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Export finance

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Export finance

As a growing business you may be considering exporting for the first time. While exporting can have significant benefits for a business there are some risks associated with it, not least the longer lead times between providing the goods or services and getting paid.

Manufacturers who import raw materials face other challenges, such as overseas suppliers who want to be paid for materials before shipping, so they will need finance to fill the gap between importing the materials and the point where the finished goods are produced and paid for by the end customer.

1. General sources of finance

Getting access to working capital

For exporters, access to working capital is vital to filling new orders, capitalising on new markets and maintaining adequate inventory levels. Businesses can make use of private, institutional and governmental sources of working capital.

Revolving credit

If your business is established and has good credit and references, you can apply for a line of credit/overdraft from a financial institution and only pay interest on the money actually withdrawn from the credit line. Business credit cards are another source of revolving credit.

Debt financing

Businesses that are well established and have good credit history can apply for short and long-term business loans from banks and financial institutions to meet working capital needs.

Accounts receivables financing

Another way to obtain much-needed working capital is to sell your accounts receivables (unpaid invoices) to a financing company. This could be done in a couple of ways.

- **Invoice discounting** – This is mostly aimed at larger businesses with well-established systems and procedures in credit control and sales ledger management. In very simple terms, it allows you to receive up to 90% of the money you're owed within 24 hours of submitting an invoice. An advantage is its anonymity: your customers never need to know that their invoices are providing a source of financing.
- **Factoring** – This is primarily for smaller businesses which don't have a large finance department and which may have customers who don't always pay on time. You issue your invoices as normal, but your bank manages the issuing of statements and collects the money owed to you.

2. Export buyer finance

Buyer finance is a loan made available to your buyer so that they can purchase your goods or services. The buyer's ability to get a loan from a financial institution in the UK, their own country or a third country might be critical to the deal going ahead. Buyer finance loans are often a medium to long-term financing solution for purchasing capital goods or for large projects.

Finance for your overseas buyer can take the form of a **direct loan** from a bank or other financial institution to your buyer. The loan may cover all or part of the export contract value.

At your buyer's direction, the lender may provide funds to you as export contract payments. Your buyer makes loan repayments to the lender in accordance with the loan agreement.

Sometimes a bank may be unwilling to lend to your overseas buyer, especially in risky or developing markets, unless the bank can share the buyer's loan default risk with others.

For example, another financial institution may be willing to give a **guarantee** to the lender to cover some or all of your buyer's payment obligations in the event of a default under the loan agreement. Once the loan and guarantee are in place, the lender (at the buyer's direction) may advance the loan funds to you as export contract payments. Your buyer then repays the lender in accordance with the loan agreement.

3. Support for exporters with raising finance

UK Export Finance (UKEF)

This government agency offers a range of products to help exporters raise finance.

- **Export Working Capital Scheme** – For businesses that have difficulty obtaining credit on their own, UKEF can help by providing partial guarantees to lenders to cover the credit risks associated with export working capital facilities. UKEF can typically guarantee lenders 50% of the risk, although it may go up to 80% subject to detailed assessment.
- **Bond Support Scheme** – If you secure an advance payment from your export customer, you may be asked for a guarantee. Or you may be asked for a tender, performance or warranty bond. UKEF provides a guarantee to your bank so that the bank will issue the guarantee to your overseas customer. This may also increase your working capital by releasing cash that is sometimes required by the bank to secure the bond.
- **Bond Insurance Policy** – Sometimes a bond is called due to events beyond the exporter's control. UKEF can provide an insurance policy to protect exporters against a demand for payment under a bond which is either unfair or called due because of political events.

- **Export Insurance Policy** – UKEF provides an insurance policy that covers the exporter against not being paid under their export contract. The policy covers costs incurred if the export contract is terminated because the buyer defaults before the goods are delivered, or if they fail to pay due to unspecified political, economic or administrative events.
- **Letter of Credit Guarantee Scheme** – Letters of credit are one of the safest ways to get paid. UKEF provides a guarantee to the exporter's bank so they can confirm a letter of credit.
- **Buyer and Supplier Credit Facilities** – Export contracts can require providing goods or services on payment terms in excess of two years. Banks can provide loans to exporters or overseas buyers to help fund payment terms of two years or more. UKEF provides a guarantee to the exporter's bank so it can do this. These loans involve stage payments – this means the exporter will receive payments in line with their contract and the buyer will be given credit to pay over an extended period.
- **Direct Lending Facility** – UKEF also provides loans directly to overseas buyers so that they can purchase goods or services from the UK.

