

6.6: What Options Do Companies Have for Export and Import Financing?

Learning Objectives

1. Understand how companies receive or pay for goods and services.
2. Learn the basics of export financing.
3. Discover the role of organizations like OPIC, JETRO, and EX-IM Bank.

How Companies Receive or Pay for Goods and Services

You've already learned about two of the three documents required for getting paid in export/import transactions. The *letter of credit* is a contract between banks that stipulates that the bank of the importer will pay the bank of the exporter upon getting the proper documentation about the merchandise. Because importers and exporters rarely know each other, the letter of credit between two banks ensures that each party will do what it says it will do. The *bill of lading*, which is issued by the carrier transporting the merchandise, proves that the exporter has given the carrier the merchandise and that the carrier owns title to the merchandise until paid by the importer. Both the letter of credit and the bill of lading can function as collateral against loans. The final document, the **draft (or bill of exchange)** is the document by which the exporter tells the importer to pay a specified amount at a specified time. It is a written order for a certain amount of money to be transferred on a certain date from the person who owes the money or agrees to make the payment. The draft is the way in which an exporter initiates the request for payment.

There are two types of drafts. The **sight draft** is paid on receipt of the draft (when it is "seen") and the **time draft** is payable at a later time, typically 30, 60, 90, or 120 days in the future as specified by the time draft.

Giving the importer 120 days to pay the draft is very attractive for the importer because it allows time for the importer to sell the goods before having to pay for them. This helps the importer's cash flow. Importers will prefer to give business to an exporter who offers these attractive payment terms, which is why exporters offer them. However, waiting 120 days to get paid could cause cash-flow problems for the exporter. To avoid this problem, the exporter may choose to factor the contract. In **factoring**, the exporter sells the draft at a discount to an intermediary (often a bank) that will pay the exporter immediately and then collect the full amount from the importer at the specified later date. For example, the factor (bank) pays the exporter 93 percent of the value of the draft now. The factor now owns the draft and collects the full amount owed 120 days later from the importer. The factor earns roughly a 7 percent return in 120 days (but bears the risk that the importer defaults on the payment or takes longer to pay). Factor rates are typically 5 to 8 percent of the total amount of the draft.

Of course, it's possible for the exporter to ask for **cash in advance** from the importer or buyer, but this is a risky agreement for the buyer to make. As a result, importers prefer to do business with exporters who do not require cash in advance.

An **open account**, in direct contrast to cash in advance, is an arrangement in which the exporter ships the goods and then bills the importer. This type of agreement is most risky for the exporter, so exporters avoid it when possible or offer it only to their own subsidiaries or to entities with whom they have long-term relationships.

Basics of Export Financing

Financing against collateral is called **secured financing**, and it's the most common method of raising new money. Banks will advance funds against payment obligations, shipment documents, or storage documents.

There are several common sources of financing:

- A loan from a commercial bank
- A loan from an intermediary, such as an export management company that provides short-term financing
- A loan from a supplier, for which the buyer can make a down payment and ask to make further payments incrementally
- A loan from the corporate parent
- Governmental or other organizational financing

Did You Know?

Banks like HSBC provide trade finance and related services, including a highly automated trade-processing network of Internet trade services, export document-preparation system, and electronic documentary-credit advising. Some of these banks also provide specialized financing services, such as factoring.

Some companies have mechanisms for providing credit to their business customers. For example, package delivery company United Parcel Service (UPS) also owns warehouses to which its customers can ship their products. Because UPS can see and track the inventory that its business customers send using this service, it can lend those companies money based on their warehouse inventory and goods-in-transit. Simply put, UPS information systems know that a company's goods are on their way or in the warehouse, so UPS can lend money based on that knowledge.

Success Tips for Entrepreneurs

Entrepreneurs and small businesses can look to the US Small Business Administration (SBA) for help with their import or export businesses. Although the SBA itself doesn't loan money, it does guarantee loans and offers good loan programs for small businesses. Let's look at two programs in particular. The SBA's Export Express loan program is the most flexible program available to small businesses. The funds that small businesses obtain through this program can be used to pay for any activity that will increase exports, be it helping the exporter fund the purchase of the export items, take part in trade shows, obtain letters of credit, or translate marketing materials that it will use to sell the goods in overseas markets. Small businesses can get loans or lines of credit of up to \$250,000. Obtaining a loan requires going to a bank or other lender and asking if they are an SBA Export Express lender. If so, the small business can apply for the loan with that lender and then send the application to the SBA for final approval. The SBA will review the application to make sure that the funds will be used to enter new export markets (or to expand the company's current market) and that the company has been in business for at least one year. US Small Business Administration, "Finance Start-Up," accessed September 5, 2010, www.sba.gov/smallbusinessplanner/start/financestartup/SERV_EXPORT.html.

A second loan program, the SBA's Export Working Capital Program (EWCP), provides loans for businesses that can generate export sales but don't have the working capital to purchase inventory or to stay in business during the long payment cycles. The maximum loan amount or line of credit for the EWCP is \$2 million. More information on these loan programs is available at the SBA's international trade website: <http://www.sba.gov/international>.

Another useful tip for entrepreneurs is to use the Automated Export System (AES) to file the necessary documentation required for exporting. The AES is available to companies of all sizes but is of particular value to entrepreneurs and small businesses that might otherwise have to fill out all this documentation themselves. By filing the documents electronically, entrepreneurs get immediate feedback if there are any errors in their paperwork and can make the corrections right away. This can save days of costly delays. The AES lets entrepreneurs and businesses submit all the export information required by all the agencies involved in the export process. The process begins by filing the export document. If all the necessary information has been provided, the entrepreneur or business gets a confirmation message with approval. If there have been errors, the error message explains the omission or erroneous information so that it can be corrected. For more information, see www.aesdirect.gov.

