

Exporting & Importing

- I. Exporting and importing
- II. Export/import financing
- III. International-trade documentation
- IV. Special assistance for exporters and importers

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Exporting & Importing

- International trade offers many attractive opportunities:
 - Profit
 - Diversification
 - New ideas

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Exporting & Importing

- International trade is also frequently (but not always):
 - More *difficult*,
 - More *expensive* and
 - *Riskier* than is domestic trade.

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Risks of International Trade

- *Commercial risk*
 - *Risk of non-performance*
- *Documentation risk*

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Country Risk (1)

- **Economic risk**
 - **Recession**
 - **Economic chaos**
 - **High inflation**
 - **FX risk**

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Country Risk (2)

- *Sovereign risk*
 - = *political risk*
- *Transfer risk*
- **Bureaucratic interference**
- **Expropriation**
- **War & insurrection**

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Country Risk (3)

- **Legal risk**
 - Protection of legal rights (e.g., copyrights)
 - Jurisdiction: What court?
 - Efficiency
 - Fairness

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Trade Protection

Fortunately, the market has developed many tools and institutions to moderate the difficulties, expenses & risks so that companies can take advantage of the opportunities.

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Attraction of IT for *Exporters*

- Broader and more diverse markets
- Diversification of markets
- *Economies of scale*
- *Economies of scope*

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Exporter's Needs (1)

- **Acceptable price & pricing terms**
- **Pre-export financing**
- **Protection against:**
 - *Risk of non-completion*
 - *Risk of non-payment*
 - *Transfer risk*

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Exporter's Needs (2)

- **Protection against FX fluctuation**
- **Avoiding documentation problems**
- **Shipping**

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Exporter's Needs (3)

- **Insurance**
 - **Cargo**
 - **War risk**
 - **Piracy**

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Attraction of IT to Importers

- Price
- Quality
- Variety
- Service

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Importer's Needs (1)

- Protection from *risk of non-completion*
 - *What?* The correct goods and quantity
 - *How?* By *which carrier?* On what *terms?*
 - *When?* Delivery by a certain date
 - *Where?* Delivery to a certain location
 - *For whom?* In whose name is the title?

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Importer's Needs (2)

- Price & acceptable pricing terms
- Financing
- Protection against FX risk
- Avoiding documentation problems

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Importer's Needs (3)

- Shipping
- Insurance
- Prompt movement of goods through customs
- Prompt access to the goods

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The 4 Key IT Documents

- The concerns of both importers and exporters are resolved or greatly reduced by four special documents:
 - *Commercial letter of credit*
 - *Bill of lading*
 - *Bank draft*
 - *Banker's acceptance*

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Commercial Letter of Credit (L/C)

- A bank's *conditional* promise to pay when *all conditions* of the contract (i.e., the letter of credit) have been *satisfied*
 - A Written agreement
 - Issued by a bank (the *issuer*)

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Commercial Letter of Credit (2)

- Issued at the request of the importer (the *applicant*)
- Promising to pay a specified or maximum amount to the exporter (the *beneficiary*)

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Commercial Letter of Credit (3)

- With payment to be made to the exporter
 - At some specified future time
 - If specified conditions have been satisfied *completely and exactly*
 - The beneficiary is informed by an *advising bank*^{grth}

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Commercial Letter of Credit (4)

- If those conditions are fully satisfied, the bank *must* pay.
 - Even if it is to the disadvantage of the bank!

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Commercial Letter of Credit (5)

- An L/C reduces the risks of international trade for both the buyer and the seller.
- With an L/C, the issuing bank's guarantee of payment is added to that of the importer.
 - The exporter thus has a *double guarantee*.

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Commercial Letter of Credit (6)

- The bank pays against *delivery of documents* which are evidence of satisfactory performance—not against delivery of the goods.
- The L/C specifies what documents are needed for payment to be made.
- *Documentary commercial L/Cs*

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Commercial Letter of Credit (7)

- For the *exporter*, an L/C provides:
 - Protection against:
 - *Credit risk* of the importer
 - *Some country risk* of the importer's government
 - Likely to be permitted even if money and capital controls are introduced.
 - Facilitates pre-export financing

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For the Importer (1)

- An L/C provides:
 - A source of credit which makes the import possible
 - Pre-payment is not needed.
 - Especially important for small

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For the Importer (2)

- L/C offers protection against fraud
- However, an L/C is *not* a guarantee by the bank of the customer's satisfaction of the underlying transaction.
 - The bank does *not* inspect the shipment!!!

