fast, and less costly than LCs.
Cons: (1) Banks' role is limited, and they do not guarantee payment; (2) Not appropriate for air shipments or straight consigned ocean shipments.

Key Points

- Because D/Cs provide less security for exporters, they are less complicated and less expensive than LCs.
- Under a D/C transaction, the importer is not obligated to pay for goods before shipment.
- If structured properly, the exporter retains control over the goods until the importer either pays the draft amount at sight or accepts the draft and thereby incurs a legal obligation to pay at a specified later date.
- Under a D/C transaction, the goods can be controlled for ocean shipments, but they are more difficult to control for air and overland shipments.
- D/C transactions involving air and overland shipments allow the importer to receive the goods without payment or receiving any documents held by the exporter, unless the exporter employs agents in the importing country to take delivery until goods are paid for.
- The exporter's bank and the importer's bank play an essential role in D/Cs.
- Although the banks control the flow of documents, they neither verify the documents nor take any risks. They can, however, influence the mutually satisfactory settlement of a D/C transaction, given that refusal by the importer to pay will reflect on their reputation with their bank.

When to Use Documentary Collections

With D/Cs, the exporter has little recourse against the importer in case of non-payment. Thus, D/Cs should be used only under the following conditions:

- The exporter and importer have a well-established relationship.
- The exporter is confident that the importing country is politically and economically stable.
- An open account sale is considered too risky, and an LC is unacceptable to the importer.
- The importer is unable to take delivery of the goods without documents, such as an ocean bill of lading, controlled by the exporter.

Typical Simplified Documentary Collection Transaction Flow

1. The exporter ships the goods to the importer and receives the documents from the contracted shipper.
2. The exporter compiles and presents the documents to their bank with payment and document release instructions.
3. The exporter's remitting bank sends the documents to the importer's collecting or presenting bank.
4. The collecting bank releases the documents to the importer on receipt of payment or acceptance of the draft.
5. The importer uses the documents to obtain the goods and to clear them at customs.
6. Once the collecting bank receives payment, it forwards the proceeds to the remitting bank.
7. The remitting bank then credits the exporter's account.

Two Types of Documentary Collections

There are two types of D/Cs. The first type is called "documents against payment" (D/P), an arrangement in which an importer receives the documents required to obtain the goods only against payment. The second type is called "documents against acceptance" (D/A), an arrangement in which an importer receives the documents required to obtain the goods by signing a promise to pay the draft on a specified future date.

Documents against Payment (D/P) Collection

With a D/P collection, the exporter ships the goods and then gives the documents to their bank, which will forward the documents to the importer's bank, along with instructions on how to collect the money from the importer. In this arrangement, the importer's bank releases the documents to the importer only upon payment for the goods. Once payment is received, the importer's bank transmits the funds to the exporter's bank for payment to the exporter. Below is an overview summary of a D/P collection:

- **Time of Payment:** After shipment, but before documents are released.
- **Transfer of Goods:** After payment is made at sight.
- **Exporter Risk:** If the draft is unpaid, arrangements may need to be made to have the goods disposed of or returned or delivered to someone else in the importer's country.

Documents against Acceptance (D/A) Collection

With a D/A collection, the exporter extends credit to the importer by using a time draft. The documents are released to the importer to claim the goods upon their signed acceptance of the time draft. By accepting the draft, the importer becomes legally obligated to pay at a specific date. At maturity, the importer's bank contacts the importer for payment. Upon receipt of payment, the importer's bank transmits the funds to the exporter's bank for payment to the exporter. Below is an overview summary of a D/A collection:

- **Time of Payment:** On maturity of draft at a specified future date.
- **Transfer of Goods:** Before payment, but upon acceptance of draft.
- **Exporter Risk:** No control over goods after acceptance and payment is not assured at due date. If the draft is not accepted to begin with, arrangements may need to be made to have the goods disposed of or returned or delivered to someone else in the importer's country.

Chapter 6
Open Account

An open account transaction in international trade is a sale where the goods are shipped before payment is due, which is typically in 30, 60 or 90 days. Obviously, this option is advantageous to the importer in terms of cash flow and cost, but it is consequently a risky option for an exporter. Because of intense competition in export markets, foreign buyers often press exporters for open account terms, if possible, denominated in their local currency. 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 lose sales to their competitors. However, while open account terms will 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. Exporters can substantially mitigate the risk of non-payment associated with open account trade by using trade finance techniques such as export credit insurance, factoring and standby letters of credit. Exporters may need to obtain export working capital financing to reduce the burden on cash flow caused by granting extended terms.

Characteristics of an Open Account Transaction

Applicability: Recommended for use (a) in low-risk trading relationships or markets and (b) in competitive markets to win customers with the use of one or more appropriate trade finance techniques.

Risk: Substantial risk to the exporter because the buyer could obtain the goods and default on payment.

Pros: (1) Boosts competitiveness in global markets; (2) Helps establish and develop successful trade relationships.

Cons: (1) Significant exposure to the risk of non-payment; (2) Additional costs associated with risk mitigation measures and financing.

Key Points

- The goods, along with the necessary documents, are shipped directly to the importer who has agreed to pay the exporter's invoice at a specified date, which is usually in 30, 60 or 90 days.
- The exporter should be confident that the importer will accept shipment and pay at the agreed time and that the importing country is commercially and politically secure.
- Open account terms may help win customers in competitive global markets with the use of one or more of the following trade finance techniques: (a) export working capital financing, (b) export credit insurance, (c) export factoring, and (d) standby letters of credit.
- Open account terms may also be offered to importers who demand to pay in their local currency with the use of a proper foreign exchange risk hedging technique, such as forward contracts.

Export Working Capital Financing

Exporters who lack sufficient funds to extend open account terms in global markets need export working capital (EWC) financing that covers the entire cash cycle, from the purchase of raw materials through the ultimate collection of the sales proceeds. EWC financing can be structured to support export sales in the form of a loan or a revolving line of credit. Due to the repayment risk associated with export sales, EWC financing for U.S. small and medium-sized enterprises (SMEs) is generally only available through commercial lenders participating in the EWC Guarantee Programs administered by the U.S. Small Business Administration and the Export-Import Bank of the United States.

Export Credit Insurance

Export credit insurance (ECI) provides protection against commercial losses (such as default, insolvency, bankruptcy) and political losses (such as war, nationalization, and currency inconvertibility). ECI allows exporters to increase sales by offering more liberal open account terms to new and existing customers while providing security for banks that are providing working capital and are financing exports. ECI can also be used for sales using documentary collections and even as an alternative to confirmation for sales using letters of credit, but exporters will not likely be allowed to choose to insure only individual transactions—insurance companies normally require "whole turnover" of export sales on a year-to-year basis.

Export Factoring

Factoring in international trade is the discounting of short-term receivables. The exporter transfers title to their short-term foreign accounts receivable to a factoring house, or a "factor," for cash at a discount from the face value. Factoring allows an exporter to ship on open account as the factor assumes the financial liability of the importer to pay and handles collections on the receivables. Factoring houses most commonly work with exports of consumer goods.

Standby Letters of Credit

A standby letter of credit (SBLC) acts as an insurance policy issued by the importer's bank in favor of the exporter in a trade transaction, assuring that payment will be made if the importer fails to pay as agreed. The SBLC is suitable once a regular trade relationship is established between an exporter and importer. Using an SBLC, as a condition for trading on open account terms, greatly improves cash flow for the importer while mitigating the risk of non-payment for the exporter. An exporter can also consider selling on open account terms to an unknown importer with an SBLC issued by a reputable bank in a stable country, which is generally seen as a sign of the importer's good faith as well as a proof of their credit quality and ability to make payment.

Forward Contract

Exporters can use a forward contract to offer open account terms to foreign buyers who demand to pay in their local currency. A forward contract enables the exporter to sell a set amount of foreign currency at a pre-agreed exchange rate with a delivery date in the future (typically three days to one year) to their foreign exchange service provider. This ensures that the U.S. exporter will receive a predetermined payment in U.S. dollars at a future date regardless of fluctuating exchange rates upon receiving payment in foreign currency from the importer. A forward contract does not provide protection against the risk of currency inconvertibility.

