

Export Finance: Proactive Strategies for Structuring Cross-Border Sales



Trade finance is one of the oldest means of financing exports, and according to the World Trade Organization, it is used to pay for approximately 90 percent of global trade. In past years, many companies have used open account terms to sell to overseas clients; however, they may want to reevaluate using trade as a financing structure as they continue to expand overseas, particularly in the current market environment. Although trade finance mechanisms are likely to be more expensive and require a longer timeframe to complete the transaction, the protection afforded by them often justifies the additional expense and time burden, such as the added effort of managing discrepancies in the letter of credit. Companies should think about ensuring that the higher cost of credit leaves enough room for required profit margins.

A brief description of trade finance structures and their benefits as well as other forms of payment follows:

Four Ways to Pay

There are four basic ways to consider structuring an export sale (see Payment Risk Diagram on page 2). Some of these are used exclusively or can be combined (cash-in-advance for example with the balance of the sale structured by letter of credit):

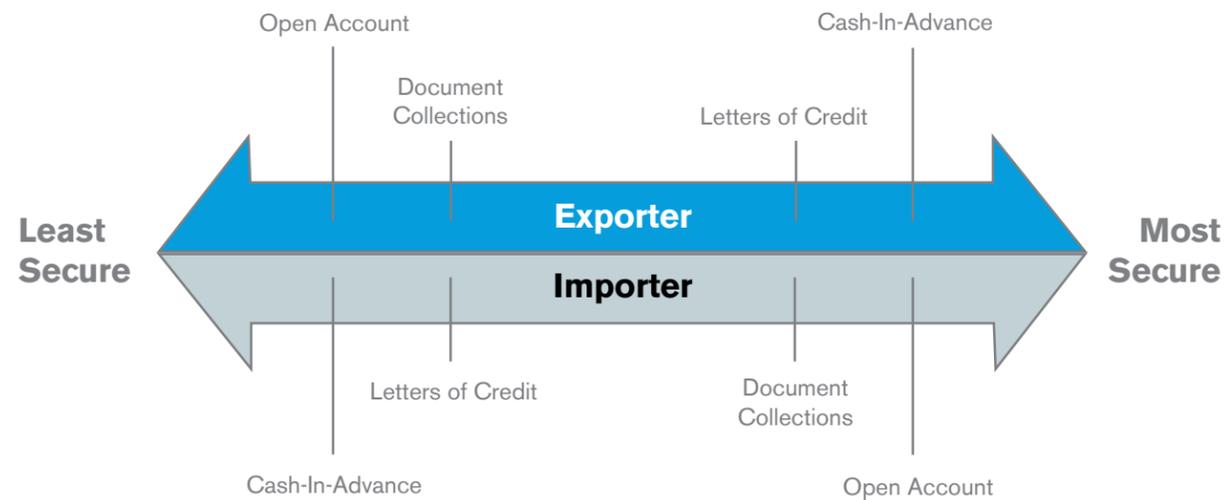
Cash-in-advance

In this approach, the buyer pays cash upfront by wire transfer, credit card or check. While this arrangement provides maximum security for the exporter, it places all of the risk with the importer and may deter a potential sale. For this reason, cash-in advance tends to be used only in high-risk trade relationships.

Letter of credit

A letter of credit is a commitment by a bank on behalf of the buyer guaranteeing payment to the exporter, as

Payment Risk Diagram



Source: U.S. Department of Commerce

long as the exporter meets specific documentary terms and conditions. The letter of credit spreads the risk of the transaction to both the buyer and seller, with their banks serving as honest brokers in between.

An exporter can also use a letter of credit as an instrument to enhance its working capital position instead of approaching a bank for a credit facility.

For example, an exporter could require the buyer overseas issue a letter of credit on terms, (typically 90 to 120 days but in some markets such as Saudi Arabia buyers ask for up to 360 days). Once the exporter presents documents to its bank and these are accepted by the importer's bank, the exporter can request that its bank discount the draft under the letter of credit, obtaining working capital to continue to fund its growth. Rates for financing under this structure depend on the issuing bank and country risk but are often discounted close to 100 percent and generally priced below working capital credit lines.

Silicon Valley Bank (SVB) has export clients that sell in most markets around the world using predominantly letters of credit to finance their working capital needs so it continues to be a common form of financing.

Documentary collection (D/C)

A faster way of handling payments through a neutral third-party is to arrange a documentary collection—where the exporter uses only a draft and some additional documents and entrusts the collection of payment to its bank.

This approach costs less than a letter of credit, but it does ensure that the banks act as intermediaries handling documents between the buyer and seller. Collections are often used for situations in which companies still want their banks involved but aren't quite ready to move to an open account structure. Exporters can structure sales on a collection basis with drafts on terms, as with a letter of credit, and discount the proceeds for their benefit.

Open account

In an open account sale, the exporter ships and delivers product before payment is due from the buyer. Since it is the least secure payment option for the exporter, companies tend to use the open account structure for established trade relationships.

In today's competitive export markets, foreign buyers often press exporters for open account terms. Exporters who are reluctant to extend credit could lose sales to competitors who are willing to offer better payment terms. The trade finance techniques mentioned above

provide opportunities for the seller to extend favorable terms to the buyer while at the same time realizing cash on the sale much sooner.

A Helping Hand from Export Credit Agencies

Several government agencies and programs offer export finance resources and assistance, including the United States Commercial Service (www.export.gov), U.S. Small Business Administration (www.sba.gov) and the Export-Import Bank (Ex-Im Bank) of the United States (www.exim.gov). Among these, the Ex-Im Bank in particular provides significant value to fast-growing technology and life sciences exporters.

