The Handbook of International Trade and Finance

The complete guide to risk management, international payments and currency management, bonds and guarantees, credit insurance and trade finance




Anders Grath

Second Edition

KoganPage

SECOND EDITION

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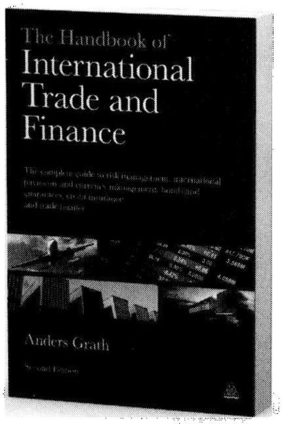

The Handbook of International Trade and Finance

PREFACE

This handbook was originally published more than 20 years ago, and has since been updated in new editions. It has also been published as separate country-specific editions in several European countries where it has become a reference handbook for companies, banks and other institutions involved in international trade, irrespective of their size or the nature of their business.

However, for practical reasons it was not possible to cover more than a handful of countries in this way, thus the idea for a completely new and country-neutral edition that could be marketed in most countries involved in international trade around the world. The only drawback is that it is not feasible to describe the specifics for every country; on the other hand, the basic aspects of international trade, payments and finance are almost the same all over the world, and that is the foundation for this handbook.

There is great advantage in being able to combine this basic description with detailed references where such country-specific information can be found. This information is nowadays readily available from internet sites from a variety of domestic institutions in most countries. Therefore it has been possible to create a situation where this book provides the foundation at the same time as readers from all over the world can add whatever detailed and country-specific information they require. There is another big advantage in such an approach: that the basics of this handbook should be relatively stable over time, whereas detailed information from local and domestic institutions will certainly change over time.

All editions published over the years have been based on the same concept, which is their practical nature. They contain no theoretical elements, just information based on the author's 30 years of payment and finance experience gained from managerial positions as head of international departments in a number of European banks. In such positions you are necessarily involved in thousands of trade transactions each year, and the advice and comments given in this book are based on that experience.

I am very pleased with this second international edition now published by Kogan Page, and feel confident that it will continue to be the reference handbook of choice in numerous countries around the world, for many years to come. It will certainly be of significant benefit to international traders in the daily work of expanding their businesses or when entering new global markets, but the book will equally be increasingly used in trade education and as a practical tool within international departments of commercial banks and other trade-related institutions.

ACKNOWLEDGEMENTS / DISCLAIMER

The author would like to thank the companies, banks and other institutions that have contributed with support, advice and comments when creating this book; however, the author is solely responsible for the views, illustrations and recommendations expressed.

While every care has been taken to ensure the accuracy of this work, no responsibility for loss occasioned to any person or company acting or refraining from action as a result of any statement in it can be accepted by the author or publisher.

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Introduction

An international trade transaction, no matter how straightforward it may seem at the start, is not completed until delivery has taken place, any other obligations have been fulfilled and the seller has received payment. This may seem obvious; however, even seemingly simple transactions can, and sometimes do, go wrong.

There are many reasons why these things happen, but behind them all is the basic fact that the risk assessment of the transaction and/or the way these risks were covered went wrong. An example is the risk assessment of the customer, where exporters do not always fully realize that some larger countries are divided into regions or states, often with different cultures, which may affect trade patterns and practices. In some countries, what the seller thought was a signed contract may just be seen as a letter of intent by the buyer until it also has been countersigned by them by a more senior and internally authorizing manager. Or it may be that the seller has agreed to terms that were previously used but are not suitable in a changed environment.

Another reason may be that the parties simply did not use the same terminology or did not focus on the details of the agreed terms of payment. This would inevitably lead to undefined terms, which are potentially subject to future disputes, something that would perhaps not be revealed until delivery has been made – when the seller is in a weaker bargaining position. Even though such errors seldom lead to non-payment, it is more likely that they will lead to delays in payment, possibly with an increased commercial and/or political risk as a consequence.

Another common consequence of unclear or undefined terms of payment is that the seller may have outstanding claims on the buyer; or that the buyer is of the same opinion with regard to the seller and takes the opportunity to make unilateral payment deductions owing to real or alleged faults or deficiencies in the delivery.

