U.S. Department of Commerce
International Trade Administration

Trade Finance Guide

A Quick Reference for U.S. Exporters

Trade Finance Guide: A Quick Reference for U.S. Exporters is designed to help U.S. companies, especially small and medium-sized enterprises, learn the basic fundamentals of trade finance so that they can turn their export opportunities into actual sales and to achieve the ultimate goal of getting paid—especially on time—for those sales. Concise, two-page chapters offer the basics of numerous financing techniques, from open accounts, to forfaiting to government assisted foreign buyer financing.

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The International Trade Administration's mission is to create prosperity by strengthening the competitiveness of U.S. industry, promoting trade and investment, and ensuring fair trade and compliance with trade laws and agreements. To learn more about the ITA write to: International Trade Administration, Office of Public Affairs, U.S. Department of Commerce, Washington, DC 20230 or visit the ITA's Web site at www.trade.gov.

Introduction
Opportunities, Risks, and Trade Finance

Welcome to the third edition of the *Trade Finance Guide: A Quick Reference for U.S. Exporters*. This guide is designed to help U.S. companies, especially small and medium-sized enterprises (SMEs), learn the basic fundamentals of trade finance so that they can turn their export opportunities into actual sales and to achieve the ultimate goal of getting paid—especially on time—for those sales. This guide provides general information about common techniques of export financing. Accordingly, you are advised to assess each technique in light of your specific situation or needs. This edition includes two new chapters on "Consignment" and "Government-Backed Agricultural Export Financing" with minor updates on other chapters. The *Trade Finance Guide* will be revised and updated as needed. Future editions may include new chapters discussing other trade finance techniques and related topics.

Benefits of Exporting

The United States is the world's second largest exporter, with $2.06 trillion in goods and services exports in 2011, according to the World Trade Organization's *World Trade Report 2012*. In 2011, the United States was the top exporter of services and second largest exporter of goods, behind only China. However, 95 percent of the world's consumers live outside of the United States. So if you are selling only domestically, you are reaching just a small share of potential customers. Exporting enables SMEs to diversify their portfolios and insulates them against periods of slower growth in the domestic economy. Free trade agreements (FTAs) have helped to open markets such as Australia, Canada, Central America, Chile, Israel, Jordan, Korea, Mexico, and Singapore. FTAs create more export opportunities for U.S. businesses. The *Trade Finance Guide* is designed to provide U.S. SMEs with the knowledge necessary to grow and become competitive in overseas markets.

A QUICK GLANCE

Trade Finance Guide

A concise, simple, and easy-to-understand guide designed to help U.S. small and medium-sized exporters learn quickly how to get paid from their foreign customers in the most effective manner.

Trade Finance

A means to turn export opportunities into actual sales and to get paid for export sales–especially on time–by effectively managing the risks associated with doing business internationally.

Opportunities

- Reaching the 95 percent of potential customers worldwide who live outside the United States
- Diversifying customer portfolios

Risks

- Non-payment or delayed payment by foreign buyers
- Political and commercial risks as well as cultural influences

Key Players in the Creation of the Trade Finance Guide

The International Trade Administration (ITA) is an agency within the U.S. Department of Commerce whose mission is to foster economic growth and prosperity through global trade. ITA provides practical information to help you select your markets and products, ensures that you have access to international markets as required by our trade agreements, and safeguards you from unfair competition such as dumped and subsidized imports. ITA is made up of the following four units: (a) **Manufacturing and Services**, the industry analysis unit that supports U.S. industry's domestic and global competitiveness; (b) **Commercial Service**, the trade promotion unit that helps U.S. businesses at every stage of the exporting process; (c) **Market Access and Compliance**, the country-specific policy unit that keeps world markets open to U.S. products and helps U.S. businesses benefit from our trade agreements with other countries; and (d) **Import Administration**, the trade law enforcement unit that ensures that U.S. businesses face a level playing field in the domestic marketplace. For more information, visit *www.trade.gov* or contact the

Trade Information Center, 1-800-USA-TRADE or the Commercial Service's global network of domestic Export Assistance Centers and overseas posts. To find the nearest Export Assistance Center or overseas Commercial Service office, visit *www.export.gov*.

