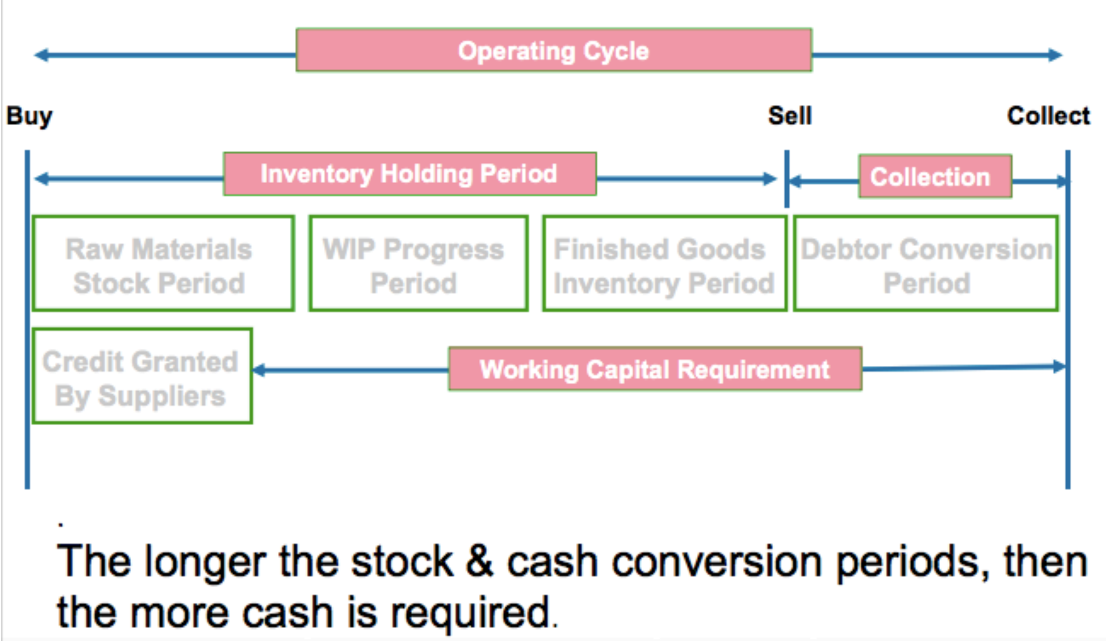
Week 9:
Trade, payments, financing & countertrade

Cash flow management:
The key aspect of a successful business is to manage the cash flows
While long term funding is required to plant and equipment items, those other assets consumed in the production of goods and services can be obtained on shorter, and often better, terms and conditions
This applies to both domestic and international sales transactions
In other words, at its simplest, cash flow management means delaying outlays of cash as long as possible while encouraging anyone who owes you money to pay it as rapidly as possible. Prepare cash flow projections for next year, next quarter and, if you're on shaky ground, next week.

Cash flow cycle requirements:



Trade finance:
Trade finance is generally reserved for those bank products specifically linked to underlying trade transactions (exports or imports)
As such, working capital loans not specifically tied to trade are generally not included in this definition
Trade finance products typically carry short-term maturities, but medium term funding can be obtained via forfaiting and even longer funds via government trade finance agencies

Domestic versus international trade:
Besides financing these working capital requirements, businesses will seek to expand from selling to overseas as well as domestic buyers
While these overseas clients have all the same risks as domestic ones, they pose additional risks as well
These challenges can be quite significant

Challenges in international trade:

- Buyer and seller unknown to each other
- Language, laws, customs, regulations
- Transportation systems and distances
- Buyers want time to pay while sellers want immediate payment
- Transfer of funds may be delayed
- Foreign exchange risk
- Tariff barriers may complicate sales
- Country stability and political problems may impact on the transaction

Conflicts between buyer and seller:

Sales contracts:
All trade transactions are subject to contractual agreement (sales contract) between the buyer and the seller
Sales contract should include method of dispatch, documents required, specification of party bearing the related costs, methods of payment
The payment methods in international trade are more complex

Payment methods in for international trade
The key payment methods for international trade include:

- *Prepayments (Cash in advance)*
  Also known as clean payment where the importer pays the exporter for the goods in advance
  This cash in advance removes the payment risk from the transaction
  It is particularly useful where the buyer is in a country subject to political unrest, the goods made to order or it is for a new and unfamiliar customer
  It may also provide the exporter some pre-shipment finance as well
  -Time of payment: Before shipment
  -Goods available to importer: After payment
  -Risks: The goods will not be shipped until the importer has paid the exporter
  -Risk to exporter: None

