

**WTO/ESCAP ARTNeT Capacity Building Workshop
for Trade Research, Bangkok, Thailand, 22 June
2009**

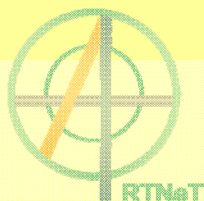
Trade Finance: An introduction

by

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**United Nations Economic and Social Commission for Asia and the Pacific
(UN ESCAP)**



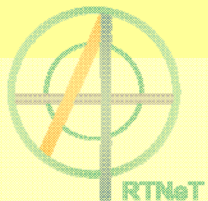
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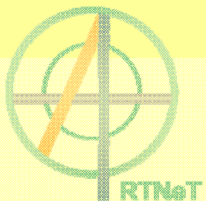
Session Overview

- Part 1 – intro to trade finance
 - Definition and Importance
 - Trade finance tools and instruments
 - Factoring
 - Inventory financing
 - Structured financing
 - Leasing
 - Export credit insurance / guarantees
 - Payment terms
 - Advance payment, L/Cs, documentary collection
 - Trade finance infrastructures; Ideas for research...
- Part 2 – recent lit. and findings; data sources



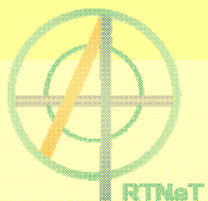
Trade Financing?

- Raising capital
 - Capital for investment
 - Working capital
- Managing risk in trade transactions
 - Credit insurance and guarantees
 - Payment terms
 - Hedging



(Trade) Financing

How important and difficult
is it?

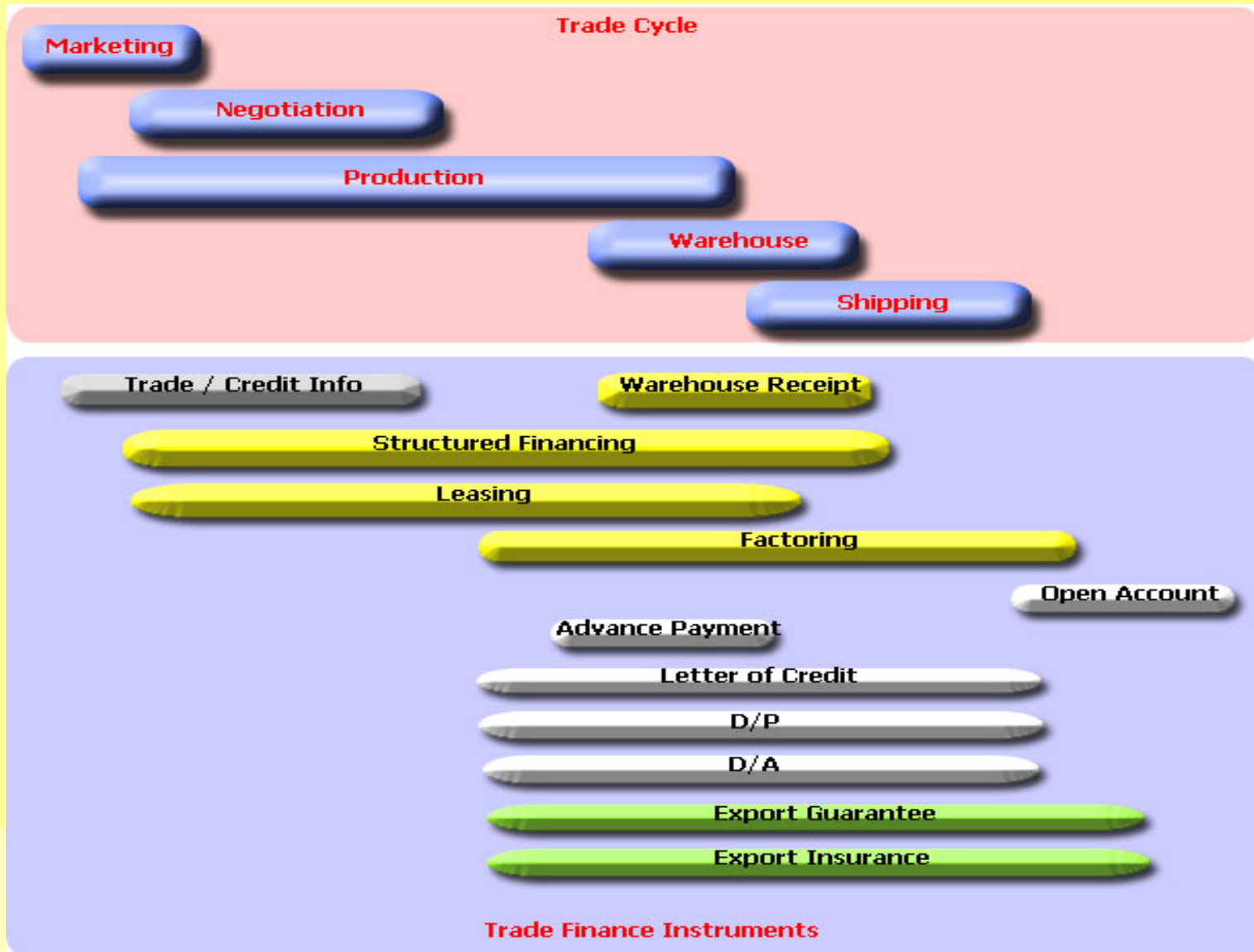


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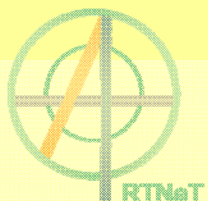
Financing is needed throughout the trade cycle



Pre & Post-Shipping Financing

- Pre-Shipping
 - Prior to the shipment of goods.
 - To support pre-export activities like wages and overhead costs.
- Post-Shipping
 - The period following shipment.
 - Ensures adequate liquidity until the purchaser receives the products and the exporter receives payment.

In international trade, the trade cycle is generally longer than in domestic trade
→ financing becomes very important