Partnership and Cooperation

The *Trade Finance Guide* was created in partnership with FCIB—The Finance, Credit, and International Business Association—a prominent business educator of credit and risk management professionals in exporting companies ranging in size from multinational to SMEs. FCIB's parent, the National Association of Credit Management, is a non-profit organization that represents nearly 16,000 businesses in the United States and is one of the world's largest credit organizations. This *Trade Finance Guide* was also created in cooperation with the U.S. Small Business Administration, the U.S. Export-Import Bank (Ex-Im Bank), the International Factoring Association, the Association of Trade & Forfaiting in the Americas, and BAFT-IFSA, the association for organizations actively engaged in international transaction banking. (BAFT-IFSA was formed by the merger of the Bankers Association for Finance and Trade (BAFT) and the International Financial Services Association (IFSA).) Their contact information is listed below and provided in other sections of the *Trade Finance Guide*.

Trade Finance Guide in Spanish

ITA has published a Spanish version of the *Trade Finance Guide* in partnership with the California Centers for International Trade Development (CITD) to help facilitate U.S. exports to Spanish-speaking countries. The CITD is a state-funded non-profit organization that promotes California's international trade and global competitiveness. With offices across California, the CITD assists local SMEs with expanding their global presence, especially in Mexico and Latin America, where Spanish is the primary language. Through this collaboration with CITD, the Spanish language *Trade Finance Guide* will enable ITA to reach thousands of potential new exporters. Visit *www.citd.org* for more information.

For More Information about the Guide

The *Trade Finance Guide* was created by ITA's Office of Financial Services Industries (OFSI). A part of ITA's *Manufacturing and Services* unit, OFSI is dedicated to enhancing the domestic and international competitiveness of U.S. financial services industries and providing internal policy recommendations on U.S. exports and overseas investment supported by official finance. For more information, contact the project manager and author of the Guide, Yuki Fujiyama, tel. (202) 482-3277; e-mail *yuki.fujiyama@trade.gov*.

How to Obtain the Trade Finance Guide

The *Trade Finance Guide* (both English and Spanish versions) is available online for free download at *Export.gov*, the U.S. government's export portal. Print copies of the Guide may be available upon request at FCIB.

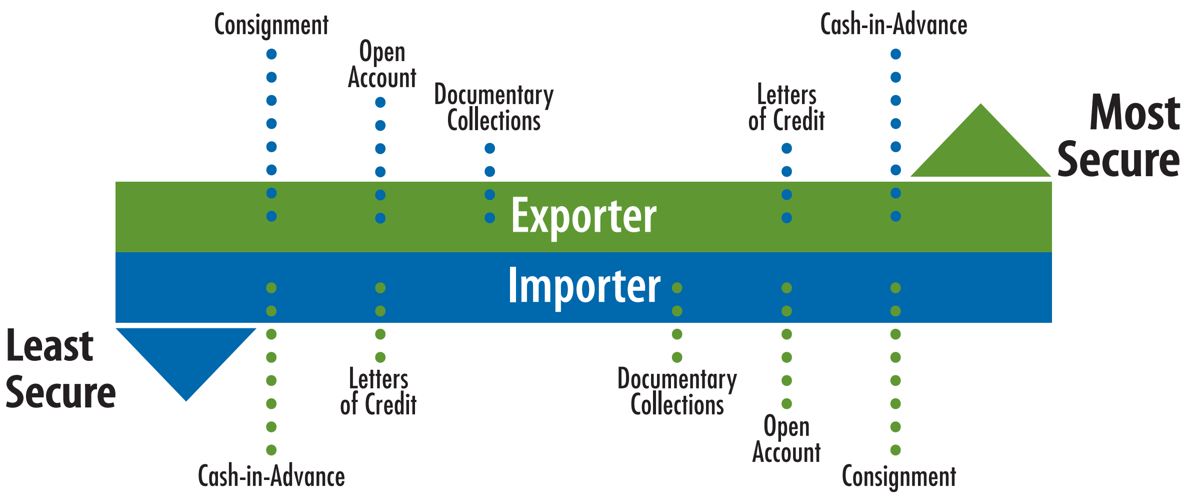
Where to Learn More about Trade Finance

As the official export credit agency of the United States, Ex-Im Bank regularly offers trade finance seminars for exporters and lenders. These seminars are held in Washington, DC and in many major U.S. cities. For more information about the seminars, visit *www.exim.gov* or call 1-800-565-EXIM (3946). For more advanced trade finance training, FCIB offers the 13-week International Credit and Risk Management online course, which was developed with a grant awarded by the U.S. Department of Commerce in 2001. For more information about the course, visit *www.fcibglobal.com* or call 1-888-256-3242. BAFT-IFSA also offers trade finance events and educational programs. For more information about the events and programs, visit *www.baft-ifsa.com* or call (202) 663-7575.