Each area of international trade requires its own knowledge to be used, from the first contacts between buyer and seller to final payment. One area of expertise is how to develop professional and undisputed terms of payment

TABLE 0.1 Leading exporters and importers in world merchandise trade, 2009 (Billion US$)

Exporters			Importers		
1	China	1202	1	United States	1605
2	Germany	1126	2	China	1006
3	United States	1056	3	Germany	938
4	Japan	581	4	France	560
5	Netherlands	498	5	Japan	552
6	France	485	6	United Kingdom	482
7	Italy	406	7	Netherlands	445
8	Belgium	370	8	Italy	413
9	Korea, Republic of	364	9	Hong Kong, China	352
				– retained imports	91
10	United Kingdom	352	10	Belgium	352
11	Hong Kong, China	329	11	Canada	330
	– domestic exports	17			
	– re-exports	313			
12	Canada	317	12	Korea, Republic of	323
13	Russian Federation	303	13	Spain	288
14	Singapore	270	14	India	250
	– domestic exports	138			
	– re-exports	132			
15	Mexico	230	15	Singapore	246
				– retained imports	114
16	Spain	219	16	Mexico	242
17	Taipei, Chinese	204	17	Russian Federation	192
18	Saudi Arabia	192	18	Taipei, Chinese	174
19	United Arab Emirates	175	19	Australia	165
20	Switzerland	173	20	Switzerland	156
21	India	163	21	Poland	147
22	Malaysia	157	22	Austria	143
23	Australia	154	23	Turkey	141
24	Brazil	153	24	United Arab Emirates	140
25	Thailand	152	25	Thailand	134
26	Austria	138	26	Brazil	134
27	Poland	134	27	Malaysia	124
28	Sweden	131	28	Sweden	120
29	Norway	121	29	Czech Republic	105
30	Indonesia	119	30	Saudi Arabia	96
31	Ireland	115	31	Indonesia	92
32	Czech Republic	113	32	Denmark	83
33	Turkey	102	33	Hungary	78
	World	**12.490 ***			

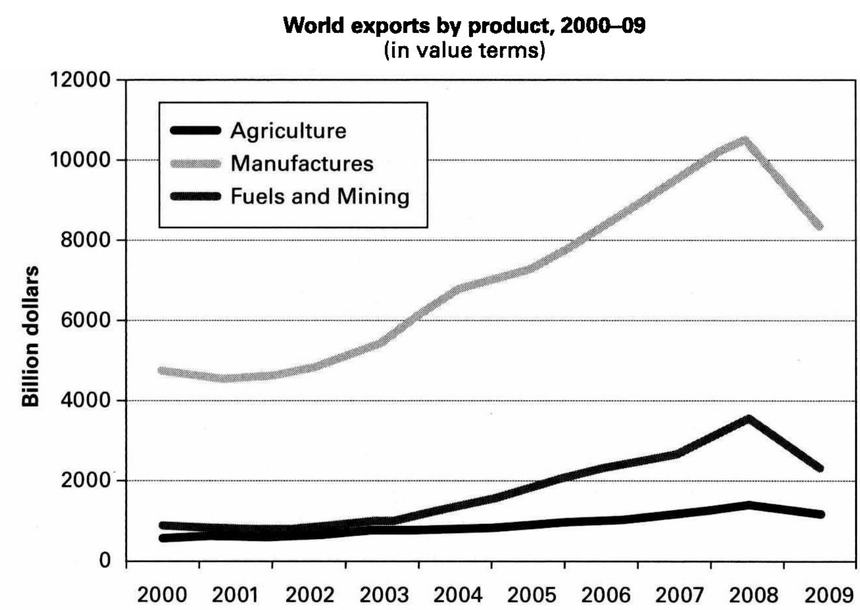
* Includes significant re-exports or imports for re-export.

SOURCE WTO, World Trade Statistics 2009 (http://www.wto.org/english/res_e/statis_e/its2010_e/its10_toc_e.htm) and, if necessary, how to solve currency and trade finance questions in a competitive way. These areas are of vital importance both in the offer and in subsequent contract discussions, not just within difficult countries or markets or in larger, more complicated deals, but also in quite ordinary day-to-day transactions.

The choice of currency could be of great importance, particularly in an increasingly competitive market, and the ability to extend finance has become a major competitive factor in negotiations. In such an environment the terms of such credits are mostly to the advantage of the buyer and, as a consequence, demand for longer periods and more advantageous terms has increased.