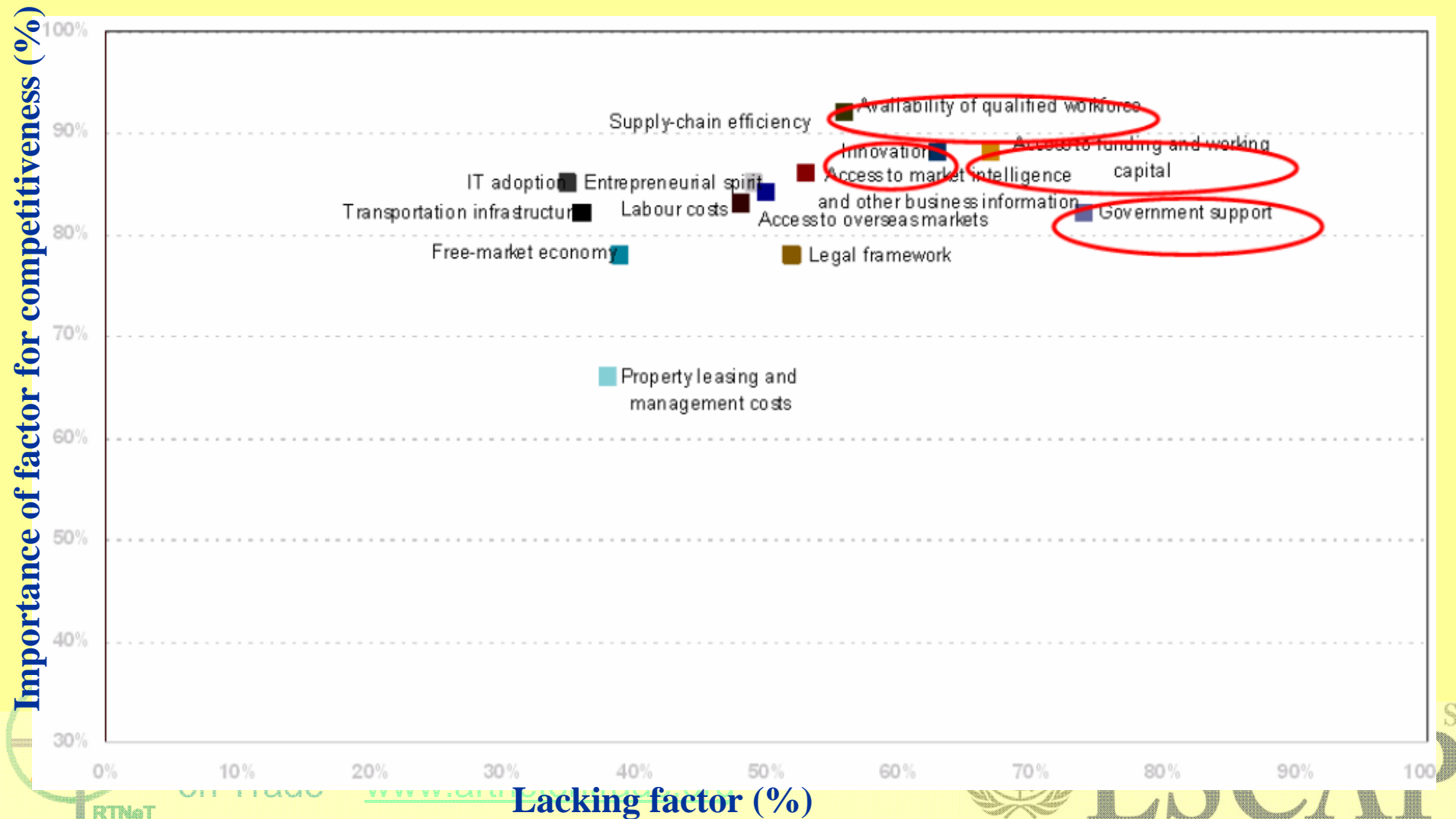


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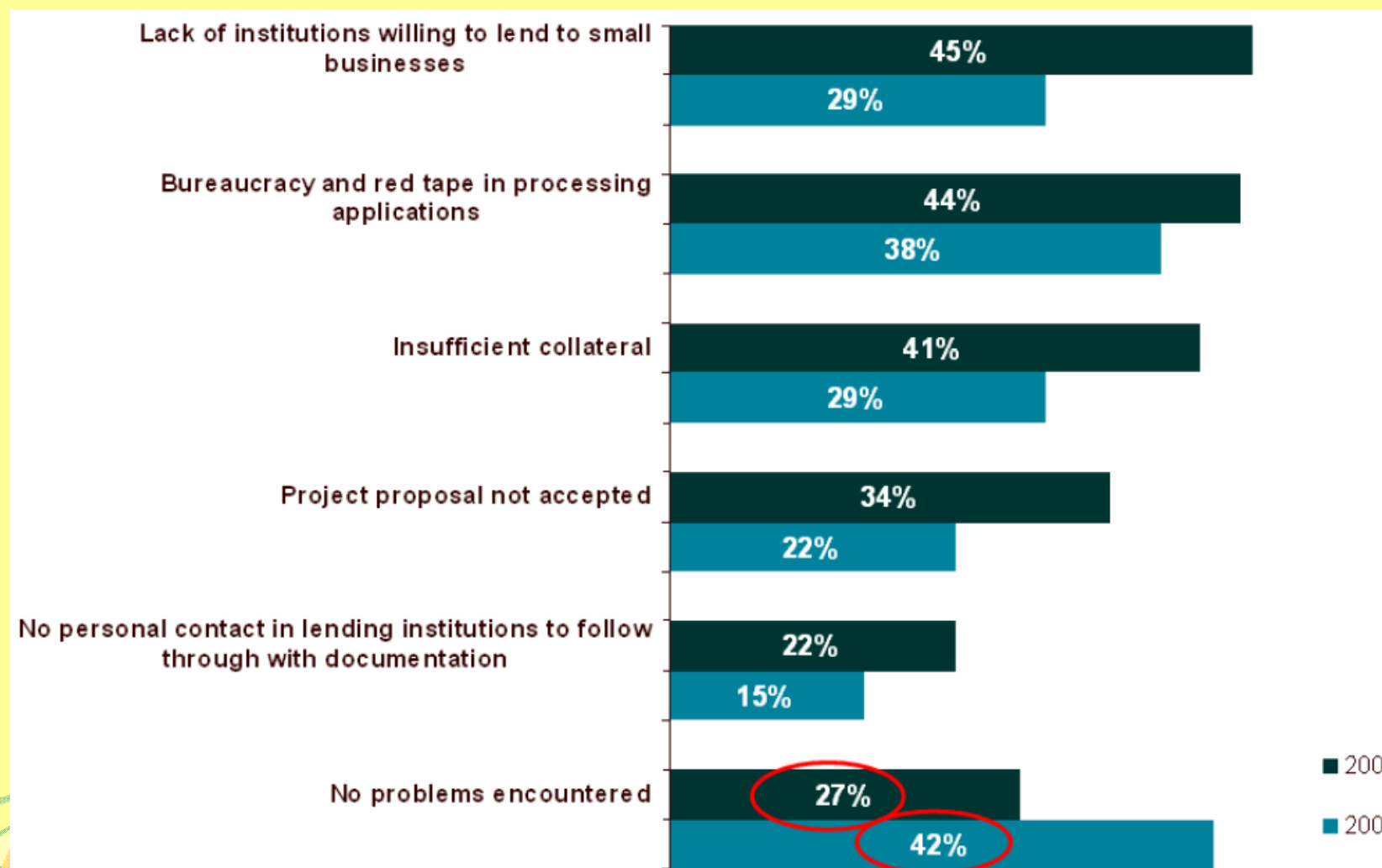


Obstacles to Asia-Pacific SME Competitiveness

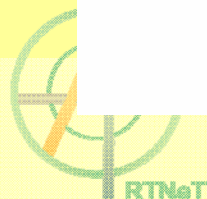
(note: 95% of firms in Asia are SMEs)



Problems encountered by Asia-Pacific SMEs in financing their activities

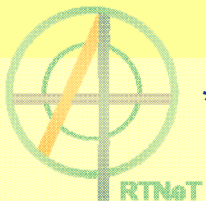


Source: 2009 UPS Asia Business Monitor www.trade.org



Obstacles to trade and investment financing

- Lack of collateral, high cost of loan...
 - Some trade finance instruments exist to solve these problems*



*may not be applicable in all countries + suitable for smaller enterprises
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Many types of assets can potentially be used to secure financing

Assets

Liabilities

Cash

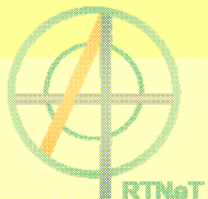
**Accounts
Receivable**

Inventory/Stocks

Equipment

Buildings / Land

...