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For the Bank

- A commercial L/C offers:
 - Fees
 - Sometimes *collateral* (e.g., deposit)
 - Loans, if the importer wants financing until the goods are sold

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Commercial Letter of Credit

■ **Major varieties of import L/Cs:**

- Irrevocable vs. revocable
- Confirmed vs. unconfirmed
- Revolving vs. non-revolving

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***Irrevocable* Letter of Credit**

■ **Can be neither modified nor cancelled without the approval of all parties.**

- Most L/Cs are irrevocable

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***Revocable* Letter of Credit**

■ **Any party to the L/C can either modify or cancel it.**

- Provides no credit-risk protection

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Unconfirmed Letter of Credit

- Only the issuing bank's (and importer's) guarantee protects the exporter

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Confirmed Letter of Credit (1)

- A 2d bank, one which is more acceptable to the exporter, adds its guarantee to that of the issuing bank.

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Confirmed Letter of Credit (2)

- Confirmation protects the beneficiary against both:
 - *Credit risk*: the possible failure of the issuing bank to pay
 - *Sovereign risk*: the possibility that a government might prevent the payment

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Non-Revolving L/C

- A separate L/C is required for each transaction.
- Most L/Cs are non-revolving.

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Revolving L/C

- An L/C *facility* is established by the bank for the benefit of the importer.
- The importer is able to demand several or many L/Cs from the bank, without the need to renegotiate the L/C terms for each L/C.

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Bill of Lading (B/L) (1)

- The document issued by the *carrier* to the *shipper* (i.e., the exporter)

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Bill of Lading (2)

- Always a *receipt* for merchandise (from the carrier to the shipper)
- Always a *contract* (cost of shipping, destination, latest date for delivery, and conditions for release to recipient)

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Bill of Lading (3)

- Also, the B/L often serves as *title* for the merchandise.

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Bill of Lading (4)

- However, the B/L does *not* offer a guarantee to the importer of the actual shipment.
- The carrier does *not* inspect closed containers.
 - [& the bank does not inspect it either—
caveat emptor!!!]

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Draft

- A written (or electronic) order from one person to a 2d person to pay a designated 3d person a specified amount at a specified time
- 1st person: ?
- 2d person: ?
- 3d person: ?

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Sight Draft

- Payment is due at "*sight*"
- Occurs when all of the documents specified in the L/C have been perfectly satisfied and presented to the issuing bank

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Time Draft

- Payment is due at some time *after "sight"* [for example, "90 days sight"].

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Payment Against a Draft

- When the bank acknowledges "sight," it assumes *unconditional* obligation to pay the exporter.
 - *Sight draft*: Immediate payment
 - *Time draft*: Deferred payment—*bankers' acceptance*

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Bankers' Acceptance (B/A) (1)

- *Letter of credit*: conditional promise of a bank to pay an exporter
- *Bankers' acceptance*: unconditional promise to pay

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Bankers' Acceptance (2)

- **Acceptance**: Formal *guarantee* to pay
 - A legal obligation of the bank
- **Unconditional**: The exporter (or other owner) of the B/A has no need to provide documents

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Bankers' Acceptance (3)

- The exporter can hold the B/A until maturity (e.g., "90 days sight)
- But the B/A is a *negotiable* (i.e., *marketable*)--it can be sold.
 - *Money-market instrument*

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Bankers' Acceptance (4)

- *Money-market instruments are generally sold at a discount.*
- $P = (\text{Face value}) / [1 + i (n/365)]$

$$P = \$100,000 / [1 + 0.04 (91/365)] \\ = \sim \$99,013$$

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Bankers' Acceptance (5)

- *Implicit interest is paid instead of explicit interest.*
- The discount decreases as the maturity date approaches.
- The full face value (minus any fees) is paid at maturity.

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Bankers' Acceptance (6)

- The B/A is generally, a very attractive form of financing.

- Its discount rate is determined by the credit-rating of the issuing bank—not that of the exporter.