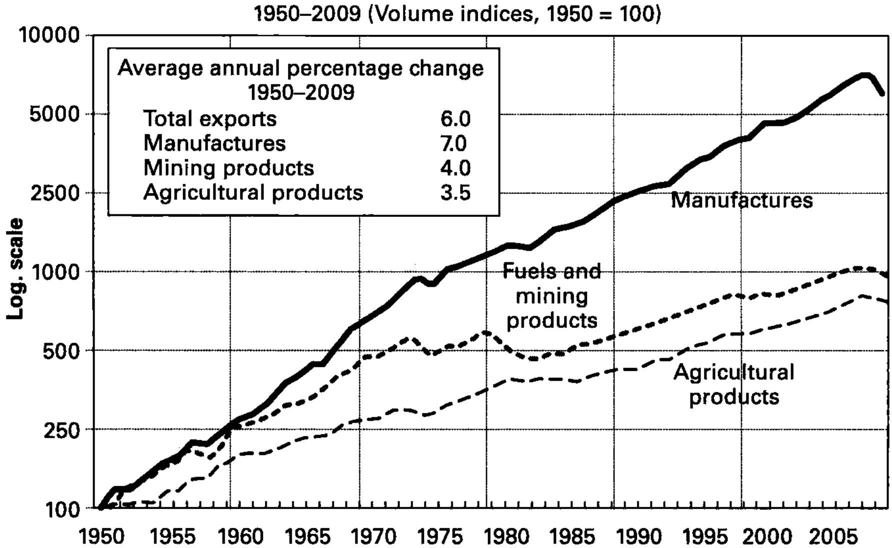
Terms of payment, currency and finance alternatives can, in some cases, and/or in similar and repetitive transactions, be developed as standard models but must, in other cases, be adapted to each transaction and its specific preconditions. This is even more obvious if one looks at Table 0.1 and evaluates the basic structure of international trade. There are also more than 150 other countries, including many developing and emerging markets countries, which are not even listed, and in many of these the structuring of the terms of payment is the key to more frequent and profitable business.

FIGURE 0.1 World commodity profiles 2009



SOURCE WTO, World Trade Statistics, 2009 (http://www.wto.org/english/res_e/statis_e/its2010_e/its10_toc_e.htm)

FIGURE 0.2 World merchandise trade by product group



SOURCE WTO, World Trade Statistics, 2009 (http://www.wto.org/english/res_e/statis_e/its2010_e/its10_toc_e.htm)

Every transaction contains many different preconditions, apart from aspects such as the buyer, the country, the nature of the goods, size, extent and complexity. This requires the seller to carry out an individual risk assessment and make decisions that ensure a profitable and secure deal, with a level of risk that is both defined and accepted at the outset.

It is therefore of great importance, for both buyer and seller, to know how to structure practical terms of payment. In practice this often means that during negotiations the seller must be willing and able to compromise – even when it comes to specific questions related to guarantees, payments, currency and finance. In these situations, and often together with other difficult negotiations, it is important to understand the connections between these parts, what is essential to hold on to and what can be waived.

Any successful negotiation must take reasonable and equal consideration of the demands from both commercial parties in order to find a compromise and avoid unnecessary discussions or misunderstandings. The experienced seller will always try to avoid such situations, thereby strengthening also the potential for future business transactions, provided that fundamental demands have been met to safeguard the transaction.

This handbook should be used as a reference manual in the practical day-to-day business of the international trading company within the sales, shipping, administrative and back-office departments. For small and medium-sized companies that do not always have the specialist finance functions in-house this is obvious, but this will also be the case even within the largest companies, where specialization often means that many employees have detailed knowledge in some, but not all, of these financial areas.

This goes not only for the exporting company, but also within importing companies buying goods or services from abroad. Many comments have been made about the advantages of describing, in practical detail, the interactive negotiating process between the commercial parties in an international trade transaction; useful knowledge for both the seller and the buyer.

That is exactly the way these handbooks have been used for over 25 years.

Cash management

One important development over recent years has been the demand for capital rationalization, or 'cash management'. This has affected all aspects of business, not least the sections covered in this handbook. It is especially obvious within the areas of payment, currency and finance where every decision has direct consequences on the capital required during all phases of the transaction, until payment is received.

This handbook demonstrates primarily how the seller can act, within the framework of a defined risk level and with their competitive edge maintained, to optimize the profitability of international trade transactions. They can then also determine, with a high degree of accuracy, when, where and how payments will be made and therefore how to minimize the capital required. The concept of risk is directly connected to the probability of timely payment, the choice of currency related to the exchange rate when paid and the financing connected to the cost of the outstanding credit. The importer will use the same knowledge, but from their own perspective.