Trade Finance Technique Unavailable for Open Account Terms: Forfaiting

Forfaiting is a method of trade financing that allows the exporter to sell their medium and long-term receivables to a forfaiter at a discount, in exchange for cash. The forfaiter assumes all the risks, thereby enabling the exporter to offer extended credit terms and to incorporate the discount into the selling price. Forfaiters usually work with exports of capital goods, commodities, and large projects. Forfaiting was developed in Switzerland in the 1950s to fill the gap between the exporter of capital goods, who would not or could not deal on open account, and the importer, who desired to defer payment until the capital equipment could begin to pay for itself.

Chapter 7
Consignment

Consignment in international trade is a variation of the open account method of payment in which payment is sent to the exporter only after the goods have been sold by the foreign distributor to the end-customer. An international consignment transaction is based on a contractual arrangement in which the foreign distributor receives, manages, and sells the goods for the exporter, who retains title to the goods until they are sold. Payment to the exporter is required only for those items sold. One of the common uses of consignment in exporting is the sale of heavy machinery and equipment, in which the foreign distributor generally needs floor models and inventory for sale. Goods not sold after an agreed upon time period may be returned to the exporter at cost. Consignment is also commonly used around the world for exporting fresh fruits and vegetables. Exporting on consignment is very risky as the exporter is not guaranteed any payment and someone outside the exporter's control has actual possession of its inventory. An additional risk is the lack of ability to reclaim and retrieve goods from the importing or distributing country. However, selling on consignment can provide the exporter some great advantages which may not be obvious at first glance. For example, consignment can help exporters compete on the basis of better availability and faster delivery of goods when they are stored near the end-customer. It can also help exporters outsource the burden of storing and managing inventory, thereby making it possible to reduce costs and keep selling prices in the local market competitive. However, while consignment can definitely enhance export competitiveness, exporters should keep in mind that the key to success in exporting on consignment and in getting paid is to partner with a reputable and trustworthy foreign distributor or a third-party logistics provider.

Characteristics of Consignment

Applicability: Recommended for use in competitive environments to enter new markets and increase sales in partnership with a reliable and trustworthy foreign distributor.

Risk: Significant risk to the exporter because payment is required only after the goods have been sold to the end customer.

Pros: (1) Helps enhance export competitiveness on the basis of greater availability and faster delivery of goods; (2) Outsources the burden of storing and managing inventory to reduce costs and keep selling prices competitive.

Cons: (1) Exporter is not guaranteed payment; (2) Additional costs associated with risk mitigation measures.

Key Points

- Payment is sent to the exporter only after the goods have been sold by the foreign distributor.
- Exporting on consignment can help exporters enter new markets and increase sales in competitive environments on the basis of better availability and faster delivery of goods.
- Consignment can also help exporters outsource the burden of storing and managing inventory, thereby making it possible to reduce costs and keep selling prices in the local market competitive.
- The importing country should be commercially and politically secure.
- Partnership with a reputable and trustworthy foreign distributor or a third-party logistics provider is essential for success.
- Exporters should begin the discussion early with their lender and insurance agency to see what options might be available to support their proposed international consignment sales.

How to Export on Consignment

To succeed in exporting on consignment, the first step is to identify and partner with a third-party logistics provider (3PL) or a reputable and trustworthy foreign distributor based in a market of interest. The next step, prior to signing a consignment agreement, is to consult with your lender and insurance agency as discussed below. A 3PL is a firm that provides logistics services with expertise in pick-up and delivery of shipments for exporters. Both reputable foreign distributors and 3PLs can help exporters reduce costs, mitigate risks, and manage expenses and time factors as well as ensure that the consignment is shipped on the most economical and optimal route.

Financing and Insurance

Exporters who sell internationally on consignment may need (1) working capital financing while waiting for payment from the foreign distributor and (2) export credit insurance (ECI) that covers the risk of non-payment. However, obtaining financing of international consignment transactions is often very challenging when compared to that of standard export transactions. ECI policies that cover consignment sales generally do so only by adding a special rider or endorsement if such optional coverage is even available. Furthermore, appropriate insurance should be obtained to cover consigned goods in transit or in possession of a foreign distributor. Thus, it is best for exporters to begin the discussion early with their lender and insurance agency to see what options might be available to support their proposed international consignment sales.

Examples of Exporting on Consignment

- Example 1: Exporting Equipment on Consignment

  A small U.S. manufacturer of packaging equipment faces challenges in meeting market demand for quick delivery of its products to Asia as well as in reducing the costs of storing and managing overseas inventory to keep prices competitive. The U.S. manufacturer enters a consigned inventory arrangement with a Japanese 3PL who receives and stocks the goods in Japan and sells them to the end customers in Asia. The Japanese 3PL receives a commission for sales made, and then sends net proceeds to the U.S. manufacturer as their goods are sold. The U.S. manufacturer's sales increase substantially because exporting on consignment helps deliver their products faster to the local market and keeps prices competitive due to reduced costs of storing and managing overseas inventory.

- Example 2: Exporting Fresh Produce on Consignment

  A reputable Canadian food distributor approaches a U.S. agriculture company to propose importing U.S. grown fresh fruits on consignment for sale through Canada's major grocery chains. The U.S. company agrees to this consignment arrangement as the Canadian distributor cannot be sure how much of the shipment will be of excellent quality or what the total payment amount will be when imported fresh fruits are through customs and ready for sale throughout Canada. After a customs inspection, the Canadian distributor delivers U.S. grown fresh fruits to the Canadian grocery chains to make sales and collect payments. Upon deducting expenses and a commission, the Canadian distributor remits the remainder of the proceeds to the U.S. company. If part of the shipment is seized or destroyed at customs due to pest or quality issues, the Canadian distributor informs the U.S. company. Exporting on consignment helps increase revenue and profitability for the U.S. company and its produce partners by making quick sales to new foreign customers while avoiding an oversupply of U.S. grown fresh fruits in the domestic market.

Chapter 8
Export Working Capital Financing and Government Guarantees

Export working capital (EWC) financing allows exporters to purchase the goods and services they need to support their export sales. More specifically, EWC financing provides a means for small and medium-sized enterprises (SMEs) that 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 short-term business operational needs in three major areas: (1) materials; (2) labor; and (3) inventory; but they can also be used to finance receivables generated from export sales as well as secure 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 place challenging demands on working capital. EWC financing helps to ease and stabilize the cash flow problems of exporters while fulfilling export sales and extending the appropriate levels of open account terms to foreign buyers. Because EWC financing does not eliminate the risk of non-payment by foreign buyers, risk mitigation is necessary for exporters to safely offer open account terms in global markets. EWC financing is usually secured by the corporate assets, specifically accounts receivable and inventory, and often requires the personal guarantees of ownership. Due to the repayment risk associated with export sales, EWC financing for U.S. SMEs is generally only available through commercial lenders participating in the EWC Guarantee Programs administered by one of the two federal agencies, the U.S. Small Business Administration (SBA) or the Export-Import Bank of the United States (EXIM). By guaranteeing the repayment of loans, both SBA and EXIM encourage commercial lenders to extend otherwise unavailable EWC financing to eligible U.S. SMEs in need of liquidity to help accept new business and compete more effectively in global markets.

Characteristics of an Export Working Capital Facility

Applicability: Used to finance short-term business operational needs in three major areas: (1) materials; (2) labor; and (3) inventory to fulfill a large export sales order or recurring export sales orders as well as extend open account terms.

Risk: Repayment and other risks associated with export sales can prevent lenders from providing the working capital needed to fulfill export orders and offer open account terms.

Pros: (1) Enables fulfillment of export sales orders and extension of open account terms; (2) Empowers borrowing against assets that lenders would otherwise be unwilling to include as collateral.

Cons: (1) Generally available only to SMEs with access to lendable assets or high-value receivables, and a personal guarantee is often required by commercial lenders; (2) Commercial lenders may not offer government guaranteed EWC financing.