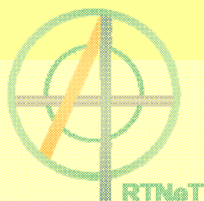
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Factoring

- This involves the sale at a discount of accounts receivable (e.g., export invoices) or other debt assets on a daily, weekly or monthly basis in exchange for immediate cash.
- The debt assets are sold by the exporter at a discount to a factoring house, which will assume all commercial and political risks of the account receivable.





PRODUCTS

[Trade Financing](#) | [Asset Based Financing](#) | [Others](#) | [Government Assistance Schemes](#) | [Enquiry Form](#)

Trade Financing

- **Factoring**

Factoring is a well-established means of providing companies with working capital. Very simply, our clients assign their accounts receivables to us in return for a cash advance of up to 90%. We undertake the task of collecting the receivables as and when they fall due and keep our clients informed of their account status. Not only does this service help our clients to increase their turnover, it also relieves them of the time-consuming tasks of sales ledgering and credit management.

Types of Factoring

IFS offers a full range of factoring services, including:

- **Domestic Factoring** : cash advances of up to 90% against your domestic receivables.
- **Export Factoring** : cash advances of up to 90% against your overseas invoices.
- **IntFactor** : factoring facilities via the Internet.
- **Non-Recourse Factoring** : factoring with credit insurance against bad debts; IFS will bear the risk should your debtors default on payment.
- **With Recourse Factoring** : factoring without credit insurance.

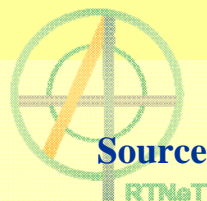
For more information on factoring, [please click here](#)

- **Accounts Receivable Financing**

This facility helps our clients convert trade credits into cash immediately. With cash in hand, clients can then secure the best possible terms from suppliers or grant more competitive credit terms to their customers.

- **Working Capital Loans**

Short-term loans are extended to meet the client's working capital requirements and these may either be revolving or repaid progressively over a period of time.



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Source: <http://www.intfactor.com.sg>

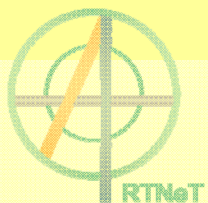
www.apartradenetwork.org



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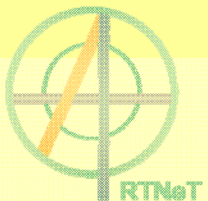
Inventory Financing

- Inventories hold up space and is a cost to the exporter until its is shipped to the importer.
- Warehouse receipts - These inventories can be a source of fund through both secured and unsecured loan against the inventories a company has.



Structured Financing

Structured Financing is a technique whereby certain assets with more or less predictable cash flows can be isolated from the originator and used to mitigate risks (e.g. transfer of foreign exchange, contract performance and sovereign risk), and thus secure a credit.



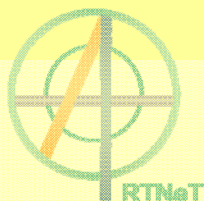
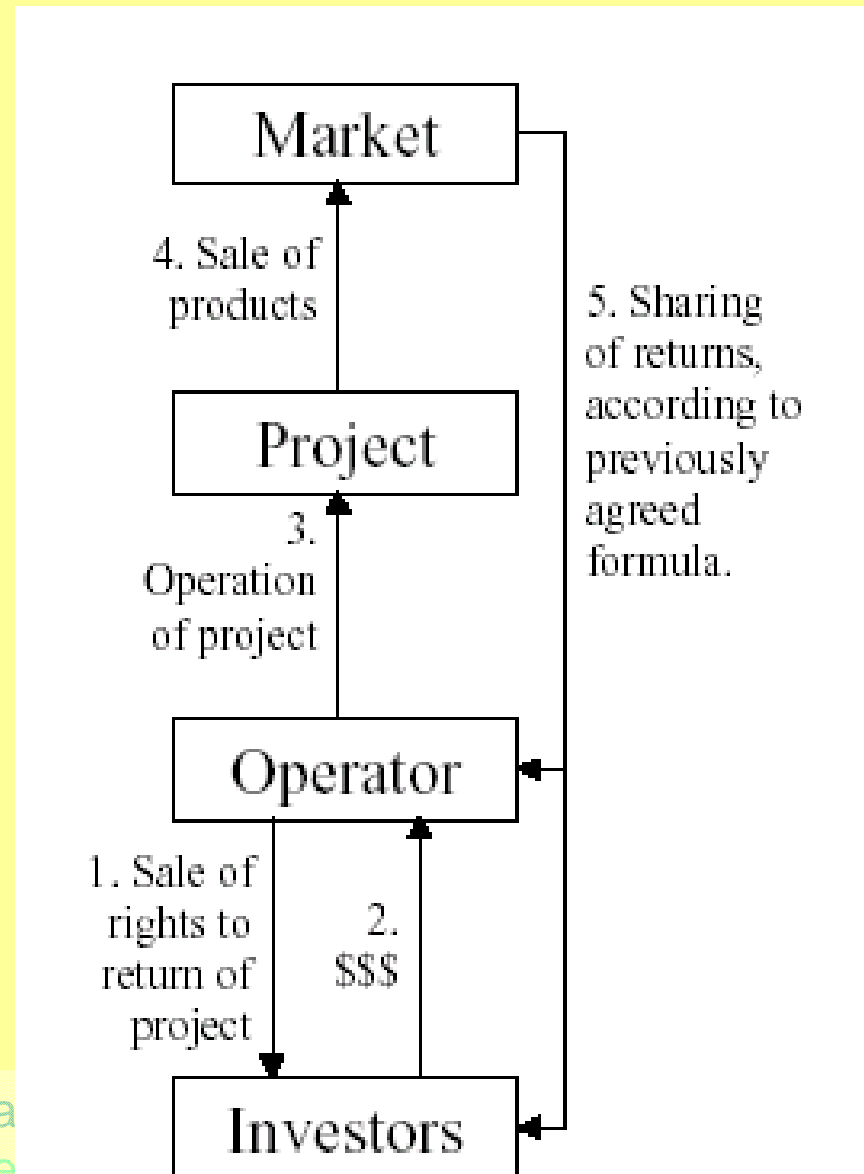
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Structured Financing

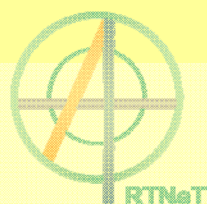
Direct sale of rights to future production (sold in export market) to investors:



STRUCTURED FINANCE

COFFEE IN KENYA – 3 MONTHS CREDIT

	No Structured Finance	With Structured Finance
Value of Goods	US\$7,000,000	US\$7,000,000
Advance Rate	50%	80% <i>(increased utilisation of assets by 30%)</i>
Loan Proceeds	US\$3,500,000	US\$5,600,000 <i>(Extra credit US\$2.1 mil)</i>
Interest rate pa	LIBOR + 15%	LIBOR + 2.5% <i>(Savings in interest charged over US\$ 3.5 mil = US\$120,000)</i>
Storage/insurance/inspection & other professional fees	1.7%	2.55% <i>(Additional upfront fees US\$ 59,000)</i>
Total storage etc. etc. & interest costs	US\$304,000	US\$298,000 <i>(Savings achieved, US\$6,000)</i>



Leasing

- Consider when buying any tangible assets
- True lease (vs. financial lease)
 - No asset ownership transfer
 - Lease term less than life of equipment
 - Maintenance provided by lessor
- Main advantage: lower initial expenditure of cash
- Main disadvantage: overall cost (and commitment to property)



Lease vs. Buy calculator available at:
<http://www.bloomberg.com/analysis/calculators/leasebuy.html#results>

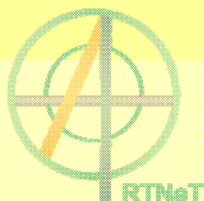
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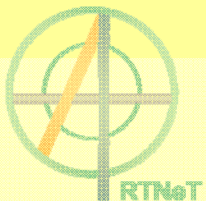
What is the key difference between financing international trade transactions and domestic transactions?

- **The additional risks involved!!!**
 - Country risk
 - Exchange rate risk
 - Lack of knowledge/information about your buyer (or supplier) → counterparty or buyer default risk
 - More difficult and costly to resolve disputes



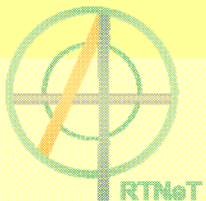
Export Credit Insurance

- Export credit insurance involves insuring exporters against possible:
 - Commercial risk such as non-acceptance of goods by buyer, the failure of buyer to pay debt, and the failure of foreign banks to honor documentary credits.
 - Political risk arises from factors like war, riots and civil commotion, blockage of foreign exchange transfers and currency devaluation.



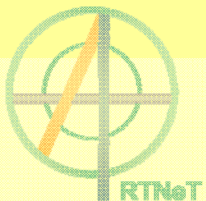
Export Credit Guarantees

- Issued by a financial institution, or a government agency
- Instruments to safeguard export-financing **banks** from losses that may occur from providing funds to exporters.
 - To assist companies without sufficient track records to obtain credit (and/or export insurance) from banks



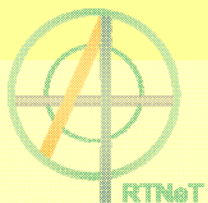
Payment Terms And Associated Risks

- Advance Payment
 - Time of payment : Before shipment
 - Goods available to buyers : After payment
 - Risk to exporter : None
 - Risk to importer : Relies completely on exporter to ship goods as ordered



Payment Terms And Associated Risks

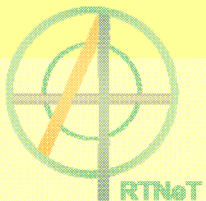
- Open account
 - Time of payment : after receipt of goods by buyer (as agreed upon)
 - Goods available to buyers : Before payment
 - Risk to exporter : Relies completely on buyer to pay account as agreed upon
 - Risk to importer : None

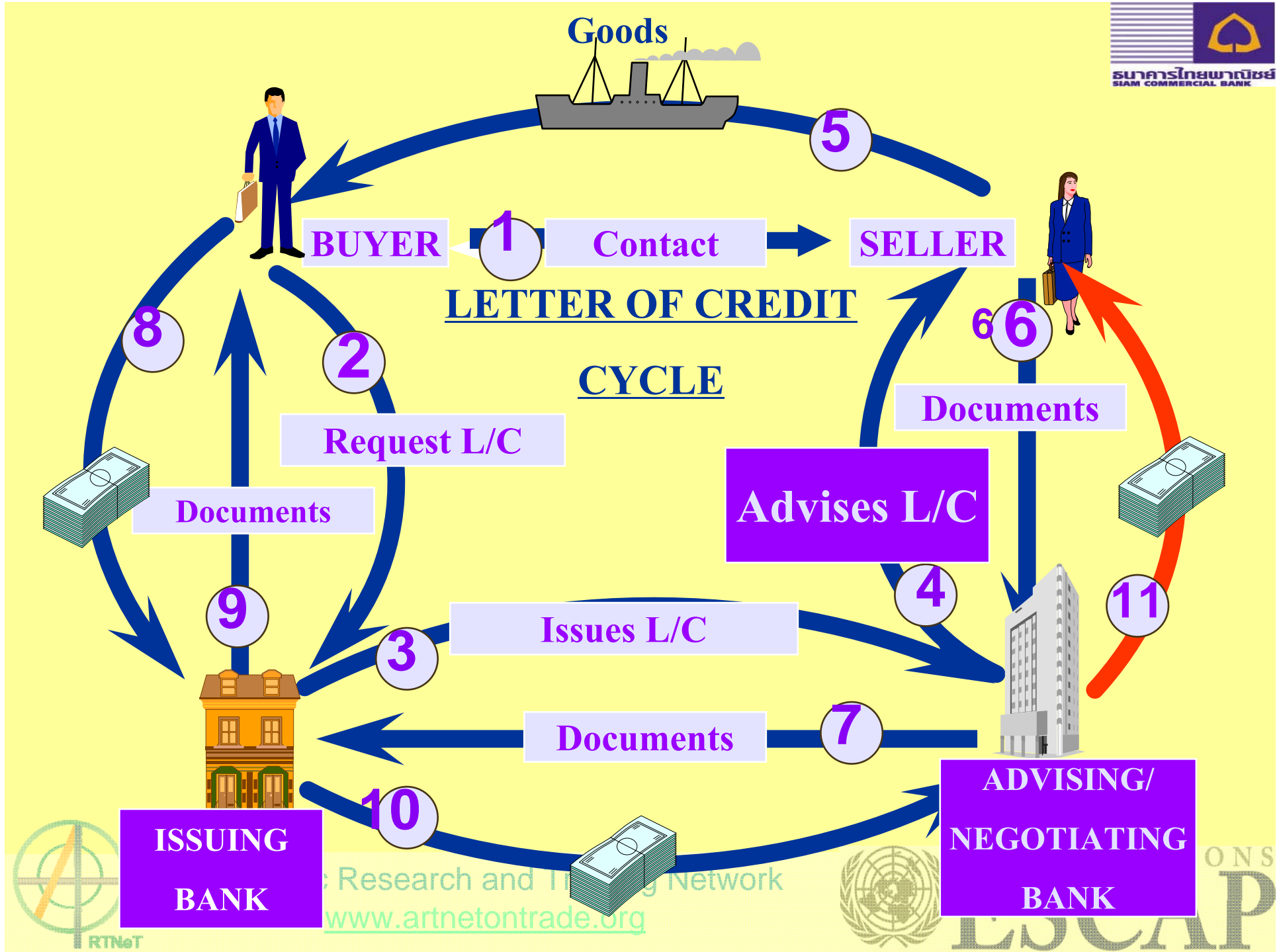


Payment Terms And Associated Risks

- Letters of credit (L/C) or Documentary Credit
 - Time of payment : After shipment is made (once terms and conditions specified in L/C are met)
 - Goods available to buyers : After payment
 - Risk to exporter : Very little or none
 - Risk to importer : Relies on exporter to ship goods as described in documents

