

OUTLINE FOR CHAPTER 16

- Understand
 - Basic needs of export/import financing
 - Main instruments (letter of credit, bill of exchange, and bill of lading)
 - Export Credit Insurance
 - Eximbank
 - Countertrade

Chapter 20 - Import and Export Financing

- Usually there are more formal rules in export/import trade than purely domestic trade
 - Hard to get information on each party
 - Communication is harder
 - Customs are different
 - Don't want to end up in a court in a foreign country

Basic Needs of Import/Export Financing

- Risk of Noncompletion - both the buyer and seller do not want to be in the position of having neither money nor goods
 - Seller wants to have legal title to goods until getting paid or at least assurance of payment
 - Buyer doesn't want to pay until receiving the goods or receiving title to the goods.
- Transaction Exposure
- Financing

Main Instruments in Export-Import Financing

- Letter of Credit
- Draft or Bill of Exchange
- Bill of Lading

- There are some open account transactions especially between related companies and companies that trade frequently with each other

Letter of Credit

- Issued by a bank at the request of an importer
- The bank promises to pay a beneficiary (usually the exporter or the exporter's bank) after receiving certain documents specified in the Letter of Credit

Letter of Credit



Letter of Credit

- The bank puts itself in the middle between the buyer and the seller
- Exporter likes it because it reduces the risk of noncompletion. Even if there are foreign exchange blockages the exporter is more likely to get paid since banks have more access to foreign exchange than most companies.

Letter of Credit - Continued

- Exporter may also get pre-export financing easier
- Importer will often not have to pay until the bank receives the proper documents and all conditions stated in the LC have been satisfied.
- Disadvantage – Cost to the importer

Typical Transaction

- 1) After exporter and importer agree on a transaction, importer applies to his bank for a L/C
- 2) Assuming bank agrees, bank sends L/C to exporter's bank specifying what documents must be included
- 3) After exporter ships goods, exporter draws a draft against the issuing bank, attaches documents and gives all this to the (exporter's) bank

Typical Transaction - Continued

- 4) Exporter's bank sends everything to issuing bank
- 5) Issuing bank (if documents are in order) honors draft
- 6) Exporter's bank receives funds and passes them on to the exporter
- 7) At some time during this process the importer will pay the issuing bank

Types of L/C

- 1) Irrevocable vs. Revocable - irrevocable l/c can not be canceled or modified unless all parties agree
- 2) Confirmed vs. Unconfirmed - if confirmed the exporter's bank is obligated to honor drafts if for some reason issuing bank can not or will not pay

Types of L/C - Continued

- 3) Revolving vs. nonrevolving - nonrevolving l/c are valid for only one transaction

Draft or Bill of Exchange

- An order written by exporter telling an importer or its bank to pay a certain amount of money now or a particular time in the future
- Drawer issues bill - exporter
- Drawee the party to whom the draft is addressed (if buyer - trade draft and if bank - bank draft)

Drafts - Continued

- Sight drafts are payable right away while time drafts are payable in the future
- If drawee agrees to pay time draft - write accepted on draft
- If drawee is a bank and draft is a time draft then once it is accepted it becomes a banker's acceptance

Banker's Acceptance

- If an exporter needs money right away can discount acceptance
- Banker's acceptances are instruments (like CD's) that investors hold to earn extra short-term income

Bill of Lading

- Issued by common carrier to exporter
- Three main purposes:
 - 1) receipt (carrier has received merchandise)
 - 2) contract (lists responsibilities of carrier)
 - 3) document of title (used to obtain payment or promise of payment before goods are released to importer)
- Can also function as collateral so exporter can get money by its local bank prior to receiving it from importer

Government Programs to Help Finance Exports

- Most governments want to encourage exports (jobs) so in many countries there are institutions that offer export credit insurance at favorable rates and also government supported banks for export financing

Export Credit Insurance

- Exporters often get business because they offer more favorable credit terms than their competitors
- Export credit insurance allows companies to offer favorable credit terms because in cases of default the insurance companies will pay a substantial part of the loss
- If the exporter has export credit insurance, the importer may not need a letter of credit which will save the importer money

Export Credit Insurance in the U.S.

- Offered by Foreign Credit Insurance Association (FCIA), which is an unincorporated association of private insurance companies operating with Eximbank (Export-Import Bank)

FCIA

- Insurance against
 - commercial risk (insolvency or lack of payment of buyer)
 - political risk (actions of governments beyond control of buyer or seller)
 - examples- buyer can't get dollars or approved currencies and transfer them to the insured, civil war, or importer can't import goods

FCIA - Continued

- Coverage for U.S. goods produced and shipped from U.S.
- Coverage
 - commercial 90-95%
 - political 95-100%

Eximbank

- Independent agency of U.S. government
- Started in 1934
- Purpose - Push exports
- Eximbank guarantees repayment of export loans given by U.S. banks to foreign borrowers (6 months to 10 years)
- Also lends funds to foreign borrowers directly (requires private participation) for buying U.S. goods

Eximbank - Continued

- Can provide working capital to help small exporters
- If foreign governments provide unfair subsidies, then Eximbank can provide help to those U.S. exporters affected by those subsidies

State Programs

- Many states have programs that give exporters special financing

Countertrade

- Goods and services are paid for or partially paid for by other goods and services
- Often one country involved may be less developed, a centrally planned economy, has more political risk, and/or has poor quality goods
- Countertrade is often a second best solution (free trade is best)

Examples of Countertrade

- Examples include
 - simple barter (goods for goods - Pepsi for vodka)
 - buyback or compensation agreement (export plant and equipment and get paid in output of new firm - build a car plant and get paid in cars)