Chapter 1
Methods of Payment in International Trade

To succeed in today's global marketplace and win sales against foreign competitors, exporters must offer their customers attractive sales terms supported by the appropriate payment methods. Because getting paid in full and on time is the ultimate goal for each export sale, an appropriate payment method must be chosen carefully to minimize the payment risk while also accommodating the needs of the buyer. As shown in figure 1, there are five primary methods of payment for international transactions. During or before contract negotiations, you should consider which method in the figure is mutually desirable for you and your customer.

Figure 1: Payment Risk Diagram



Key Points

- International trade presents a spectrum of risk, which causes uncertainty over the timing of payments between the exporter (seller) and importer (foreign buyer).
- For exporters, any sale is a gift until payment is received.
- Therefore, exporters want to receive payment as soon as possible, preferably as soon as an order is placed or before the goods are sent to the importer.
- For importers, any payment is a donation until the goods are received.
- Therefore, importers want to receive the goods as soon as possible but to delay payment as long as possible, preferably until after the goods are resold to generate enough income to pay the exporter.

Cash-in-Advance

With cash-in-advance payment terms, an exporter can avoid credit risk because payment is received before the ownership of the goods is transferred. For international sales, wire transfers and credit cards are the most commonly used cash-in-advance options available to exporters. With the advancement of the Internet, escrow services are becoming another cash-in-advance option for small export transactions. However, requiring payment in advance is the least attractive option for the buyer, because it creates unfavorable cash flow. Foreign buyers are also concerned that the goods may not be sent if payment is made in advance. Thus, exporters who insist on this payment method as their sole manner of doing business may lose to competitors who offer more attractive payment terms.

Letters of Credit

Letters of credit (LCs) are one of the most secure instruments available to international traders. An LC is a commitment by a bank on behalf of the buyer that payment will be made to the exporter, provided that the terms and conditions stated in the LC have been met, as verified through the presentation of all required documents. The buyer establishes credit and pays his or her bank to render this service. An LC is useful when reliable credit information about a foreign buyer is difficult to obtain, but the exporter is satisfied with the creditworthiness of the buyer's foreign bank. An LC also protects the buyer since no payment obligation arises until the goods have been shipped as promised.

Documentary Collections

A documentary collection (D/C) is a transaction whereby the exporter entrusts the collection of the payment for a sale to its bank (remitting bank), which sends the documents that its buyer needs to the importer's bank (collecting bank), with instructions to release the documents to the buyer for payment. Funds are received from the importer and remitted to the exporter through the banks involved in the collection in exchange for those documents. D/Cs involve using a draft that requires the importer to pay the face amount either at sight (document against payment) or on a specified date (document against acceptance). The collection letter gives instructions that specify the documents required for the transfer of title to the goods. Although banks do act as facilitators for their clients, D/Cs offer no verification process and limited recourse in the event of non-payment. D/Cs are generally less expensive than LCs.

Open Account

An open account transaction is a sale where the goods are shipped and delivered before payment is due, which in international sales is typically in 30, 60 or 90 days. Obviously, this is one of the most advantageous options to the importer in terms of cash flow and cost, but it is consequently one of the highest risk options for an exporter. Because of intense competition in export markets, foreign buyers often press exporters for open account terms since the extension of credit by the seller to the buyer is more common abroad. Therefore, exporters who are reluctant to extend credit may lose a sale to their competitors. Exporters can offer competitive open account terms while substantially mitigating the risk of non-payment by using one or more of the appropriate trade finance techniques covered later in this Guide. When offering open account terms, the exporter can seek extra protection using export credit insurance.