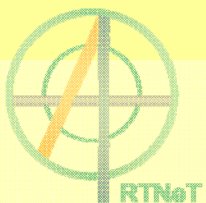
An L/C is **an undertaking issued by a bank** for the account of the buyer (the Applicant), to pay the Beneficiary (seller) the value of the Draft and/or documents **provided that** the terms and conditions of the L/C are complied with.

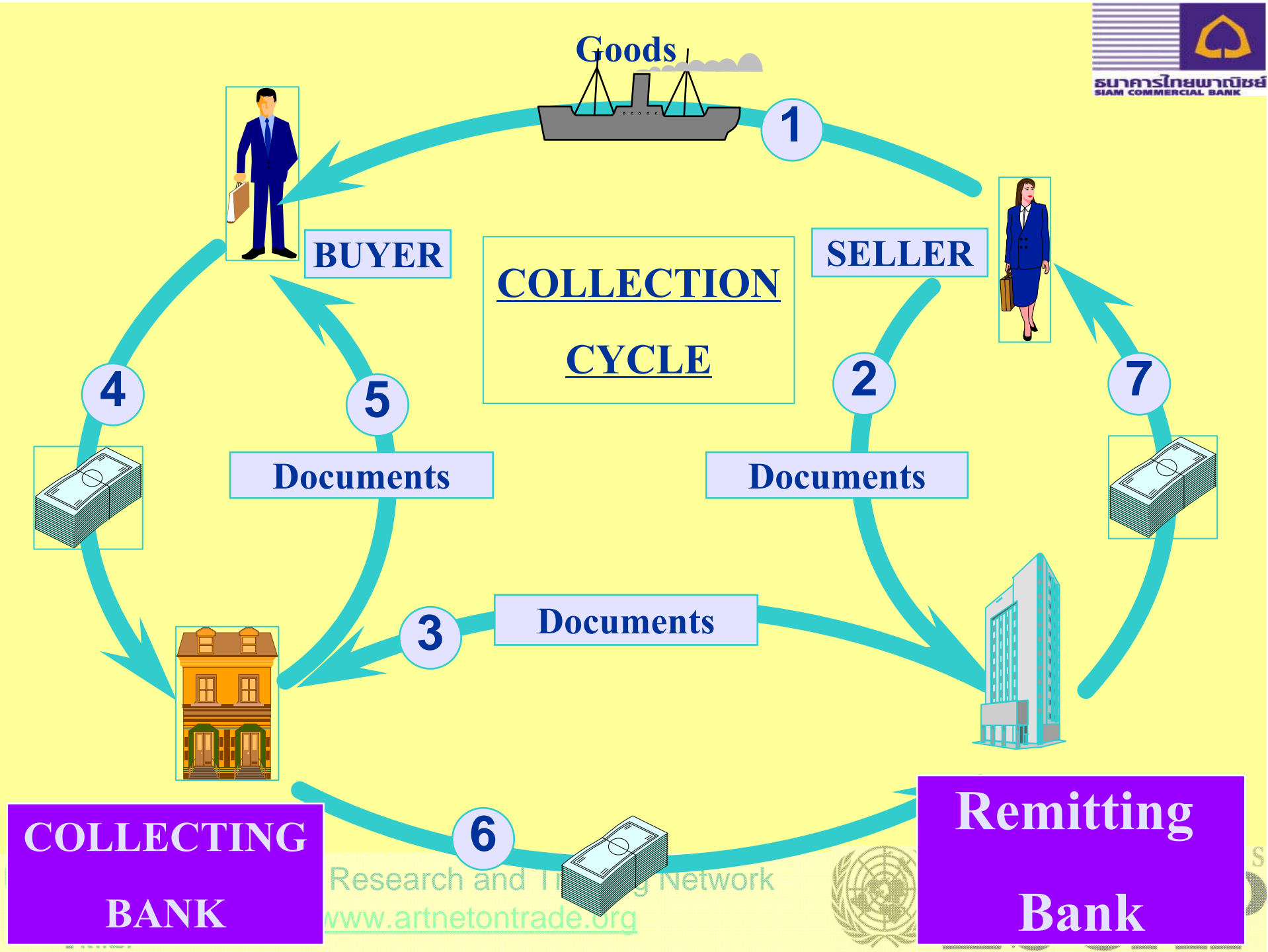




Payment Terms And Associated Risks

- Documentary Collection (Documents against payments)
 - Time of payment : After presentation of draft (bill of exchange)
 - Goods available to buyers : After payment
 - Risk to exporter : If draft is unpaid, must dispose of goods
 - Risk to importer : goods shipped are not as described in the documents
- (Documents against acceptance)