Key Points

- An EWC facility can support a single export transaction (transaction-specific loan) or multiple export transactions (revolving line of credit) on open account terms.
- A transaction-specific loan is generally issued for up to one year or a period of time corresponding to a specific export project while a revolving line of credit is generally issued for a one-year period of time but may extend up to three to five years.
- Availability is generally limited to financially-stable large corporations or SMEs with access to strong personal guarantees, lendable assets, or high-value accounts receivable.
- EWC financing for U.S. SMEs is generally only available through commercial lenders participating in loan guarantee programs administered by SBA and EXIM.
- Exporters need risk mitigation to safely offer the appropriate levels of open account terms.

Government Export Working Capital Guarantees

SBA and EXIM provide guarantees for EWC facilities extended by participating lenders to eligible U.S. SME exporters. These government guarantees allow U.S. SME exporters to obtain needed credit facilities from participating lenders when commercial financing is otherwise not available or when their borrowing capacity needs to be increased. Advance rates offered by commercial lenders on export inventory and foreign accounts receivables are generally not sufficient to meet the needs of SME exporters. In addition, some commercial lenders simply do not lend to SME exporters without a government guarantee due to repayment risks associated with export sales.

Necessity of Risk Mitigation

While EWC financing certainly makes it easier 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 non-payment by foreign customers. Thus, risk mitigation is necessary for exporters to safely offer open account terms in global markets and to obtain EWC financing. For example, a lender may require an exporter to obtain export credit insurance on its foreign receivables as a condition of providing working capital and financing for exports. Exporters should also be aware that a government guarantee protects the lender and not the business and thus should not take the place of a risk mitigant.

Where and How to Obtain an Export Working Capital Facility

Many commercial lenders offer EWC facilities guaranteed by SBA or EXIM. To qualify, exporters generally need: (a) to be in business profitably for at least 12 months (not necessarily exporting), (b) to demonstrate a need for financing, and (c) to provide documents to demonstrate that a viable transaction exists. Note that personal guarantees, collateral assets, or high-value accounts receivable are generally required for SMEs to obtain SBA or EXIM guaranteed EWC facilities. The lender will place a lien on the exporter's corporate assets, such as inventory and accounts receivable, to ensure repayment of a loan. In addition, all export sale proceeds will usually be collected and applied to the principal and interest by the lender before the balance is passed on to the exporter. Fees and interest rates are usually negotiable between the lender and the exporter.

Revolving Lines of Credit and Transaction-Specific Loans

There are two types of EWC facilities: (1) revolving lines of credit and (2) transaction-specific loans. Revolving lines of credit represent the most common form of EWC and are appropriate for recurring export orders because they are designed to cover temporary funding needs. Revolving lines of credit have a very flexible structure that enables exporters to draw funds against their current account up to a specified limit. Transaction-specific loans, which are appropriate for large and periodic export orders often related to a specific project, are typically used if the outflows and inflows of funds are predictable over time. Transaction-specific loans are often structured in 12 months that correspond with need or the tenor of a specific project.

Chapter 9
Export Credit Insurance

Export credit insurance (ECI) protects an exporter of products and services against the risk of non-payment by a foreign buyer. In other words, ECI significantly reduces the payment risks associated with doing international business by giving the exporter conditional assurance that payment will be made if the foreign buyer is unable to pay. Simply put, exporters can protect their foreign receivables against a variety of risks that could result in non-payment by foreign buyers. ECI generally covers commercial risks that could result in non-payment by the foreign buyers, such as insolvency of the buyer, bankruptcy, currency devaluation or protracted defaults (slow payment). ECI also covers certain political risks such as war, terrorism, riots, and revolution as well as currency inconvertibility, expropriation, and changes in import or export regulations. ECI is generally offered either on a single-buyer basis or on a portfolio multi-buyer basis for short-term (up to one year) and medium-term (one to five years) repayment periods. The cost of multi-buyer ECI is generally a fraction of one percent of the value of insured sales while the cost of single-buyer ECI varies widely due to more concentrated risk. ECI premiums are based on individual risk factors such as the proposed payment terms, the foreign buyer's creditworthiness, the countries involved in the transaction, the structure of the deductible and co-insurance, and the exporter's previous international sales experience. Overall, the cost of ECI is generally much less than the fees charged for letters of credit and can often pay for itself with the additional sales generated from offering competitive open account terms. In addition, the cost of ECI may be built into the sales price since most foreign buyers are willing to pay for a slightly higher price in exchange for open account with favorable extended credit terms.

Characteristics of Export Credit Insurance

Applicability: Recommended for use in conjunction with open account terms and pre-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: (1) Reduces the risk of non-payment by foreign buyers; (2) Offers open account terms safely in global markets.

Cons: (1) Risk sharing in the form of a deductible and co-insurance (coverage is usually below 100 percent); (2) Excludes physical loss or damage to the goods as well as foreign exchange loss.

Key Points

- ECI allows exporters to offer competitive open account terms to foreign buyers while minimizing the risk of non-payment.
- The cost of ECI, which is generally much less than the fees charged for letters of credit, is often built into the sales price to accommodate foreign buyers who wish to trade on open account terms.
- Even creditworthy buyers could default on payment due to circumstances beyond their control.
- ECI should be a proactive purchase, in that exporters should obtain coverage before a customer becomes a problem.
- With reduced non-payment risk, exporters can increase export sales, establish market share in emerging and developing countries, and compete more vigorously in the global market.
- When foreign accounts receivable are insured by ECI, lenders are more willing to increase the exporter's borrowing capacity and offer attractive financing terms.
- ECI does not cover physical loss or damage to the goods shipped to the buyer, or any of the risks for which coverage is available through cargo, marine, fire, casualty, or other forms of insurance.

Short- and Medium-Term Coverage

Short-term ECI, which provides 90 to 95 percent coverage against commercial and political risks that result in buyer payment defaults, typically covers (a) consumer goods, materials, and services up to 180 days, and (b) small capital goods, consumer durables, and bulk commodities up to 360 days. Medium-term ECI, which provides 100 percent coverage after a required minimum 15 percent down payment, usually covers large capital equipment up to five years.

Where Can I Get Export Credit Insurance?

ECI policies are offered by private-sector risk insurance carriers as well as the Export-Import Bank of the United States (EXIM), the government agency that assists in financing the export of U.S. goods and services to international markets. U.S. exporters and lenders are strongly encouraged to consider the use of a top tier specialized insurance broker to explore ECI options. Brokers provide a number of valuable services, typically at no charge to the policyholders, as they receive their compensation from commissions paid by a private insurance carrier or EXIM. Reputable, well-established specialized insurance brokers that sell ECI policies can be easily found on the Internet and the EXIM registered insurance broker locater on its website.

How Short-Term Single-Buyer ECI Works

The steps below provide a simplified example of how short-term single-buyer ECI works to help the exporter.

1. A new-to-export small U.S. company (exporter) discusses a potential sale with a first-time foreign buyer who wishes to trade on open account with 30-day payment terms.

2. With the foreign buyer approaching a European competitor who regularly sells on open account terms in global markets, the exporter contacts a specialized insurance broker or EXIM to discuss ECI options by presenting details of the proposed sale, such as the company's previous exporting experience, the foreign buyer's business information, the type of goods being sold, and the proposed payment terms

3. The exporter should explore ECI options before pricing negotiations with the foreign buyer in order to consider building the ECI cost into the sale price.

4. The insurance broker evaluates the transaction and associated risks to quote a premium for an ECI policy and discuss coverage terms.

5. Should the premium and coverage terms be acceptable, the exporter, in consultation with the insurance broker, develops and presents a transaction proposal for the foreign buyer, with, if appropriate, the ECI cost built into the sales price.

6. If the transaction proposal and terms are accepted by the foreign buyer, the exporter signs a sales contract.

7. The exporter pays a premium for the ECI policy after the sale occurs. Therefore, there is no risk to the exporter for applying for ECI coverage in the event the sale does not go forward.

8. The exporter then ships goods to the foreign buyer, if applicable, upon receipt of an agreed upon cash down payment.

9. If the foreign buyer defaults on payment terms, ECI pays the exporter by typically covering up to 90 to 95 percent of the contract value.