Consignment

Consignment in international trade is a variation of open account in which payment is sent to the exporter only after the goods have been sold by the foreign distributor to the end customer. An international consignment transaction is based on a contractual arrangement in which the foreign distributor receives, manages, and sells the goods for the exporter who retains title to the goods until they are sold. Clearly, exporting on consignment is very risky as the exporter is not guaranteed any payment and its goods are in a foreign country in the hands of an independent distributor or agent. Consignment helps exporters become more competitive on the basis of better availability and faster delivery of goods. Selling on consignment can also help exporters reduce the direct costs of storing and managing inventory. The key to success in exporting on consignment is to partner with a reputable and trustworthy foreign distributor or a third-party logistics provider. Appropriate insurance should be in place to cover consigned goods in transit or in possession of a foreign distributor as well as to mitigate the risk of non-payment.

Chapter 2
Cash-in-Advance

With the cash-in-advance payment method, the exporter can eliminate credit risk or the risk of non-payment since payment is received prior to the transfer of ownership of the goods. Wire transfers and credit cards are the most commonly used cash-in-advance options available to exporters. With the advancement of the Internet, escrow services are becoming another cash-in-advance option for small export transactions. However, requiring payment in advance is the least attractive option for the buyer, because it tends to create cash-flow problems, and it often is not a competitive option for the exporter especially when the buyer has other vendors to choose from. In addition, foreign buyers are often concerned that the goods may not be sent if payment is made in advance. Exporters who insist on cash-in-advance as their sole payment method for doing business may lose out to competitors who are willing to offer more attractive payment terms.

CHARACTERISTICS OF CASH-IN-ADVANCE

Applicability

Recommended for use in high-risk trade relationships or export markets, and appropriate for small export transactions

Risk

Exporter is exposed to virtually no risk as the burden of risk is placed almost completely on the importer.

Pros

- Payment before shipment
- Eliminates risk of non-payment

Cons

- May lose customers to competitors over payment terms
- No additional earnings through financing operations

Key Points

- Full or significant partial payment is required, usually via credit card or bank or wire transfer or escrow service, before the ownership of the goods is transferred.
- Cash-in-advance, especially a wire transfer, is the most secure and least risky method of international trading for exporters and, consequently, the least secure and an unattractive method for importers. However, both the credit risk and the competitive landscape must be considered.
- Exporters may select credit cards as a viable cash- in-advance option, especially for small consumer goods transactions.
- Exporters may also select escrow services as a mutually beneficial cash-in-advance option for small transactions with importers who demand assurance that the goods will be sent in exchange for advance payment.
- Insisting on cash-in-advance could, ultimately, cause exporters to lose customers to competitors who are willing offer more favorable payment terms to foreign buyers.
- Creditworthy foreign buyers, who prefer greater security and better cash utilization, may find cash-in-advance unacceptable and simply walk away from the deal.

Wire Transfer: Most Secure and Preferred Cash-in-Advance Method

An international wire transfer is commonly used and is almost immediate. Exporters should provide clear routing instructions to the importer when using this method, including the receiving bank's name and address, SWIFT (Society for Worldwide Interbank Financial Telecommunication) address, and ABA (American Bankers Association) number, as well as the seller's name and address, bank account title, and account number. The fee for an international wire transfer can be paid by the sender (importer) or it can be deducted from the receiver's (exporter's) account.

Credit Card: A Viable Cash-in-Advance Method

Exporters who sell directly to foreign buyers may select credit cards as a viable cash-in-advance option, especially for small consumer goods transactions. Exporters should check with their credit card companies for specific rules on international use of credit cards. The rules governing international credit card transactions differ from those for domestic use. Because international credit card transactions are typically placed using the Web, telephone, or fax, which facilitate fraudulent transactions, proper precautions should be taken to determine the validity of transactions before the goods are shipped. Although exporters must tolerate the fees charged by credit card companies and assume the risk of unfounded disputes, credit cards may help the business grow because of their convenience and wide acceptance.