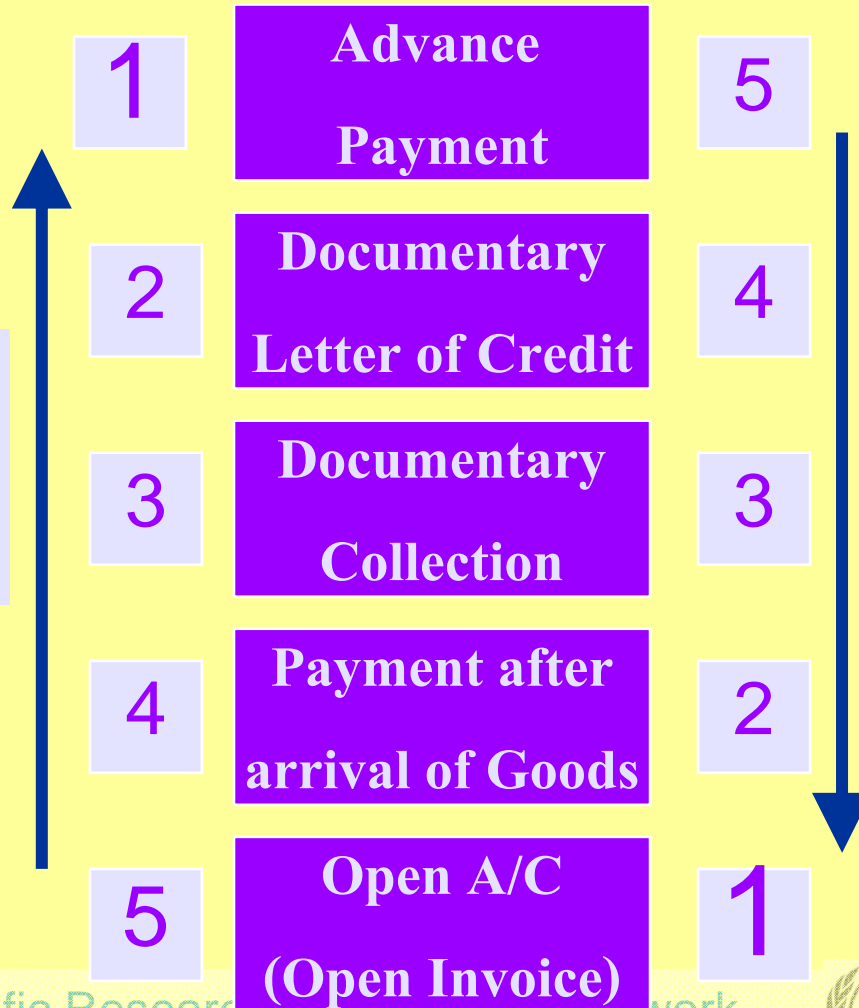


Payment Terms And Associated Risks

Best

Term of Payment

Exporter's
Point of View



Worst

Term of Payment

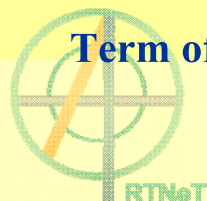
Importer's
Point of View

Worst

Term of Payment

Best

Term of Payment



Many of the trade finance tools and instruments not accessible in countries of the region → Need to build a Trade Finance Infrastructure

“The laws, regulations, institutions and other instruments (*) required to:

- (1) Provide capital and credit to firms involved in international trade transactions
- (2) Manage the risks involved in these transactions,
- (3) Ensure international payment through efficient mechanisms (e.g., electronic systems)



(*) Trained staff

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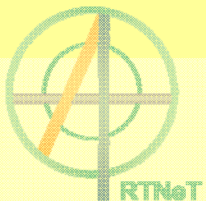
Are trade finance institutions available and functioning?

Trade Finance Institutional Structure model (TFIS)

Level I Institutions: Direct governmental role

Level II Institutions: Full or partial government ownership but limited direct management role

Level III Institutions: Market driven – No or very limited government ownership

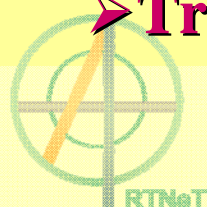


Level I Institutions: Direct governmental role

- Central Bank / Monetary Authority
- Ministry of Finance
- Ministry in charge of trade
- Other financial and insurance sector regulatory bodies

To PROVIDE WHAT?

- **A stable and favourable macroeconomic, legal and financial environment**
- **A vision and strategy for trade development**
- **Financial and trade policies and regulations supportive of trade**
- **Trade promotion and SME development schemes**

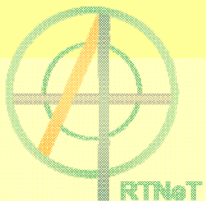


Level II Institutions: Full or partial government ownership but limited direct management role

- Export Credit Insurance and Guarantee Agency
- National Export-Import Bank (EXIM)
- Other trade-related specialized financial institutions/agencies

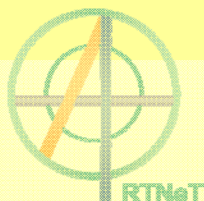
OFFERING

- Specialized support to SMEs and other organization with limited access to trade credit
- Innovative trade related financing options, export risk management tools
- Tie-ups with International Trade finance firms with expertise in innovative structures and developing markets
- Access to financing provided by multilateral financial and donor agencies



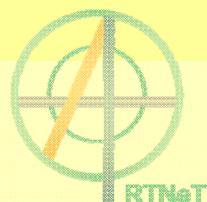
Level III Institutions: Market driven – No or very limited government ownership

- Commercial banks
- Other privately owned non-banking financial institutions (leasing companies, factoring houses...)



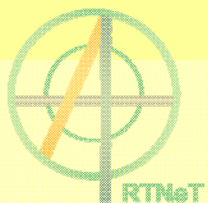
Conclusions/ideas for research

- Trade finance is an essential enabler of trade
- But little research work in this area as yet
 - National situation often unclear and unmonitored (from a trade perspective) → See Trade Finance Pointer Methodology and 50+ indicators
 - Which institutional models are most suited to specific context (e.g., should small economies have EXIM banks?) – How much should governments be involved and provide guarantees?
 - Many countries have taken steps to facilitate trade finance since the beginning of the global crisis? Which of those steps have been (most) effective
 - Have the global and regional trade finance schemes been effective in Asia, particularly in LDCs? → typically involve channeling funds through domestic commercial banks, which may lack capacity to do so effectively
 - Is there merit in developing new regional trade finance arrangements, if so which type?



Annex 1

International Standards And Conventions In Trade Financing



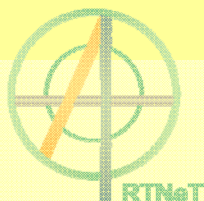
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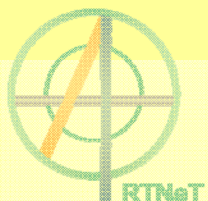
International Standards And Conventions In Trade Financing

- Incoterms 2000
 - Standard trade definitions most commonly used in international sales contracts
- Uniform Customs and Practice for Documentary Credits (UCP500)
 - UCP500 is the Uniform Customs and Practice for documentary credit
- eUCP
 - In November 2002, ICC published a new Guide call eUCP to supplement UCP 500.



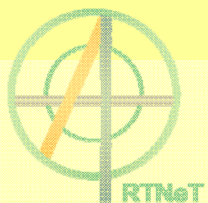
International Standards And Conventions in Trade Financing

- ICC Uniform Rules for Collection (URC522)
 - Provides a basic introduction to the operation of collections as part of international trade
- Uniform Rules for Bank-to-Bank Reimbursements under Documentary Credits (URR 525)
- Uniform Rules for Demand Guarantees, (RDG 458)



Annex 2

Trade Finance Pointers



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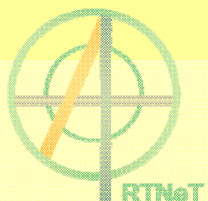
A Good Trade Finance Infrastructure requires:

- Appropriate financial sector regulations well coordinated and not contradictory
- International and national finance/banking expertise (public and private sectors)
- A conducive environment for trade finance (including an effective legal framework)

What is a more favorable environment for trade finance development? How do we know if we have it?