Ex-Im Bank was established as an independent agency of the U.S. government in 1934 to finance the export sale of U.S.-made goods and services. In the years since, it has supported more than \$450 billion in exports through a variety of programs including loan guarantees (working capital and medium-term loans) to primarily financial institutions and export credit insurance.

As one of the top users of the Export-Import Bank Working Capital Guarantee program, SVB has placed in the top three banks on a volume basis year-over-year. SVB also earned Ex-Im Bank's Small Business Bank, Bank of the Year Award in 2005.

The Ex-Im Bank Working Capital Guarantee program provides loan guarantee coverage to financial institutions to support their client's sales in more than 100 countries around the world, providing coverage for advance rates as high as 90 percent on accounts receivable and 75 percent on inventory. Borrowers pay the same interest rate on export-related collateral as they pay for domestic-related collateral, and they pay an annual facility of no more than 1.5 percent of the total loan amount to arrange the guarantee. Because SVB is a Super Delegated Lender within the Ex-Im bank program, we can obtain approval from Ex-Im Bank in less than ten business days.

Export Credit Insurance: Protection for the Exporter

Companies may want to consider obtaining export credit insurance in their favor if they are looking for protection to their direct benefit for the export sale. Export Credit

Insurance policies are offered by both private sector insurers, such as FCIA, Atradius and Coface, and government agencies, such as Ex-Im Bank.

Export credit insurance gives the exporter conditional assurance that payment will be made in the event that a foreign buyer is unable to pay, depending on terms and conditions outlined in the policy. It also provides security

Case Study: Ex-Im Bank in Action

A U.S.-based maker of semiconductor components sells more than 60 percent of its products abroad, in Mexico, Spain and Taiwan. The majority of its manufacturing activities take place in the U.S. and the company bills and collects its invoices out of its headquarters in Pennsylvania.

When the company wanted to expand production to meet increasing demand in early 2007, it contacted its bank for working capital financing. Citing the higher risk of foreign-related collateral, its bank was only willing to lend on the company's domestic accounts receivable and inventory. The company turned to SVB for a second opinion.

After reviewing the company's financial statements, export contracts and sales and collections cycle, SVB's lending team and its Global Credit Products team was able to lend on the company's domestic and export-related collateral through the Ex-Im Bank Working Capital Guarantee program.

The semiconductor company received a \$14 million working capital facility, \$10 million of which was guaranteed by Ex-Im Bank. More significantly, the company received a higher advance rate of 90 percent on Ex-Im Bank-guaranteed A/R and 75 percent on Ex-Im Bank-guaranteed inventory (compared to rates of 80 percent and 25 percent for domestic-only loans). In this agreement, SVB kept the interest rate on both the domestic loan and the export-related loan the same. The only additional expense to the company for this new financing strategy was an annual facility fee of approximately 1 percent charged by Ex-Im Bank.

to banks that offer their clients working capital to finance exports. This type of insurance protects exporters against a wide range of commercial losses (default, insolvency, bankruptcy) and political losses (war, nationalization, currency inconvertibility), ensuring access to financing for both the production of goods for export as well as any credit the exporter needs while it awaits payment.

Policies may be offered for short-term or medium-term coverage. Prices are determined by individual risk factors; however, fees tend to run less than the cost of a letter of credit. Most policies cost between 100-200 basis points of the insured sales.

Export credit insurance is most effective when it's used proactively. Ideally, you should put a policy in place before a customer becomes a problem.

Government Guarantee or Insurance Policy?

Both an Ex-Im Bank guarantee and an export credit insurance policy help mitigate risk in international sales, but there are some key differences between the two techniques that will determine which solution is best for each company:

Guarantee versus insurance

An Ex-Im Bank guarantee secures loans made by a lender, while an insurance policy guarantees receivables owed to the exporter or borrower. If the exporter borrows against the insured receivables, which happens in many cases, the lender will be named as the loss payee and will be the ultimate beneficiary. A financial institution would normally view a guarantee as a stronger form of repayment than being named as loss payee within an insurance policy.

Coverage

While export credit insurance covers up to 95 percent of the sales that are insured, an Ex-Im Bank guarantee covers up to 90 percent of the loan facility.

Cost

The cost of an Ex-Im Bank guarantee is lower. Costs for insurance policies depend on the financial condition of the buyer, as well as country risk, and can range from 100

to 200 basis points of the gross amount of insured sales over the policy period (usually one year).

Approval time

Arranging an export credit insurance policy takes approximately two weeks, provided the insurer has a complete application and information on the buyer while an Ex-Im Bank guarantee requires approximately ten business days for approval in addition to the time to underwrite and document the credit facility.

Complexity

In general, insurance policies are more complex to manage than an Ex-Im Bank guarantee, for both the exporter/borrower and the lender.

Plan Ahead

The time to develop an international growth strategy is now, before you've exhausted all domestic growth opportunities. Planning an efficient structure for financing export sales is a critical component and the right approach can not only protect against the risk of nonpayment but also allow better use of working capital.

Companies that focus on this aspect of their business are in a stronger position to expand and compete aggressively in the global economy.

About Silicon Valley Bank

Silicon Valley Bank is the premier commercial bank for emerging, growth and mature companies in the technology, life science, private equity and premium wine industries. SVB provides a comprehensive suite of financing solutions, treasury management, corporate investment and international banking services to its clients worldwide. Through its focus on specialized markets and extensive knowledge of the people and business issues driving them, Silicon Valley Bank provides a level of service and partnership that measurably impacts its clients' success. Founded in 1983 and headquartered in Santa Clara, Calif., the company serves clients around the world through 26 U.S. offices and five international operations. Silicon Valley Bank is a member of global financial services firm SVB Financial Group, with SVB Analytics, SVB Capital, SVB Global and SVB Private Client Services.

More information on the company can be found at www.svb.com.

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