Escrow Service: A Mutually Beneficial Cash-in-Advance Method

Exporters may select escrow services as a mutually beneficial cash-in-advance option for small transactions with importers who demand assurance that the goods will be sent in exchange for advance payment. Escrow in international trade is a service that allows both exporter and importer to protect a transaction by placing the funds in the hands of a trusted third party until a specified set of conditions are met. Here's how it works: the importer sends the agreed amount to the escrow service. After payment is verified, the exporter is instructed to ship the goods. Upon delivery, the importer has a pre-determined amount of time to inspect and accept the goods. Once accepted, the funds are released by the escrow service to the exporter. The escrow fee can either be paid in full by one party or split evenly between the exporter and the importer. Cross-border escrow services are offered by international banks and firms that specialize in escrow and other deposit and custody services.

Payment by Check: A Less-Attractive Cash-in-Advance Method

Advance payment using a check drawn on the importer's account and mailed to the exporter will result in a lengthy collection delay of several weeks to months. Therefore, this method may defeat the original intention of receiving payment before shipment. If the check is in U.S. dollars and drawn on a U.S. bank, the collection process is the same as it would be for any U.S. check. However, funds deposited by non-local checks, especially those totaling more than $5,000 on any one day, may not become available for withdrawal for up to 10 business days due to Regulation CC of the Federal Reserve (§ 229.13 (ii)). In addition, if the check is in a foreign currency or drawn on a foreign bank, the collection process can become more complicated and can significantly delay the availability of funds. Moreover, if shipment is made before the check is collected, there is a risk that the check may be returned due to insufficient funds in the buyer's account or even because of a stop-payment order.

When to Use Cash-in-Advance Terms

- The importer is a new customer and/or has a less-established operating history.
- The importer's creditworthiness is doubtful, unsatisfactory, or unverifiable.
- The political and commercial risks of the importer's home country are very high.
- The exporter's product is unique, not available elsewhere, or in heavy demand.
- The exporter operates an Internet-based business where the acceptance of credit card payments is a must to remain competitive.

Chapter 3
Letters of Credit

Letters of credit (LCs) are one of the most versatile and secure instruments available to international traders. An LC is a commitment by a bank on behalf of the importer (foreign buyer) that payment will be made to the beneficiary (exporter) provided that the terms and conditions stated in the LC have been met, as evidenced by the presentation of specified documents. Since LCs are credit instruments, the importer's credit with his bank is used to obtain an LC. The importer pays his bank a fee to render this service. An LC is useful when reliable credit information about a foreign buyer is difficult to obtain or if the foreign buyer's credit is unacceptable, but the exporter is satisfied with the creditworthiness of the importer's bank. This method also protects the importer since the documents required to trigger payment provide evidence that goods have been shipped as agreed. However, because LCs have opportunities for discrepancies, which may negate payment to the exporter, documents should be prepared by trained professionals or outsourced. Discrepant documents, literally not having an "*i* dotted and *t* crossed," may negate the bank's payment obligation.

Key Points

- An LC, also referred to as a documentary credit, is a contractual agreement whereby the issuing bank (importer's bank), acting on behalf of its customer (the importer or buyer), promises to make payment to the beneficiary or exporter against the receipt of "complying" stipulated documents. The issuing bank will typically use intermediary banks to facilitate the transaction and make payment to the exporter.
- The LC is a separate contract from the sales contract on which it is based; therefore, the banks are not concerned with the quality of the underlying goods or whether each party fulfills the terms of the sales contract.
- The bank's obligation to pay is solely conditioned upon the seller's compliance with the terms and conditions of the LC. In LC transactions, banks deal in documents only, not goods.
- LCs can be arranged easily for one-time transactions between the exporter and importer or used for an ongoing series of transactions.
- Unless the conditions of the LC state otherwise, it is always irrevocable, which means the document may not be changed or cancelled unless the importer, banks, and exporter agree.

CHARACTERISTICS OF A LETTER OF CREDIT

Applicability

Recommended for use in higher-risk situations or new or less-established trade relationships when the exporter is satisfied with the creditworthiness of the buyer's bank

Risk

Risk is spread between exporter and importer, provided that all terms and conditions as specified in the LC are adhered to.