Chapter 10
Export Factoring

Export factoring is a complete financial package that may include and combine export working capital financing, credit protection, foreign accounts receivable bookkeeping, and collection services. A factoring house, or 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. Export factoring is regularly done without recourse so that the factor assumes the credit risk of the foreign buyer to pay and handles collections on the receivables. Thus, by virtually eliminating the risk of non-payment by foreign buyers, export factoring allows the exporter to offer open account terms, 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 create debt on the balance sheet. Export factoring is most suited for continuous short-term export sales of consumer goods on open account terms; however, it can be used by almost any exporting company that sells a product or service on payment terms in a variety of industries.

Characteristics of Export Factoring

Applicability: Best suited for an established exporter who wants (a) to have the flexibility to sell on open account terms, (b) to avoid incurring any credit losses, or (c) to outsource credit and collection functions.

Risk: Credit risk inherent in an export sale is virtually eliminated.

Pros: (1) Eliminates the risk of non-payment by foreign buyers; (2) Faster payments and improved cash flows.

Cons: (1) Generally more costly than export credit insurance; (2) Generally only available in developed countries.

Key Points

- Export factoring offers 100 percent credit risk protection against the foreign buyer's inability to pay – no deductible or risk sharing.
- Export factoring promotes faster payments and improves cash flows.
- Export factoring is most suited for continuous short-term export sales of consumer goods on open account terms; however, it can be used by any exporting company that sells a product or service on payment terms.
- Export factoring is an option for small and medium-sized exporters, particularly during periods of rapid growth, because cash flow is preserved, and the risk of non-payment is virtually eliminated.
- Export factoring is less suitable for the new-to-export company as factors generally (a) do not take on a client for a one-time deal and (b) require access to a certain volume of the exporter's yearly sales.
- Export factoring is generally a more expensive option that may impact a significant amount of an exporter's margin than other less expensive financing options.
- Export factoring is generally not available in developing and emerging countries.
- The advance rate is generally limited to 80 percent of invoices that are factored.

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. The import factor then handles the local collection and payment of the accounts receivable. During all stages of the transaction, records are kept for the exporter's bookkeeping.

Two Common Export Factoring Financing Arrangements and Their Costs

In **discount factoring**, the factor issues an advance of funds against the exporter's receivables and awaits payment and collection from the importer. The cost is variable, depending on the time frame and the dollar amount advanced. 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, and usually ranging between 1 and 4 percent, depending on the country, sales volume, and amount of paperwork.

Limitations of Export Factoring

- Factoring is limited to countries with laws that support the buying and selling of receivables.
- Factoring generally does not work with foreign account receivables that have more than 180-day terms.
- Factoring may be cost prohibitive for exporters with tight profit margins.

What Types of Industries Use Export Factoring?

Companies turn to export factoring for a variety of reasons, including but not limited to: eliminating the risk of non-payment by foreign buyers, speeding up invoicing for faster payments, improving cash flows, expanding operations, or simply reducing administrative burden in the short or long term. Companies that get the most out of export factoring are those that sell consumer goods on a continuous basis. However, almost any company that exports a product or service on payment terms can benefit from utilizing export factoring. Below is a short list of industries that use export factoring.

- Consumer Goods
- Agricultural Products
- Textiles, Apparel, and Footwear
- Light Manufacturing Products
- Raw Materials and Chemicals
- Services, Logistics, Business Process Outsourcing

Where to Find a Factor?

The international factoring business involves networks, which are similar to correspondents in the banking industry. There are two sources for global networks: FCI (formerly known as Factors Chain International) and the International Factoring Association (IFA). Headquartered in the Netherlands, FCI is the global representative body for factoring and financing of open account domestic and international trade receivables. For more information about FCI, visit https://fci.nl/en. Headquartered in Avila Beach, California, the IFA, the largest association of commercial finance companies in the world, provides a way for commercial factors to get together and discuss a variety of issues and concerns in the industry. For more information about the IFA, visit https://www.factoring.org.

Export Factoring Industry Profile

According to FCI, the total worldwide volume for factoring in 2020 was $3.35 trillion, up more 2.7 percent from 2019. The 2020 data indicates that exporters and importers around the world are becoming more and more familiar with the advantages to be derived from a factoring arrangement. Although 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 use export factoring are manufacturers, distributors, wholesalers, or service firms with sales ranging from several million dollars to several hundred million dollars. Factoring is also a valuable financial tool for larger U.S. corporations to manage their balance sheets. Total international factoring volume in the United States is now worth around $79 billion annually, greatly contributing to the growth in U.S. exports.

Chapter 11
Forfaiting

Forfaiting is a method of trade finance that allows exporters to obtain cash by selling their medium and long-term foreign accounts receivable at a discount on a "without recourse" basis. A forfaiter is a specialized finance firm or a department in a bank that performs non-recourse export financing through the purchase of medium and long-term trade receivables. "Without recourse" or "non-recourse" means that the forfaiter assumes and accepts the risk of non-payment by the importer or obligor. Similar to factoring, forfaiting virtually eliminates the risk of non-payment once the goods have been delivered to the importer or obligor in accordance with the terms of sale. However, unlike factors, forfaiters typically work with exporters who sell capital goods, commodities, or large projects and need to offer extended periods of credit from 180 days to seven years or more. In forfaiting, receivables are often guaranteed by the importer's bank, which allows the exporter to take the transaction off the balance sheet to enhance key financial ratios. The current minimum transaction size for forfaiting is $100,000, but forfaiters normally prefer deals in the $250,000 to $500,000 range or more. The average value of forfaiting transactions is $2 to 5 million, but some transaction sizes can be as high as $200 million. In the United States, most users of forfaiting are established medium-size and large corporations, but U.S. exporters of all sizes are slowly embracing forfaiting as they become more aggressive in seeking financing solutions for countries considered "high risk".

Characteristics of Export Forfaiting

Applicability: Suited for exports of capital goods, commodities, and large projects on medium and long-term credit (180 days to seven years or more).

Risk: Risk inherent in an export sale is virtually eliminated.

Pros: (1) Eliminates the risk of non-payment by importers; (2) Offers strong capabilities in emerging and developing markets.

Cons: (1) Cost is often higher than commercial lender financing; (2) Limited to medium- and long-term transactions valued over $100,000, although the $250,000 to $500,000 range is normally preferred by forfaiters.

Key Points

- Forfaiting eliminates virtually all risk to the exporter, with 100 percent financing of contract value.
- Exporters can offer medium and long-term financing in markets where the credit risk would otherwise be too high.
- Forfaiting generally works with bills of exchange, promissory notes or letters of credit.
- In most cases, the importers must provide a bank guarantee in the form of an "aval", letter of guarantee, or letter of credit.
- Financing can be arranged on a one-off (transaction-specific) basis in any of the major currencies, usually at a fixed interest rate, but a floating rate option is also available.
- Forfaiting can be used in conjunction with officially supported credits backed by export credit agencies such as the Export-Import Bank of the United States.

Three Additional Major Advantages of Forfaiting

Volume: Forfaiting can work on a one-off transaction basis, without requiring an ongoing volume of business.
Speed: Commitments can be issued within hours or days depending on details and country.
Simplicity: Documentation is usually simple, concise, and straightforward.

How Forfaiting Works

The exporter approaches a forfaiter *before* finalizing a transaction's commercial structure. Once the forfaiter commits to the deal and sets the discount rate, the exporter can incorporate the discount into its 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 its commitment. Since this payment is without recourse, the exporter has no further interest in the financial aspects of the transaction and it's the forfaiter who must collect the future payments due from the importer.

When to Contact a Forfaiter

Forfaiting is widely used by exporters and financial institutions throughout Europe because their sales and financing professionals work very closely together to develop a contract price proposal in order to make the cost of financing competitive and attractive to importers. This approach is not widely embraced or practiced in the United States. Thus, exporters should contact a forfaiter at the earliest point in formulating their sales and financing proposals. Doing so will help exporters better understand the subtleties and complexities of dealing in certain markets, including how to create a financing proposal at interest rates that are competitive, without reducing the margin on their sale.