ITC's Trade Finance Pointers (TFPs) Methodology

- What are TFPs?
 - Indicators of factors that affect the trade finance environment
 - A trade finance “blood test” result sheet based on 52 indicators
- What are TFPs for?
 - To detect where to focus efforts to develop a more conducive trade finance environment

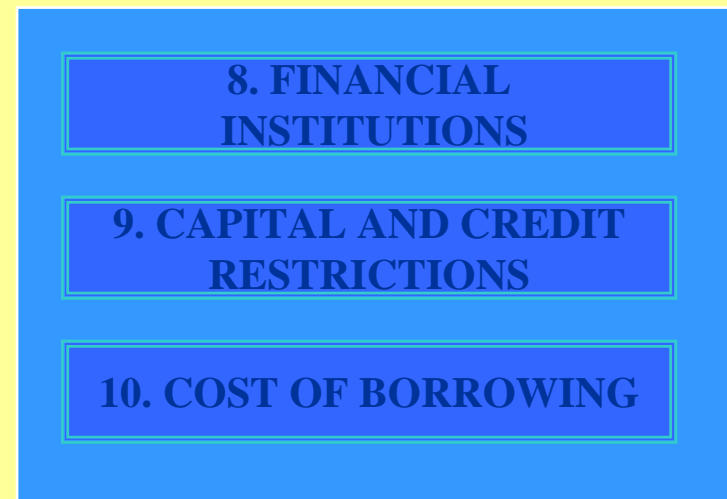


TFPs: 52 indicators in 10 areas

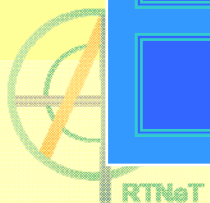
Macro Indicators (Indirect Effect)



Financial Institutions & Capacity Indicators (Direct Effect)



Trade Finance
Infrastructure
Development



Trade Finance and Training Network
www.tradeandtraining.org



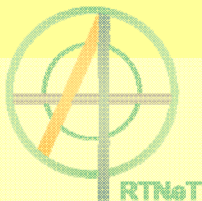
TFPs: Data Sources

Secondary sources for most indicators

- World Bank Development Indicators 2003
- International Financial Statistics, IMF
- International Trade Finance, ITC
- www.cofacrating.com

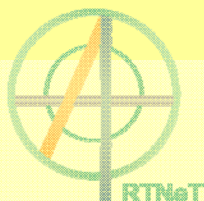
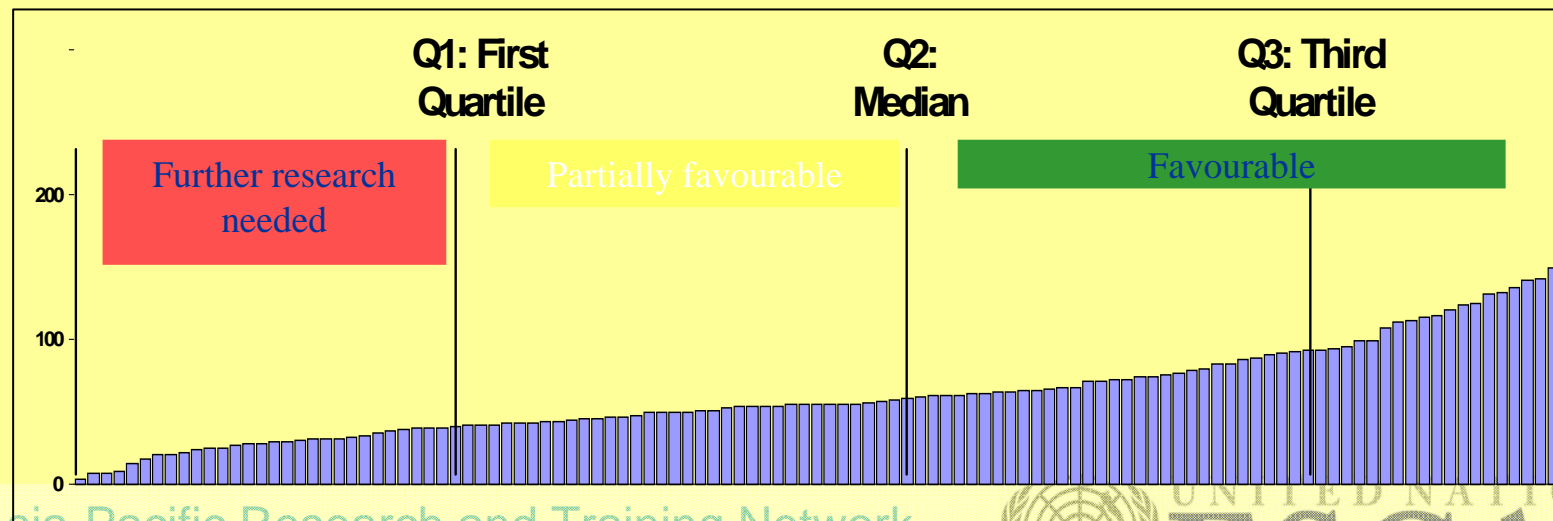
... Supplemented by a national survey

- on Legal Environment, Financial institutions, Capital & Credit Restrictions



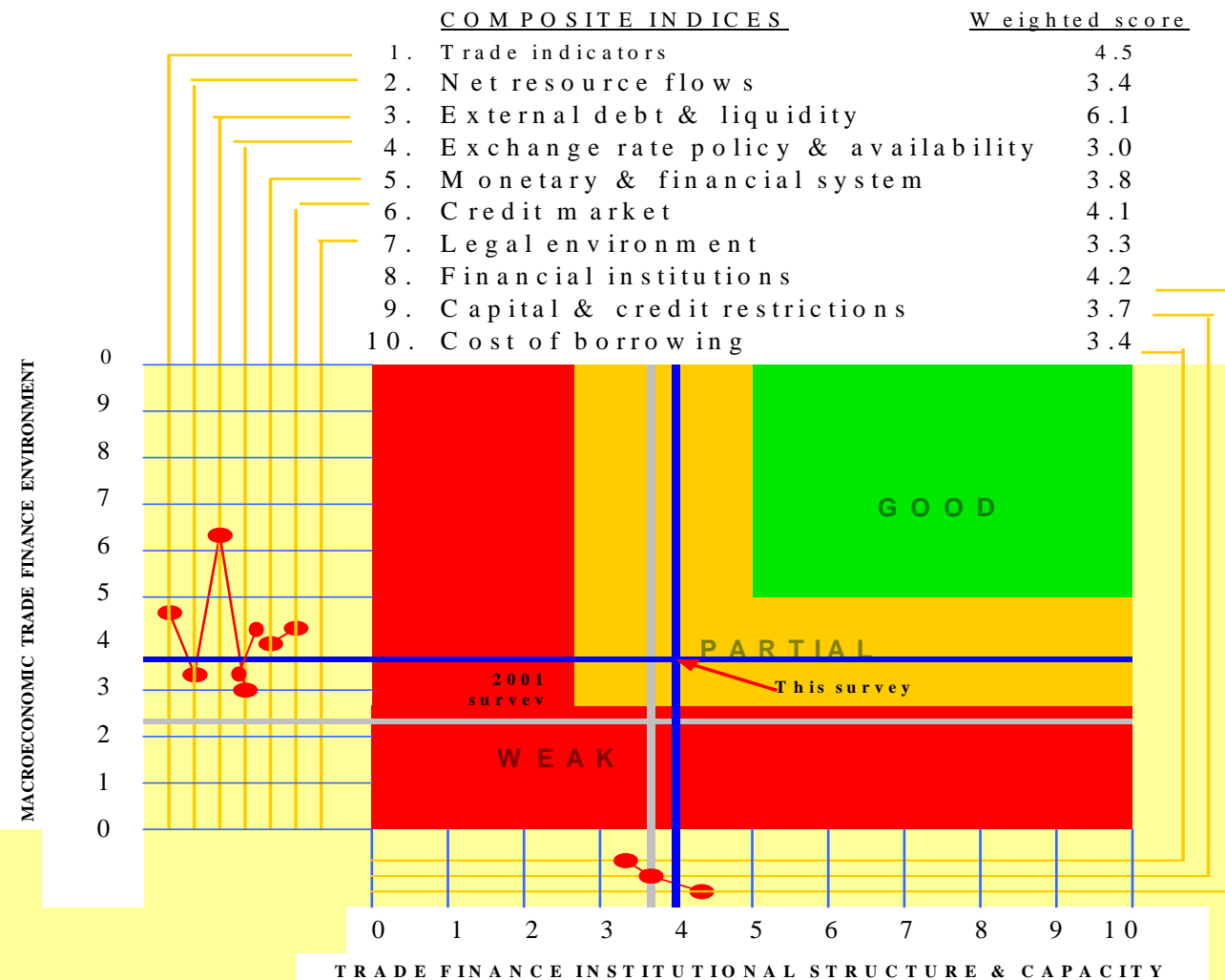
Combined the indicators describe the status of the Trade Finance infrastructure of a country.