Pros

- Payment made after shipment
- A variety of payment, financing and risk mitigation options available

Cons

- Labor intensive process
- Relatively expensive method in terms of transaction costs

Confirmed Letter of Credit

A greater degree of protection is afforded to the exporter when an LC issued by a foreign bank (the importer's issuing bank) is confirmed by a U.S. bank. The exporter asks its customer to have the issuing bank authorize a bank in the exporter's country to confirm (this bank is typically the advising bank, which then becomes the confirming bank). Confirmation means that the U.S. bank adds its engagement to pay the exporter to that of the foreign bank. If an LC is not confirmed, the exporter is subject to the payment risk of the foreign bank and the political risk of the importing country. Exporters should consider getting confirmed LCs if they are concerned about the credit standing of the foreign bank or when they are operating in a high-risk market, where political upheaval, economic collapse, devaluation or exchange controls could put the payment at risk. Exporters should also consider getting confirmed LCs when importers are asking for extended payment terms.

Illustrative Letter of Credit Transaction

1. The importer arranges for the issuing bank to open an LC in favor of the exporter.
2. The issuing bank transmits the LC to the nominated bank, which forwards it to the exporter.
3. The exporter forwards the goods and documents to a freight forwarder.
4. The freight forwarder dispatches the goods and either the dispatcher or the exporter submits documents to the nominated bank.
5. The nominated bank checks documents for compliance with the LC and collects payment from the issuing bank for the exporter.
6. The importer's account at the issuing bank is debited.
7. The issuing bank releases documents to the importer to claim the goods from the carrier and to clear them at customs.

Special Letters of Credit

LCs can take many forms. When an LC is made transferable, the payment obligation under the original LC can be transferred to one or more "second beneficiaries." With a revolving LC, the issuing bank restores the credit to its original amount each time it is drawn down. A standby LC is not intended to serve as the means of payment for goods but can be drawn in the event of a contractual default, including the failure of an importer to pay invoices when due. Similarly, standby LCs are often posted by exporters in favor of an importer to pay invoices when due. Standby LCs are often posted by exporters in favor of importers because they can serve as bid bonds, performance bonds, and advance payment guarantees. In addition, standby LCs are often used as counter guarantees against the provision of down payments and progress payments on the part of foreign buyers.

Tips for Exporters

- Consult with your bank before the importer applies for an LC.
- Consider whether a confirmed LC is needed.
- Negotiate with the importer and agree upon detailed terms to be incorporated into the LC.
- Determine if all LC terms can be met within the prescribed time limits.
- Ensure that all the documents are consistent with the terms and conditions of the LC.
- Be cautious of discrepancy opportunities that may delay or cause non-payment.

Chapter 4
Documentary Collections

A documentary collection (D/C) is a transaction whereby the exporter entrusts the collection of payment to the exporter's bank (remitting bank), which sends documents to the importer's bank (collecting bank), along with instructions for payment. Funds are received from the importer and remitted to the exporter through the banks in exchange for those documents. D/Cs involve using a bill of exchange (commonly known as a draft) that requires the importer to pay the face amount either at sight (document against payment [D/P] or cash against documents) or on a specified future date (document against acceptance [D/A] or cash against acceptance). The collection cover letter gives instructions that specify the documents required for the delivery of the goods to the importer. Although banks do act as facilitators (agents) for their clients under collections, D/Cs offer no verification process and limited recourse in the event of non-payment. D/Cs are generally less expensive than letters of credit (LCs).

Key Points

- D/Cs are less complicated and less expensive than LCs.
- Under a D/C transaction, the importer is not obligated to pay for goods before shipment.
- If structured properly, the exporter retains control over the goods until the importer either pays the draft amount at sight or accepts the draft to incur a legal obligation to pay at a specified later date.
- Although the goods can be controlled under ocean shipments, they are more difficult to control under air and overland shipments, which allow the foreign buyer to receive the goods with or without payment unless the exporter employs agents in the importing country to take delivery until goods are paid for.
- The exporter's bank (remitting bank) and the importer's bank (collecting bank) play an essential role in D/Cs.
- Although the banks control the flow of documents, they neither verify the documents nor take any risks. They can, however, influence the mutually satisfactory settlement of a D/C transaction.