Cost of Forfaiting

The cost of forfaiting to the exporter is determined by the rate of discount based on the aggregate of the LIBOR (London Inter-Bank Offered Rate) or base rate equivalent for the tenor of the receivables and a margin reflecting the risk being sold. In addition, there are certain costs that are borne by the importer that the exporter should also take into consideration. The degree of risk varies based on the importing country, the length of the loan, the currency of the transaction, and the repayment structure – the higher the risk, the higher the margin and therefore the higher all-in discount rate. However, forfaiting can be more cost-effective than traditional trade finance tools because of the many attractive benefits it offers to the exporter.

Forfaiting Industry Profile

Forfaiting was developed in Switzerland in the 1950s to fill the gap between the exporter of capital goods, who would not or could not deal on open account, and the importer, who desired to defer payment until the capital equipment could begin to pay for itself. Although the number of forfaiting transactions is growing worldwide, there are currently no official statistics available on the size of the global forfaiting market. Industry sources estimate that forfaiting transactions worth $60 to $75 billion are outstanding at any given time, that the total annual volume of new transactions worth around $30 billion, and that two percent of world trade is financed through forfaiting, of which three percent takes place in the United States. Forfaiting firms have opened around the world, but the Europeans maintain a hold on the market, including in North America. Although forfaiting firms remain a few in number in the United States, the innovative financing they provide should not be overlooked as a viable means of export finance for American exporters.

Where to Find a Forfaiter

The International Trade and Forfaiting Association (ITFA) is a useful source for locating forfaiters willing to finance exports. Headquartered in Switzerland, ITFA is the worldwide trade association for over 300 financial institutions engaged in global trade, forfaiting, supply chain and receivables financing. U.S.-based members of ITFA's Americas Regional Chapter can be located at https://itfa.org.

Chapter 12
SBA Export Finance Programs

Small and medium-sized enterprises (SMEs), which are broadly defined as companies with fewer than 500 employees in the United States, are the backbone of the American economy, creating two-thirds of all new jobs in recent decades. A U.S. Chamber of Commerce Technology Engagement Center study revealed that SME exporters account for 98 percent of all identified U.S. exporters and play a vital role in the American economy by generating $541 billion in output in 2017 and supporting more than 6 million jobs. In addition, according to studies by the U.S. International Trade Commission, SMEs that export tend to grow even faster, add jobs faster, and pay higher wages than SMEs that do not. However, despite these impressive data and promising benefits, many SMEs face financing challenges in going global or expanding export sales because most commercial lenders in the U.S. do not provide SMEs with working capital advances on export orders, export receivables or letters of credit due to the repayment risk associated with international sales. One viable solution to such challenges is the export finance programs offered by the U.S. Small Business Administration (SBA). As a federal agency created to help foster the growth of U.S. SMEs and American entrepreneurs, SBA helps U.S. SMEs start exporting and/or expand export sales through the three main programs: (1) Export Working Capital Program, (2) Export Express Loan Program, and (3) International Trade Loan. In addition, SBA administers the State Trade Expansion Program (STEP), which provides financial awards to state and territory governments to assist SMEs with export development. With SBA's export finance and STEP grant programs, U.S. SME exporters can more easily enter, grow, and succeed in global markets.

Characteristics of SBA Export Finance Programs

Applicability: Suitable for SME exporters in need of working capital to enter, grow and succeed in global markets.

Risk: SBA assumes the repayment risk of export working capital loans extended by participating commercial lenders to SMEs.

Pros: (1) Obtaining otherwise unavailable working capital financing to start exporting and/or expanding export sales; (2) Helping to offer competitive open account terms to foreign buyers.

Cons: (1) Maximum loan amount is limited to $5 million.; (2) Not all commercial lenders offer SBA guaranteed export working capital loans.

Key Points

- SBA offers three export finance programs to help eligible SMEs start exporting and/or expanding export sales by guaranteeing the repayment of working capital loans extended to them by participating commercial lenders.
- SBA export finance loans are available for manufacturers with less than 500 employees as well as wholesalers, export trading companies and service exporters with less than 100 employees.
- To qualify for SBA export finance loans, SMEs must be in business for at least one year; however, early-stage SMEs may qualify with strong export expertise and business experience.
- SBA financed transactions must be shipped and titled from the United States; however, they are not subject to the same U.S. content requirement or military sales restrictions imposed on those transactions financed by the Export-Import Bank of the United States.
- SBA's STEP grant program provides eligible SMEs with grants to help fund their export business development activities.

SBA’s Export Working Capital Program

SBA’s Export Working Capital Program (EWCP) provides participating commercial lenders with up to a 90 percent guarantee on export loans up to $5 million as a credit enhancement to make the necessary export working capital available to eligible SMEs. To start the application process, SMEs should contact their local lenders to see if they are approved to underwrite EWCP loans or contact SBA for a referral to a participating lender. SMEs can apply for EWCP loans in advance of finalizing an export sale or contract. With an approved EWCP loan in place, SME exporters have greater flexibility in negotiating export payment terms—secure in the assurance that adequate financing will be in place when the export order is won.

SBA’s Export Express Loan Program

SBA’s Export Express Loan Program (Export Express) offers a streamlined loan product for eligible SMEs with financing needs up to $500,000. Export Express can take the form of a term loan or a revolving line of credit. As an example, proceeds can be used to fund participation in a foreign trade show, finance standby letters of credit, translate product literature for use in foreign markets, finance specific export orders, as well as to finance expansions, equipment purchases, and inventory or real estate acquisitions, etc.

SBA’s International Trade Loan Program

SBA’s International Trade Loan Program (ITL) provides participating commercial lenders with up to a 90 percent guarantee on term loans up to $5 million to eligible SMEs that plan to start or continue exporting or that have been adversely affected by competition from imports. ITL loans must specifically be used to acquire, construct, renovate, modernize, improve or expand facilities and equipment to be used in the United States to produce goods or services involved in international trade. Other eligible uses involve bringing back production facilities to the United States, working capital financing, and refinancing any eligible business debt that is currently offered to the borrower on unreasonable terms.

SBA’s State Trade Expansion Program

Through awards to U.S. state and territory governments, SBA’s State Trade Expansion Program (STEP) helps SMEs overcome obstacles to exporting by providing grants to cover costs associated with entering and expanding into international markets. Eligible SMEs can apply for STEP grants from states participating in the program based on the rules and guidelines of each STEP grant awardee. Under the STEP grant program, eligible SMEs can be reimbursed for expenses associated with participation in virtual and in-person trade shows, trade missions, and export training workshops, as well as other eligible expenses including shipping sample products, compliance testing, fee-based services offered by the U.S. Commercial Service, internationally-focused website development and design of marketing media, and other activities and expenses as determined by SBA.

For More Information

For more information about SBA’s Export Finance and STEP Programs, visit the SBA website at *www.sba.gov/tradetools*.

Chapter 13
EXIM Export Finance Programs

The United States is the second largest exporter in the world for goods and the largest for services. U.S. exporters, 98 percent of which are small and medium-sized enterprises (SMEs), play a vital role in the American economy by creating jobs and generating economic growth. However, cross-border transactions present financing challenges to SMEs because, due to the repayment risk associated with export sales, the availability of commercial working capital loans is generally limited only to financially stable large corporations. SME exporters also face challenges in offering competitive open account credit terms in global markets because of the risk of non-payment by foreign buyers. In addition, international sales of high-value capital equipment and exports to large-scale projects, which require medium- or long-term financing, often pose special challenges, not only to SMEs, but also to large established corporations as commercial lenders 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 the Export-Import Bank of the United States (EXIM). As the official export credit agency of the United States, EXIM supports American jobs by facilitating U.S. exports through three primary programs: (1) Working Capital Loan Guarantees, (2) Export Credit Insurance, and (3) Foreign Buyer Financing. EXIM does not compete with commercial lenders or insurance firms but provides export finance products that fill gaps in trade financing by assuming country and credit risks that the private sector is unable or unwilling to accept. With EXIM's export financing, U.S. SME exporters can turn their business opportunities into real transactions, ensure they get paid for export sales, and continue to grow and succeed in global markets.

Characteristics of EXIM Export Finance Programs

Applicability: Suitable for the export of goods and services to foreign markets as well as high-value capital equipment or large-scale projects that require extended-term financing.

Risk: BEXIM assumes country and credit risks that the private sector is unable or unwilling to accept.

