Chapter 8

The Finance and Insurance of Exports

INTRODUCTION

Chapter 4 made the point that in a buyer's market, particularly in an inflationary situation, credit arrangements are as important as price. This chapter considers some of the problems of financing credit through banks or other financial instruments. The need to obtain credit facilities through the banking system implies collateral: an increasingly important form of this is credit insurance. Such credit insurance is the complement to marine insurance, but instead of covering physical risk, i.e. destruction, loss or damage to goods, it covers the commercial and political risk of foreign transactions. It reduces such risks to a measurable cost – again like marine insurance.

The system of credit insurance described here is the British system administered by a government agency, the Export Credit Guarantee Department. The same principles apply largely to the credit systems applied by other countries, e.g. the U.S. Foreign Credit Insurance Association system.

Finally, this chapter discusses methods of trading which do not involve financing by the exporter. A half-way stage is the use of factoring; a more complex and increasingly sophisticated method is that of barter techniques.

FINANCING INTERNATIONAL TRADE

Ideally, foreign trade would be conducted on a basis of cash on delivery, by a documentary letter of credit.
Any commercial bank will advise on letters of credit. Briefly, the best type of credit so far as the seller is concerned is irrevocable and confirmed. The term ‘irrevocable’ means that it cannot be cancelled unilaterally by the buyer; the term ‘confirmed’ means that a bank in the exporter’s country has guaranteed payment provided that the exporter produces satisfactory details of delivery.

This type of finance involves one bank in the buyer’s country and one in the seller’s country being willing to accept agreed documents and pay out on them. The normal procedure is that the commercial banks concerned will have trading links, and possibly accounts with one other, being in a correspondent relationship. The buyer’s bank will inform the correspondent bank in the seller’s country of its readiness to meet drafts presented to it, on the terms agreed. On that basis the seller will be informed by means of a letter of credit that payment will be made against the presenting of specified documents – generally shipping documents – correctly filed. The letter of credit will indicate whether the credit is irrevocable and whether it has been confirmed. It is of course desirable that the letter of credit should be in the exporter’s hands before the goods leave his control; preferably it should be available before any export expenses are incurred.

An alternative is cash against documents. Here, once again, the agreed documents are presented to the seller’s bank with instructions that these are to be presented to the buyer’s bank in the overseas country for payment there. The effect is much the same as by the ordinary letter of credit in that the seller’s bank will not hand over the documents until it receives the agreed payment. The main difference is the delay in payment while the documents are sent to the buyer’s country and any subsequent delay in transferring payment back.

There are alternative methods of payment which use bank facilities, but in general they are to be recommended only if the importer is well known to, and trusted by, the seller; the advice of the exporter’s own bank should be sought on them. The main point which has to be kept in mind is that banks are likely to be even more cautious in affording payment against documents involving an overseas transaction than they would for an internal transaction, and the formalities have normally