-Risk to importer: Relies completely on exporter to ship goods (and as ordered)

- *Letters of credit (need not involve credit)*
  The L/C is the safest method of payments for both the exporter and importer
  It is a formal undertaking by the buyer's bank that it will pay subject to certain documents being provided
  Once created, the seller can use the L/C as the basis to finance producing the goods
  L/C's involves both the banks of importer and exporter and relies on accurate preparation of all the associated paperwork
    -Time of payment: When shipment is made
    -Goods available to importer: After payment
    -Risks: These are issued by a bank on behalf of the importer promising to pay the exporter upon presentation of the shipping documents; it need not be directly related to financing
    -Risk to exporter: Very little or none
    -Risk to importer: Relies completely on exporter to ship goods as described in documents
- *Sight Drafts & Time Drafts*
  These drafts are drawn by the exporter instructing the importer to pay the draft's face value
  The importer is expected to pay this amount when the correct documentation (shipping documents and title to the goods) is presented – immediately with a sight draft, or after specific period with a time draft
  Banks on both ends usually act as intermediaries in the processing of shipping documents and the collection of payment. In banking terminology, these are known as documentary collections or documents on collection (or D/C)
  Once the importer pays the invoice (a document against payment of D/P transaction) or provides a bank guarantee of payment within a specified period (a document against acceptance or D/A), the exporter has access to funding
  This only becomes a bankers' acceptance (B/A) – a bank accepted bill of exchange – when the importer's bank signs as the acceptor of the draft
  A B/A is an instrument that can be discounted for cash in the money market
    -Time of payment: On presentation of draft
    -Goods available to importer: After payment
    -Risks:
      Sight drafts (documents against payment) – when the shipment has been made, the draft is presented to the importer for payment
      Time draft - is for a specific period after documents are received
    -Risk to exporter: Disposal of unpaid goods
    -Risk to importer: Relies completely on exporter to ship goods as described
- *Consignments*

A consignment is where the exporter ships the goods to the buyer but retains ownership
The idea is that importer has access to them but does not have to pay until they are sold
The proceeds are usually remitted immediately on their sale or after a specific period from sale
Given the risk, this is normally confined to transactions with affiliated firms
They may also just limit the transactions to demonstrator models rather than all sales
So the importer has physical possession but not ownership of goods, this changes only after sold to third party, then the importer must pay

-Time of payment: Immediately after their sale to third party or after an agreed period
-Goods available to importer: Before payment
-Risks: The exporter retains actual title to the goods shipped to the importer which may limit risk (little security against importer not paying)
-Risk to exporter: Allows importer to sell inventory before paying exporter
-Risk to importer: None

- *Open Accounts*

Open account arrangement is where the exporter provides the imported with a specific number of days to settle after the shipment or invoice date
It reserved for clients with which the export has a long standing relationship as well as having good credit standing or an affiliated company
Importer has ownership and specific time to pay exporter
While it entails the most risk, it is the most common payment methods

-Time of payment: As agreed upon
-Goods available to importer: Before payment
-Risks: The exporter ships the merchandise and expects the buyer to remit payment according to the agreed-upon terms (little security against importer not paying)
-Risk to exporter: Relies completely on buyer to pay account as agreed upon
-Risk to importer: None

METHOD	USUAL TIME OF PAYMENT	GOODS AVAILABLE TO BUYERS	RISK TO EXPORTER	RISK TO IMPORTER
Prepayment	Before shipment	After payment	None	Relies completely on exporter to ship goods as ordered
Letter of credit	When shipment is made	After payment	Very little or none, depending on credit terms	Assured shipment made, but relies on exporter to ship goods described in documents
Sight draft; documents against payment	On presentation of draft to buyer	After payment	If draft unpaid, must dispose of goods	Same as above unless importer can inspect goods before payment
Time draft; documents against acceptance	On maturity of drafts	Before payment	Relies on buyer to pay drafts	Same as above
Consignment	At time of sale by buyer	Before payment	Allows importer to sell inventory before paying exporter	None; improves cash flow of buyer
Open account	As agreed	Before payment	Relies completely on buyer to pay account as agreed	None

Functions of trade finance:

1. To reduce both buyer and seller risk
2. To pinpoint who bears those risks that remain
3. To facilitate the transfer of risk to a third party
4. To facilitate financing