Pros: (1) Allows exporter to offer competitive open account terms while minimizing the risk of non-payment by foreign buyers; (2) Enables buyer financing as part of an attractive sales package.

Cons: (1) EXIM's support is not available in all developing and emerging markets; (2) Financing may be subject to certain restrictions based on political or economic conditions.

Key Points

- EXIM, the official export credit agency of the United States, supports American jobs by facilitating U.S. exports through three primary export finance programs by assuming country and credit risks that the private sector is unable or unwilling to accept.
- EXIM's Working Capital Loan Guarantee ensures the repayment of loans extended by participating commercial lenders to eligible U.S. exporters in need of liquidity to help accept new business and grow in global markets.
- EXIM's Export Credit Insurance helps U.S. exporters offer competitive open account in global markets while minimizing the risk of non-payment by foreign buyers.
- EXIM's Foreign Buyer Financing helps turn high-value export or large-scale project opportunities, especially in risky emerging markets, into real transactions for U.S. exporters by providing creditworthy foreign buyers with guarantees for term financing offered by commercial lenders. Direct loans at a fixed rate can be offered in select circumstances.
- EXIM offers enhanced financing and assistance to small businesses as well as businesses owned by minorities, women, veterans, and people with disabilities.
- EXIM also has several other special initiatives to provide financing support for:
    - Renewable energy and environmentally beneficial exports.
    - Exports to sub-Saharan Africa.
    - Exporters facing competition from China in 10 specified export areas.
    - Exports related to medical technology, transportation security, and textile manufacturing.

EXIM's Working Capital Loan Guarantee

EXIM's Working Capital Loan Guarantee helps U.S. exporters obtain needed credit facilities from participating commercial lenders to acquire goods and services to fulfill export orders and help extend open account terms to their foreign buyers. Advance rates offered by commercial lenders on export inventory and foreign accounts receivable are generally not sufficient to meet the needs of U.S. exporters. In addition, some commercial lenders simply do not lend to U.S. exporters without a government guarantee due to repayment risks associated with export sales. Thus, this program encourages commercial lenders to extend working capital facilities to eligible U.S. exporters by guaranteeing their loan repayment obligations.

EXIM's Export Credit Insurance

EXIM's Export Credit Insurance (ECI) helps U.S. exporters offer competitive open account terms in global markets while minimizing the risk of non-payment by foreign buyers. EXIM's ECI is offered either on a single-buyer basis or on a portfolio multi-buyer basis for short-term (up to one year) and medium-term (one to five years) repayment periods. The cost of ECI, which is generally much less than the fees charged for letters of credit, is often built into the sales price to accommodate foreign buyers who wish to trade on open account terms. Exporters are encouraged to enlist the service of a reputable specialized insurance broker to shop for ECI policies, which are also offered by many private commercial risk insurance companies, to explore the best coverage options. With reduced non-payment risk, U.S. exporters can increase international sales, establish market share in emerging and developing countries, and compete more vigorously in global markets.

EXIM's Foreign Buyer Financing

EXIM's Foreign Buyer Financing assists U.S. exporters by guaranteeing repayment of 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. This program 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. There is no minimum or maximum limit to the size of the export sale that may be supported by this program. EXIM 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 (12 to 18 years for certain sectors). Direct loans at a fixed rate can be offered in select circumstances.

For More Information

Military items are generally not eligible for EXIM financing nor are sales to foreign military entities. Goods must meet EXIM's U.S. content requirements and ship from a U.S. port. Finally, EXIM's support may not be available or subject to restrictions in certain countries due to political or economic conditions. For more information about EXIM export finance programs, visit *www.exim.gov*.

Chapter 14
USDA Export Finance Programs

The United States is the world's largest exporter of agricultural products. U.S. agricultural exports play a vital role in building and strengthening the nation's economy. As is the case with any cross-border transaction, international sales of agricultural products often pose financing challenges to exporters as commercial lenders may be reluctant to extend credit to foreign buyers, especially those in risky emerging markets. One viable solution to these challenges is government-backed agricultural export financing offered by the U.S. Department of Agriculture (USDA). USDA's Foreign Agricultural Service (FAS) operates two export finance programs that assist the commercial financing of U.S. agricultural products and goods and services: (1) *The Export Credit Guarantee (GSM-102) Program* and (2) *The Facility Guarantee Program (FGP)*. Both programs provide guarantees of repayment issued by USDA's Commodity Credit Corporation that may encourage commercial lenders to extend financing in countries where credit is necessary to purchase U.S. agricultural products, goods, and/or services. With USDA's export finance programs, U.S. exporters and U.S. financial institutions can ensure that financing is available and payment is guaranteed for the export of U.S. agricultural products, goods and services, thus turning their business opportunities into real transactions.

Characteristics of USDA Export Finance Programs

Applicability: Suitable for the export of agricultural products and goods and services for agricultural related facilities to markets where credit may be difficult to obtain.

Risk: USDA assumes almost all the risk of payment default.

Pros: (1) Making otherwise difficult to access financing available to buyers of U.S. agricultural products and goods and services for agricultural related facilities; (2) Payment at export upon submission of proper documents with a transparent fee structure.

Cons: (1) Guarantee only covers non-payment by the foreign (issuing) financial institution; (2) Financing may be subject to certain restrictions based on program regulations as well as political or economic conditions in foreign countries.

Key Points

- USDA's export finance programs help turn sales opportunities in developing and emerging markets into real transactions for U.S. exporters of agricultural products and goods and services for agricultural related facilities.
- The GSM-102 Program is designed to support U.S. exports of agricultural commodities and products, including high value and intermediate goods, to developing and emerging markets.
- FGP is designed to facilitate financing for the goods and U.S. services that are inputs in agricultural related facilities that will likely benefit U.S. agricultural exports in emerging markets.
- Letters of credit are required in all USDA-supported export financing transactions.

Export Credit Guarantee (GSM-102) Program

Under the GSM-102 program, USDA's Commodity Credit Corporation (CCC) provides credit guarantees to encourage commercial financing of U.S. agricultural exports, thereby assisting U.S. exporters in making sales that might not otherwise occur. USDA does not provide loans to foreign buyers but guarantees payments due from approved foreign financial institutions under letters of credit (LCs) to U.S. exporters or U.S. financial institutions. Because payment is guaranteed, U.S. exporters, or more commonly U.S. financial institutions, can offer competitive credit terms to the foreign financial institution that issued the LC for the import of U.S. food and agricultural products, benefitting the entire supply chain. The U.S. exporter must apply for the CCC guarantee and pay a fee. As such, the exporter may factor this cost into the selling price prior to the contract negotiation process. The CCC guarantee covers up to 98 percent of the loan principal and a portion of interest for terms up to 18 months depending upon the country of the foreign financial institution. The U.S. exporter can be paid at export by assigning the CCC guarantee to an approved U.S. financial institution who in turn extends the credit to the approved foreign financial institution.

Step by Step GSM-102 Program Process

1. U.S. exporter qualifies to participate in the GSM-102 program by submitting an online application.
2. U.S. exporter negotiates a firm sales contract with the importer.
3. U.S. exporter applies for a CCC guarantee. Guarantee is issued after CCC review and receipt of guarantee fee, usually within 1 to 2 business days.
4. Importer requests the opening of a LC in favor of the U.S. exporter by a USDA-approved foreign financial institution.
5. U.S. exporter typically assigns the CCC guarantee to a USDA-approved U.S. financial institution which has agreed financing terms (consistent with the guarantee) with the foreign financial institution.
6. U.S. exporter ships the commodity and presents documents to the U.S. financial institution.
7. U.S. financial institution pays the U.S. exporter at sight and extends the agreed financing terms to the foreign financial institution.
8. Importer pays the foreign financial institution per terms established between these two parties.
9. If the foreign financial institution defaults on payments to the U.S. financial institution, the holder of the CCC guarantee files a claim with USDA.