Benchmarks, calculated with data on all 155 developing countries, are used alongside traffic lights to depict three possible situations:



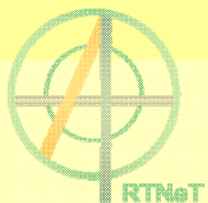
« Ready Reckoner »

Combining and inter-relating 52 indicators and 10 indices, a country's overall position - weighted - can be plotted and compared on a « Ready Reckoner ».



See ESCAP/ITC Trade Finance Infrastructure Development Handbook for details – Methodology need further development but interesting starting point...

Optional Slides



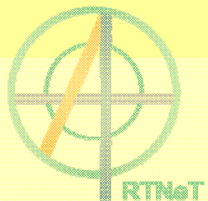
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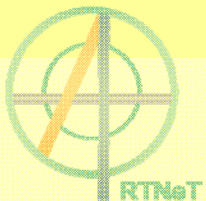
Key Issues In Trade Finance

- The mechanics & systems for arranging for and receiving payment
- The Legislation and custom requirements of the export and import countries
- Foreign exchange policy and other risks associated with international trade
- The institutions - the operations of the banking system in operating the trade finance instruments, and payments and settlements.
- Infrastructure and a host of ICT services



Trade finance tools and instruments

- To raise Capital
 - Loan / Line of Credit
 - Structured Financing
 - Leasing
 - Inventory Financing
- To Mitigate risks
 - Factoring
 - Export Credit Insurance
 - Export Credit Guarantee
- Terms of Payment
 - Advance Payment
 - Open Account
 - Collections (Documents against Payment or Acceptance)
 - Letters of Credit



Contract Value \$10m

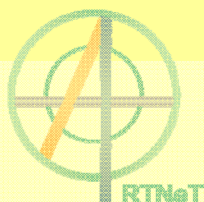
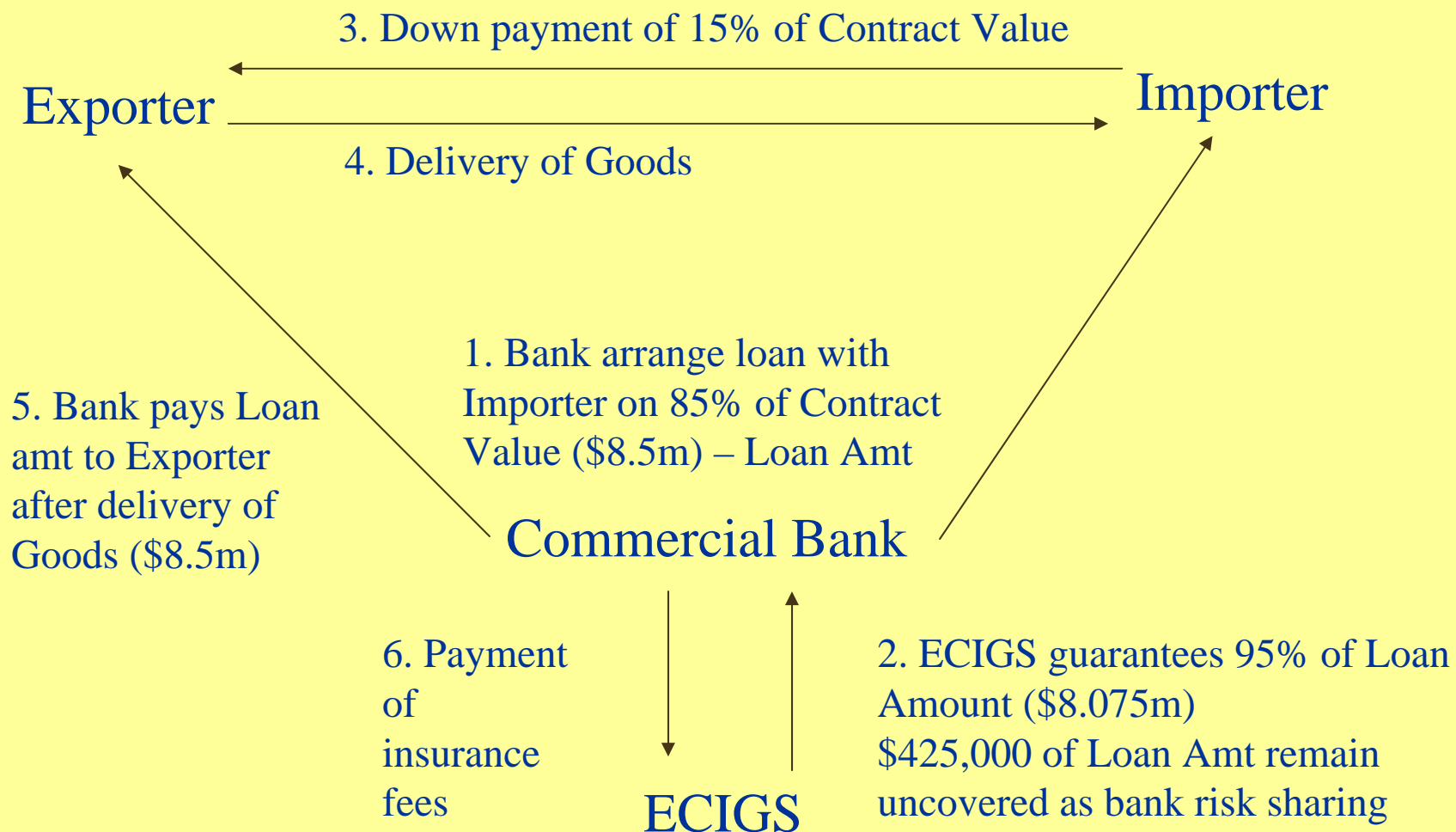


Figure II.3. The proposed national trade finance institutional structure model