CHARACTERISTICS OF A DOCUMENTARY COLLECTION

Applicability

Recommended for use in established trade relationships, in stable export markets and for transactions involving ocean shipments

Risk

Riskier for the exporter, though D/C terms are more convenient and cheaper than an LC to the importer

Pros

- Bank assistance in obtaining payment
- The process is simple, fast, and less costly than LCs

Cons

- Banks' role is limited and they do not guarantee payment
- Banks do not verify the accuracy of the documents

When to Use Documentary Collections

With D/Cs, the exporter has little recourse against the importer in case of non-payment. Thus, D/Cs should be used only under the following conditions:

- The exporter and importer have a well-established relationship.
- The exporter is confident that the importing country is politically and economically stable.
- An open account sale is considered too risky, and an LC is unacceptable to the importer.

Typical Simplified D/C Transaction Flow

1. The exporter ships the goods to the importer and receives the documents in exchange.
2. The exporter presents the documents with instructions for obtaining payment to his bank.
3. The exporter's remitting bank sends the documents to the importer's collecting bank.
4. The collecting bank releases the documents to the importer on receipt of payment or acceptance of the draft.
5. The importer uses the documents to obtain the goods and to clear them at customs.
6. Once the collecting bank receives payment, it forwards the proceeds to the remitting bank.
7. The remitting bank then credits the exporter's account.

Documents against Payment Collection

With a D/P collection, the exporter ships the goods and then gives the documents to his bank, which will forward the documents to the importer's collecting bank, along with instructions on how to collect the money from the importer. In this arrangement, the collecting bank releases the documents to the importer only on payment for the goods. Once payment is received, the collecting bank transmits the funds to the remitting bank for payment to the exporter. Table 1 shows an overview of a D/P collection:

Table 1: Overview of a D/P collection

Time of Payment	After shipment, but before documents are released
Transfer of Goods	After payment is made at sight
Exporter Risk	If draft is unpaid, goods may need to be disposed of or may be delivered without payment if documents do not control possession

Documents against Acceptance Collection

With a D/A collection, the exporter extends credit to the importer by using a time draft. The documents are released to the importer to claim the goods upon his signed acceptance of the time draft. By accepting the draft, the importer becomes legally obligated to pay at a specific date. At maturity, the collecting bank contacts the importer for payment. Upon receipt of payment, the collecting bank transmits the funds to the remitting bank for payment to the exporter. Table 2 shows an overview of a D/A collection:

Table 2: Overview of a D/A collection

Time of Payment	On maturity of draft at a specified future date
Transfer of Goods	Before payment, but upon acceptance of draft
Exporter Risk	Has no control over goods after acceptance and may not get paid at due date

Chapter 5
Open Account

An open account transaction in international trade is a sale where the goods are shipped and delivered before payment is due, which is typically in 30, 60 or 90 days. Obviously, this option is advantageous to the importer in terms of cash flow and cost, but it is consequently a risky option for an exporter. Because of intense competition in export markets, foreign buyers often press exporters for open account terms. In addition, the extension of credit by the seller to the buyer is more common abroad. Therefore, exporters who are reluctant to extend credit may lose a sale to their competitors. However, though open account terms will definitely enhance export competitiveness, exporters should thoroughly examine the political, economic, and commercial risks as well as cultural influences to ensure that payment will be received in full and on time. It is possible to substantially mitigate the risk of non-payment associated with open account trade by using trade finance techniques such as export credit insurance and factoring. Exporters may also seek export working capital financing to ensure that they have access to financing for production and for credit while waiting for payment.

Key Points

- The goods, along with all the necessary documents, are shipped directly to the importer who has agreed to pay the exporter's invoice at a specified date, which is usually in 30, 60 or 90 days.
- The exporter should be absolutely confident that the importer will accept shipment and pay at the agreed time and that the importing country is commercially and politically secure.
- Open account terms may help win customers in competitive markets and may be used with one or more of the appropriate trade finance techniques that mitigate the risk of non-payment.

CHARACTERISTICS OF AN OPEN ACCOUNT TRANSACTION

Applicability

Recommended for use (a) in low-risk trading relationships or markets and (b) in competitive markets to win customers with the use of one or more appropriate trade finance techniques

Risk

Substantial risk to the exporter because the buyer could default on payment obligation after shipment of the goods

Pros

- Boost competitiveness in the global market
- Help establish and maintain a successful trade relationship

Cons

- Significant exposure to the risk of non-payment
- Additional costs associated with risk mitigation measures