Examples of GSM-102 Eligible U.S. Food and Agricultural Products

- **Bulk commodities**: Wheat, feed grains, cotton, soybeans, rice
- **Intermediate products**: Animal feed, cattle hides, soybean meal, flour
- **High-value products**: Meat, fruits, vegetables, wine, grocery products

Facility Guarantee Program (FGP)

The Facility Guarantee Program (FGP) provides payment guarantees to finance commercial exports of U.S. goods and services that will be used to improve agriculture-related facilities in emerging countries. The FGP program is designed to expand sales of U.S. food and agricultural products to emerging markets where inadequate storage, processing, or handling capacity limit trade potential. To be eligible, USDA must determine that the transaction will likely provide downstream benefits to the expansion of U.S. agricultural exports in that market. For a nominal fee, applicants may choose to provide USDA with a Letter of Interest on a proposed transaction and will be provided preliminary feedback.

Examples of FGP Eligible Products and Services That Could Benefit U.S. Agricultural Exports

- Construction of (1) a soybean crushing facility; (2) a grain silo; and (3) cold storage facility
- Equipment or vehicle used to transport agricultural products
- Portion or component of a larger agricultural-related project
- U.S. consulting services that will likely benefit importation of U.S. agricultural products

For More Information

On behalf of USDA, FAS operates both the GSM-102 Program and the FGP. In addition to its Washington, D.C. staff, FAS has a network of 98 offices covering 175 countries to advance opportunities for U.S. agriculture around the globe. For more information about FAS and USDA export finance program, visit the FAS website at *www.fas.usda.gov*.

Chapter 15
Foreign Exchange Risk Management
How to Accept Payment in Foreign Currency for Exports

Foreign exchange (FX) risk exposure is often overlooked by small and medium-sized enterprises (SMEs) that wish to enter, grow, and succeed in global markets. Although most U.S. SME exporters prefer to trade in U.S. dollars, creditworthy foreign buyers today are increasingly requesting that payment be accepted in their local currency. To a U.S. exporter who chooses to trade in foreign currency, FX risk exposure is the potential financial losses due to foreign currency depreciation against the U.S. dollar when payment is due. Obviously, this exposure can be avoided by insisting on trading only in U.S. dollars. However, such an approach may result in losing export opportunities to competitors who are more flexible in the choice of payment currency by their foreign buyers. Trading only in U.S. dollars could also result in non-payment when foreign buyers find their U.S. dollar-denominated obligations magnified due to local currency depreciation. While the risk of non-payment can be mitigated by export credit insurance, such “what-if” protection is meaningless if export opportunities are lost due to a “payment in U.S. dollars only” policy. To remain competitive in global markets, U.S. exporters should consider being flexible in accepting payment in foreign currency while exploring ways to proactively manage FX risk exposure.

Characteristics of Foreign Currency-Denominated Export Sales

Applicability: Recommended for use (a) in competitive global markets, and (b) when foreign buyers insist on paying in their local currency.

Risk: Exporters are exposed to the risk of currency exchange losses unless FX risk management techniques are used.

Pros: (1) Competitive payment terms to win more sales; (2) Reduced non-payment risk resulting from local currency depreciation.

Cons: (1) Cost and burden of managing FX risk; (2) No potential profit from favorable FX movements except when using FX Options hedge.

Key Points

- Most foreign buyers prefer to pay in their local currency to avoid FX risk exposure.
- Exporters who choose to trade in foreign currency could boost their competitiveness and win more sales.
- The volatile nature of the FX market poses a risk to exporters, as unfavorable FX rate movements may cause significant financial losses from otherwise profitable export sales.
- When export sales are denominated in foreign currency, exporters could minimize FX risk exposure by using one or more of the FX risk management techniques.
- The primary objective of FX risk management is not to aim to make a profit, but to minimize potential financial losses resulting from unpredictable and unfavorable FX movements.

FX Risk Management Techniques

Several techniques are available for reducing short-term FX risk exposure, which are suitable for new-to-export SMEs or exporters who are exploring accepting payment in foreign currency. The FX instruments outlined below are available in all major currencies and are offered by numerous commercial banks and FX service providers. However, some techniques may be impractical or cost prohibitive for certain SME exporters.

Cash-in-Advance in Foreign Currency

One way exporters could avoid FX exposure is to demand cash-in-advance payment for foreign currency-denominated sales. The exporters can then immediately calculate the expected net proceeds in home currency using the spot exchange rate, which is the current exchange rate of two currencies.

Natural Hedges

Another way to minimize FX risk exposure is to find natural hedges, that is, matching foreign currency receipts with foreign currency expenditures. For example, an American exporter who receives payment in pesos from a Mexican buyer may use pesos for other purposes such as paying agents' commissions or paying another Mexican trading partner for supplies. If the pesos receipts and payments are comparable in value, FX risk is minimized as the exporter will rarely need to convert pesos into U.S. dollars. The risk is further reduced if those peso-denominated transactions are conducted on a regular basis.

FX Forward Hedge

The most popular way of hedging FX risk is using a forward contract, which enables the exporter to sell a set amount of foreign currency at a pre-determined exchange rate at a pre-specified time in the future with a delivery date from three days to one year into the future. For example, a U.S. exporter agrees to accept payment in euro for 1 million euros worth of goods sold to a German company on a 60-day term. In fear of euro depreciating in the next 60 days, the U.S. exporter engages in a forward contract today at the forward exchange rate of one euro to 1.25 U.S. dollars. This forward contract helps the U.S. exporter minimize FX risk exposure by ensuring the conversion of 1 million euros to 1.25 million U.S. dollars, regardless of what happens to the dollar-euro exchange rate in 60 days. However, if the German buyer fails to pay on time, the U.S. exporter will still be obligated to deliver 1 million euros in 60 days. Hence, when using forward contracts to hedge FX risk, exporters are advised to pick forward delivery dates conservatively or engage in a "window forward contract" which allows for delivery between two dates instead of a specific settlement date. If the foreign currency is collected sooner, the exporter could hold on to it until the delivery date or could "swap" the old FX contract for one with a new delivery date at a minimal cost. Note that fees or charges for forward contracts are very minimal as the FX trader makes a "spread" by buying at one price and selling to someone else at a higher price.

FX Options Hedge

If an exporter has a large transaction quoted in foreign currency and/or there exists a significant time period between quote and acceptance of the offer, an FX option may be worth considering. For an exporter, using FX option to hedge currency risk is like buying insurance against foreign currency depreciation. Under an FX option, the exporter acquires the right, but not the obligation, to exchange the foreign currency into home currency at a specified rate on or before the expiration date of the option. As opposed to a forward contract, the exporter who purchases an FX option has to pay a premium, which is similar to an insurance premium. If the value of the foreign currency goes down, the exporter is protected from the loss. On the other hand, if the value of the foreign currency goes up, the exporter simply walks away from the option contract and sells the foreign currency at a more favorable rate in the spot market. While FX options provide flexibility, they are more costly than FX forward contracts.

Chapter 16

Emerging Trends: The Digitalization of Trade Finance

For centuries, trade finance has been essential for the majority of cross-border trade transactions. However, as global trade has evolved over the years, traditional trade finance instruments such as letters of credit and loan guarantees have come to rely heavily on manual and paper-based processes that can be costly and time-consuming. Paper documents are also vulnerable to delays, human error, and fraud due to their complexity and the number of parties involved. Today's digital economy is poised to bring about a transformation of trade finance. Digitalization promises to reduce time and economic costs for small and medium sized enterprises (SMEs), allowing them to generate more predictable cash flows from export sales and better allocate working capital in a time-efficient manner. Digitalization also promises to improve the competitiveness and efficiency of SMEs in the modern world economy, making it easier for them to participate, as direct or indirect exporters, in global value chains, which are global production and trade networks developed by multinational corporations. New technologies, such as advanced electronic documentation and blockchains are beginning to transform due diligence and compliance requirements. Artificial intelligence with big data analytics allows for more precise credit scoring and better pricing options. As trade finance providers actively explore ways to streamline operations and digitize documents, SME exporters stand to benefit from expanded access to financing at reduced costs, faster transaction processing, and more efficient credit assessment of foreign buyers in the not-too-distant future. However, the lack of a global electronic infrastructure that can interconnect all parties involved in cross-border trade transactions remains a major challenge. With multiple parties located in various jurisdictions, an interoperable system is needed to fully unlock the benefits of new digital technology solutions. Nevertheless, exporters should be aware of the emerging trade finance trends so they can be ready to take advantage of new opportunities.