The expression 'cash management' is seldom explicitly used in the text, but most sections contain comments or advice that, directly or indirectly, has a bearing on the use and latent risk of capital. With this in mind, this handbook could be read as a manual for improved cash management in connection with international trade (more on this is in the final chapter concerning the practical structure and design of the terms of payment).

The main composition of this handbook

This handbook is intended to be a practical reference guide to help in the daily work – mainly seen from the perspective of the seller – within sales, shipping and administration. The contents have, therefore, been structured as follows:

- risks and risk assessment → (analysis)
- methods of payment
- guarantees, bonds and standby L/Cs
- export credit insurance
- currency risk management (alternatives)
- trade finance
- structured trade finance
- structure and design of practical terms of payment → (action).

To get a clearer picture of the focus of this handbook,
please also consider this question and answer,
taken from the seller's perspective:

Why are some companies doing more frequent and successful export deals than others?

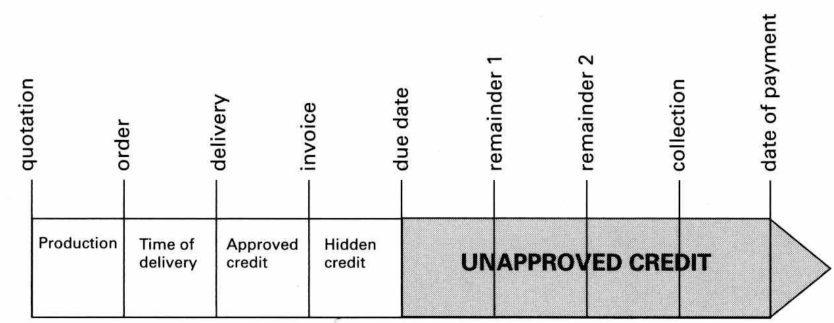
It is because they manage to cover even the most difficult export risks – only then are they in the best position to enter totally new markets.

Sell more – win market shares – enter new markets.
Who doesn't want that? But the problem is often not making the sale but ensuring that you get paid.

Why do things sometimes go wrong in the export chain, from quotation to payment – or in the worst case, non-payment? The answer is that the seller often underestimates, or simply does not fully understand, the risks involved in the transaction. Or the seller does not get the terms of payment originally anticipated and, at that stage, does not manage to cover the transaction in some other way, or even abstains from the deal altogether. Basically it is a matter of learning how to cover the trade risks in a professional way, allowing the seller to manage transactions in most parts of the world.

However, the follow-up must also be done professionally at home.

What is needed is effective handling of the transaction until shipment occurs and, thereafter, effective debt supervision.
Time is money – look at the time arrow below.



The follow-up starts immediately after the contract is signed. It can be a forward currency hedge, the issuing of guarantees, communication with the insurance company about an export credit risk policy or follow-up of the obligations of the buyer, for example the correct issue of a letter of credit. To end up in the grey area of the time arrow is always risky; there the seller is more exposed – the goods have been shipped but without the payment being received in time.

Worst of all, if pre-shipment control is not in place, even the most secure letter of credit will be worthless if the seller is not able to comply fully with its terms later on. It is often in sales negotiations in foreign countries far away from the home organization that the details for a profitable transaction have to be decided. And once the deal is signed, it may be difficult to get changes to the advantage of the seller – not least regarding the terms of payment.

The follow-up is crucial and will ultimately decide the profitability of the transaction.

Trade risks and risk assessment

1

International trade practices

All forms of business contain elements of risk, but when it comes to international trade, the risk profile enters a new dimension. Internationally, you seldom have common laws that can support the transaction, as would be the case within one country. Instead, established trade practices and conventions are used to settle the undertakings made by the parties. The main sources for international trade practices are publications issued by the International Chamber of Commerce (ICC), which will be referred to many times throughout this book.

Successful trade transactions, therefore, depend on a knowledge of these established practices and ensuring that the undertakings in the individual contract are in line with such practices. This is why it is crucial for the seller to have started with a correct risk assessment before entering into the transaction. Sometimes, however, the circumstances in a particular case are so obvious that one hardly thinks of it as a risk assessment, whereas in other situations a thorough risk assessment needs to be done.

In every new transaction one has to take it for granted that, from the outset, the parties will have different views about various aspects of the terms of payment. This is quite logical since the most important function of these terms for both seller and buyer is to minimize not only the risks involved, but also the cost of payment and of the financing of the transaction.

The negotiation process

The seller will always try to get terms that will maximize the outcome and minimize the risk. However, they must also be prepared to accommodate reasonable demands from the buyer in order to match other competitors