Finally, entrepreneurs can accept payments in many ways, including checks, credit cards, or services like PayPal.

The Role of Organizations in Providing Financing

Countries often have government-supported organizations that help businesses with import and export activities to and from their country. These services are, for the most part, free and include providing information, contacts, and even financing options.

The **Japan External Trade Organization (JETRO)** was originally established in the 1950s to help the war-torn Japanese economy by promoting export of Japanese products to other countries. By the 1980s, Japan had massive export surpluses and began to feel the need to promote imports. So JETRO's mission reversed; its focus became to assist foreign companies to export their products into Japan. JETRO now offers such free services as

- market-entry information,
- business partner matching,
- expert business consulting (through bilingual business consultants who're experts in various industries), and
- access to a global network of executives and advisors.

On the financing side, JETRO offers subsidies to potential companies, free offices for up to four months while the foreign firm researches the Japanese market, and exhibition space when the company is ready to display their products to prospective Japanese importers. "Open a Japan Office / Invest in Japan," Japan External Trade Organization, accessed November 22, 2010, www.jetro.org/index.php?option=com_content&task=view&id=652.

The current goal of JETRO is to help Japan attract foreign direct investment (FDI) as part of its economic restructuring plan. FDI refers to an investment in or the acquisition of foreign assets with the intent to control and manage them. Companies can make an

FDI in several ways, including purchasing the assets of a foreign company; investing in the company or in new property, plant or equipment; or participating in a joint venture with a foreign company, which typically involves an investment of capital or know-how.

The **Overseas Private Investment Corporation (OPIC)** was established as an agency of the US government in 1971. OPIC helps US businesses invest overseas, particularly in developing countries. As its website states, “OPIC Financing provides medium- to long-term funding through direct loans and loan guaranties to eligible investment projects in developing countries.” “Financing,” Overseas Private Investment Corporation, accessed November 22, 2010, www.opic.gov/financing. It also provides exporters’ insurance. The most useful tool of OPIC is that it can “provide financing in countries where conventional financial institutions often are reluctant or unable to lend on such a basis.” “Financing,” Overseas Private Investment Corporation, accessed November 22, 2010, www.opic.gov/financing.

The **Export-Import Bank of the United States (Ex-Im Bank)** helps exporters who have found a buyer, yet the buyer is unable to get financing for the purchase in their own country. Ex-Im Bank can provide credit support (i.e., loans, guarantees, and insurance for small businesses) that covers up to 85 percent of the transaction’s export value.

Unlike JETRO, OPIC, and Ex-Im Bank, the Private Export Funding Corporation (PEFCO) is a private-sector organization. PEFCO was formed in 1970 “to assist in financing U.S. exports by supplementing the financing available from commercial banks and other lenders.” “Overview,” Private Export Funding Corporation, accessed November 22, 2010, <http://pefco.com/about/overview.html>. PEFCO provides medium- to long-term loans if they are secured against nonpayment under an appropriate guarantee or insurance policy issued by Ex-Im Bank or for certain small-business export loans under a guarantee issued by the SBA.

Did You Know?

The Development Bank of Japan (DBJ) has loan programs for foreign-affiliated companies investing in Japan. According to Masaaki Kaji of DBJ, the loans are offered at low fixed interest rates for five- to fifteen-year terms. Katherine Hyde, “JETRO Symposium on Business Alliances/Investment in Japan: Market Brainstorms,” *Japan Society*, November 1, 2005, accessed August 29, 2010, www.japansociety.org/jetro_symposium_on_business_alliancesinvestment_in_japan_market. During the twenty-year history of the program, the three hundred companies that have received financial aid have generated \$850 billion dollars in income for the Japanese economy. DBJ also works with regional Japanese banks to provide merger and acquisition advice to small and midsize companies. One of DBJ’s most famous projects provided financing and strategic advice for the joint venture established between Starbucks and Sazaby Japan. Katherine Hyde, “JETRO Symposium on Business Alliances/Investment in Japan: Market Brainstorms,” *Japan Society*, November 1, 2005, accessed August 29, 2010, www.japansociety.org/jetro_symposium_on_business_alliancesinvestment_in_japan_market.

KEY TAKEAWAYS

- The main financial documents import/export companies use in order to get paid are the letter of credit (which states that the bank will pay the exporter upon getting the proper documentation about the merchandise), the bill of lading (which proves that the exporter has given the carrier the merchandise and that the carrier owns title to the merchandise until paid by the importer), and the draft, or bill of exchange (which tells the importer to pay a specified amount at a specified time).
- Companies can obtain funding via loans from several sources: a commercial bank, an intermediary, a supplier, their corporate parent, or a governmental or other organization.
- The role of organizations like OPIC, JETRO, and Ex-Im Bank is to provide financing, market information, and trade assistance. These organizations are often country specific (e.g., JETRO, which focuses on Japan) or specific to a category of countries (e.g., OPIC, which factors loans to developing countries).

EXERCISES

(AACSB: Reflective Thinking, Analytical Skills)

1. If you were an exporter, would you ever give your buyer three months to pay an invoice? Why or why not?
2. Describe how the SBA can help entrepreneurs and small businesses in their export ventures.
3. Explain the difference between a letter of credit and a draft.

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