A Quick Glance

Digitalization of Trade Finance: The leverage of emerging technologies to transform burdensome paper-based trade finance instruments and processes into more cost-efficient and less time-consuming digital systems.

Emerging Technologies: Advanced electronic documentation, blockchain technologies, and artificial intelligence with big data analytics promise to offer new improved efficiencies and economic benefits to trade finance providers and their SME customers.

Opportunities: (1) Prospects for faster, less costly trade finance transactions; (2) Potential for increased access to trade finance for SMEs.

Challenges: (1) Current lack of an interoperable global infrastructure for trade finance instruments; (2) Some technologies are still being developed and tested.

Key Points

- A transformation of trade finance is unfolding around the globe by leveraging emerging technologies to convert traditional, burdensome paper-based instruments and processes into more cost-efficient and less time-consuming digital systems.
- Examples of currently emerging technologies include: (1) advanced electronic documentation, (2) blockchain technologies, and (3) artificial intelligence with big data analytics.
- Digitalization promises to offer new, improved efficiencies and economic benefits to both trade finance providers and their SME customers.
- Digitalization also promises to increase participation of SMEs, as direct or indirect exporters, in global value chains by helping to improve their competitiveness and efficiency in today's modern world economy.
- As digitalization transforms trade finance, SME exporters stand to benefit from expanded access to financing at reduced costs, faster payment processing, efficient foreign buyer credit assessments, predictable cash flows, and improved confidence in exporting in the not-too-distant future.

Emerging Trends

- **Advanced Electronic Documentation:** Electronic documentation of traditional paper-based cross-border trade transaction processes, such as bills of exchange, bills of lading, and electronic passports, is driving trade finance providers to centralize their systems to more efficiently meet Know-Your-Customer (KYC) and other compliance requirements in a globalized world. Thus, emerging advanced electronic documentation tools have the potential to further make compliance easier for SME exporters while eliminating time-consuming efforts to verify business information.

- **Blockchain Technologies:** Blockchain technologies promise to reduce the complexity and costs of trade finance instruments. With shared, immutable databases that are visible to all parties, blockchains can help develop trust and transparency among parties who do not know each other well but must work together through common documentation. As such, trade finance, with the involvement of multiple parties – the exporter, the importer, the correspondent banks, and other third parties – is a suitable application of blockchain technologies. In addition, blockchains can enable speedy verification of digital documents, simpler KYC compliance, and smart export sales contracts with automated payments.

- **Artificial Intelligence with Big Data Analytics:** Artificial intelligence (AI) with big data analytics can enable trade finance providers to make faster and more accurate credit decisions in cross-border trade transactions. In other words, AI can help trade finance providers conduct more thorough due diligence of business information, which could result in granting more favorable financing and credit terms to their SME customers. AI can also enable trade finance providers to conduct more thorough and accurate compliance checks, which reduce asymmetric information differences while lowering costs for SME exporters.

New Fintech-based Trade Finance Providers and Innovative Solutions

Digitalization of trade finance is expanding the portfolio of both trade finance providers and trade finance solutions. Web-based real-time updates and smart contracts can allow for innovative and less costly trade finance solutions. New fintech-based trade finance providers are appearing outside of the traditional global financial system. Many of them are launching online only platforms that are connecting exporters and importers to provide both traditional trade finance instruments and innovative fintech-based solutions.

Risks of Digitalization

While the benefits of the global digital economy are undisputable, U.S. exporters should also be aware of some of the risks that come with innovation. Like any financial innovation, changes in trade finance can lead to unanticipated risks that could result in sudden and serious liquidity problems for new non-deposit taking fintech-based trade finance providers. The advancement of digitalization also increases the chance for cybersecurity risk, either due to human error or intentional interference from malicious actors.

Tips for Exporters

- Be mindful of emerging trends that could reduce the complexity, cost, and processing time of trade finance transactions.
- Inquire with your current trade finance provider about available or planned digital options that could enhance efficiency and reduce costs.
- Explore trade finance options, including consulting new fintech-based trade finance providers about both traditional instruments and innovative offerings.
- Be cautious of potential fraud and cyber security risks that may accompany new technologies and online trade finance platforms.

Appendix

A List of Collaborating Organizations

https://www.baft.org

The Bankers Association for Finance and Trade (BAFT) is the leading global industry association for international transaction banking. It helps bridge solutions across financial institutions, service providers and the regulatory community that promote sound financial practices enabling innovation, efficiency and commercial growth. Founded in 1921 as the Bankers Association for Foreign Trade, BAFT celebrated its centennial anniversary in June 2021.

https://www.exim.gov

The Export-Import Bank of the United States (EXIM) is the official export credit agency of the United States. EXIM is an independent Executive Branch agency with a mission of supporting American jobs by facilitating the export of U.S. goods and services. When private sector lenders are unable or unwilling to provide financing, EXIM fills in the gap for American businesses by equipping them with the financing tools necessary to compete for global sales.

https://fcibglobal.com

The Finance, Credit, and International Business Association (FCIB) is a prominent business educator of credit and trade finance professionals, with thousands of members worldwide in exporting companies ranging in size from multinationals to SMEs. FCIB's parent organization, The National Association of Credit Management (NACM), is a non-profit organization that represents nearly 15,000 businesses in the United States and is one of the world's largest credit organizations.

https://www.ictfworld.org

The Association of International Credit & Trade Finance Professionals (ICTF) is the only independent, not-for-profit, member-led association, which provides a distinct advantage to those who seek greater expertise in the field of international credit management. Having attracted more than 1,000 members in over 50 countries, ICTF serves export companies from a variety of industries and sizes, from experienced multi-nationals and SMEs that are new to international trade or trying to break into new markets.

https://www.factoring.org

The International Factoring Association (IFA) is the largest association of commercial finance companies in the world. Founded in 1999, the IFA provides a forum for over 425 corporate members to get together and discuss a variety of issues and concerns in the industry. IFA members include factoring companies, asset-based lenders, and other receivables finance companies.

https://itfa.org

The International Trade and Forfaiting Association (ITFA) is the worldwide trade association for companies, financial institutions and intermediaries engaged in global trade, forfaiting, supply chain and receivables financing. ITFA's Americas Regional Chapter supports the association's financial institution members and their exporter clients in the United States, Canada, and Brazil.

https://nasbite.org

NASBITE International is an independent, non-profit membership-based organization that coordinates and administers the Certified Global Business Professional (CGBP) credential. NASBITE's mission is to advance global business practice, education and training among those actively engaged in international trade, global business education and trade assistance. NASBITE accomplishes its missions through (1) an Annual Conference and National Small Business Exporter Summit, (2) CGBP credentialing and training, (3) other programs and services.

https://www.sba.gov

The U.S. Small Business Administration (SBA) is the only cabinet-level federal agency fully dedicated to small business and provides counseling, capital, and contracting expertise as the nation's only go-to resource and voice for small businesses. SBA's Office of International Trade provides U.S. small business expert trade counseling services, in addition to access to financing and grant funding to support global sales.

https://thunderbird.asu.edu

Thunderbird School of Global Management is one of the top ranked international business schools in the world and is the vanguard of global leadership, management, and business education for the Fourth Industrial Revolution. As part of Arizona State University, ranked the top "Most Innovative School" in the nation, Thunderbird's Master of Global Management degree is currently ranked the best in the world. Thunderbird celebrated its 75th anniversary in April 2021.

https://www.fas.usda.gov

The U.S. Department of Agriculture (USDA) is the federal executive department responsible for providing leadership on food, agriculture, natural resources, and related issues. USDA's Foreign Agricultural Service operates two export finance programs that encourage the commercial financing of U.S. agricultural products and goods and services.

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

INTERNATIONAL
TRADE
ADMINISTRATION

International Trade Administration
U.S. Department of Commerce

1401 Constitution Ave. NW
Washington, DC 20230

www.trade.gov
www.trade.gov/trade-finance-guide

Connect With ITA

www.twitter.com/TradeGov

www.facebook.com/TradeGov

www.youtube.com/TradeGov

www.linkedin.com/company/international-trade-administration