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International-Trade Documentation

- Four groups of documents are commonly required with L/Cs
 - Commercial documents
 - Bank documents
 - Transportation documents
 - Government control documents

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Commercial Documents (1)

- *Sales contract / purchase order*

- *Commercial invoice: document giving the details for the entire shipment: merchandise, quantity, total cost, terms of sale & shipping requirements*

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Commercial Documents (2)

- **Packing list:** document listing the contents of *each individual container* (e.g., a separate list for each box)
- **Certificate of inspection:** document affirming purity, weight, technical specifications, etc.
 - *Certificate of analysis*
 - *Certificate of quality*

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Bank Documents

- **Letter of credit**
 - **Draft**
 - **Bankers' acceptance**

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Transportation Documents

- **Bill of lading**
- **Insurance documents**

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Government Control Documents (1)

- **Export license**
 - *(or) import license*
- **Export declaration: monitors compliance with export-control regulations and provides statistical data for the government**

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Government Control Documents (2)

- **Certificate of origin (e.g., "Made in Mexico")**
- **Certificate of health (or of purity, quality, or sanitation)**
- **Customs invoice: document issued by the consulate of the importing country for its own customs purposes**

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Special Export-Import Assistance

- **Many institutions, both government and private, offer assistance that is acceptable to GATT / WTO and economic-integration groups**

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Acceptable Varieties of IT Assistance

- Information and advice
- Marketing promotion
- Facilitation services
- Guarantees or insurance
- Loans

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Government Assistance for Exporters

- Information and advice
 - Information on exporting
 - Educational programs for exporting

[Governments are generally much less helpful to importers.]

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Government Marketing Promotion

- Print and Internet advertising
- Trade fairs
- Marketing offices
- Marketing research
- Trade missions

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Government Facilitation Services

- *Foreign-trade zones*

- *Rebate of indirect taxes*
 - *Not direct taxes*

 - *Not subsidies*

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Export Credit Insurance (1)

- **Governments of at least 35 countries offer *export credit insurance***

- **The U.S. government does not, but does support a private association that does: *Foreign Credit Insurance Association (FCIA)***

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Export Credit Insurance (2)

- **Covers**
 - *Commercial risk (90% to 95%)*
 - = *Credit risk*

 - *Political risk (95% to 100%)*

- **Risk of *moral hazard***

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Export Credit Insurance (3)

- Used to facilitate:
 - Issuance of L/Cs on an importer's behalf (usually by a foreign bank)
 - Sales on *open account* by the exporter, in lieu of L/C financing

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Export-Import Bank of the U.S. (Eximbank) (1)

- Many governments, including the U.S., offer special financing to encourage international trade by its companies.
- Despite its name, the Eximbank has never financed a single import.

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Eximbank (2)

- Loans and *guarantees* (which offer the same protection as insurance)
 - For *capital goods only*--not commodities or consumer goods
 - Directly to foreign importers
 - (Or) to foreign banks that offer import financing for U.S. exports (e.g., L/Cs)

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Eximbank (3)

- Export credit insurance (to U.S. exporters)
- Eximbank has a special *working-capital* loan program for small business
- However, Eximbank is primarily identified with big companies. 67

Foreign Freight Forwarder

- Assists *exporters* by handling many of the routine export tasks
 - Documentation
 - Arranging shipping and insurance
 - Advancing shipping expenseskorth 68

Customhouse Broker

- Helps bring an *importer's* goods through customs
 - Often the same company that serves as a foreign freight forwarder
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Other Sources of IT Help

- International trading companies
- Insurance companies
- Quality-control inspectors

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Protection for Both Exporter & Importer

- *Due diligence*
- Pricing in own currency or *hedging* against FX risk
- Letter of credit
- Careful choice of courts or *arbitration* for the settlement of disputes

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Protection Against Exporter's Risk

- Payment in advance
- Credit insurance or guarantees

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Protection Against *Importer's Risk*

- *Due diligence*—careful analysis of the supplier
- Letter of credit
- Certificate of inspection

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Protection Against *Documentation Risk*

- Know the laws and policies thoroughly
- Importer: Structuring the purchase order and letter of credit carefully
- Exporter: Preparing the documents carefully

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