4. Making sure you get paid

Getting paid can present particular challenges for exporters. This is because the buyer and seller are in different countries, so securing payment or reclaiming the goods can be more difficult.

To address this, a number of options are available, all of which reduce the risk of non-payment to varying degrees and in different ways.

Cash in advance

In this simple arrangement the importer (or buyer) pays the exporter in advance for goods or services. All the advantages accrue to the exporter, and all the disadvantages accrue to the importer, who has parted with his money and has no assurance of receiving the goods. More usually, some element of credit will be involved.

Letters of credit (LC)

With other payment methods the exporter and the importer depend on each other for the contract to be properly fulfilled with a letter of credit (LC), however the exporter and the importer both have the additional independent assurance of the bank that issues the LC (the issuing bank). The exporter is still at some risk of non-payment if they are unable to meet the terms and conditions of the LC, or if the importer's bank finds discrepancies not previously found by either the exporter or the paying bank.

Collection (term and sight)

This is when the exporter ships the goods before payment but retains control of them until payment (or a legal promise to pay) is received from the importer.

The transaction is initiated by the exporter, who despatches the goods to the importer's country. At the same time they entrust the related documents (which may include negotiable bills of lading) to their bank, for collection of sale proceeds and the delivery of documents to the importer according to the terms of the sales contract. It is important to note that collections do not give the exporter the security of advance payment, and require both exporter and importer to exercise great care in agreeing the detail of the sales contract.

There are three types of collections, each of which provides a different level of protection for the exporter and importer. These are: **clean collection, documentary collection: documents against acceptance** (D/A), and **documentary collection: documents against payment** (D/P).

Open account trading

This applies when the exporter despatches goods to the importer and at the same time sends an invoice for those goods, for payment at an agreed date or after an agreed period. It is commonly used for trade between established pairs of exporters and importers, both of whom tend to operate in stable markets. The arrangement is based primarily on trust and the advantages accrue to the importer, while the exporter takes on all the risk. If the customers don't pay, or if they do pay but their country blocks remittance of funds to the exporter, the exporter has neither the goods nor the money, and may not be able to get their goods back.

5. Insurance

Most international trade is conducted on open credit terms. It is important to protect your company against the risk of non-payment and loss arising from a political event such as war, or natural disaster.

There are banking techniques that provide similar protection, but these may be expensive for your customer. With credit insurance you protect against non-payment and the resulting bad-debt write-off. At its simplest, you offer open account terms to your customer and if they do not pay, then you claim on your insurance. Sometimes the insurer might ask you to obtain payment security as a condition of giving cover for a certain customer or country.

It is wise to get advice from a broker on insurance issues to ensure that the insurance meets your needs.

Here are some of the export risks you can insure against:

Credit risk: the risk of non-payment.

Pre-delivery/work-in-progress risk: if your goods are made to order, you can buy cover from date of contract for the risk of insolvency or contract frustration before dispatch.

Bond unfair calling risk: it is possible to buy cover, as an extension of your export credit insurance, against the unfair call of an on-demand contract bond or bid bond.

Cargo risk: insurance for goods in transit may be provided through your logistics supplier or can be separately negotiated.

Liability risk: consider both public/products liability insurance as well as overseas local statutory insurances such as employer's liability/worker's compensation and motor.

>> Summary

Financing exports can be complicated as there is a wide variety of advice and information. Your bank will have regional or central international and trade advisers. UK Export Finance has staff in each UK Trade & Investment regional office. These are good places to start.

Export finance useful websites

UK Export Finance
gov.uk/uk-export-finance
National Customer Service Helpline – 020 7271 8010

British Exporters Association (BExA) – produces useful guides on exporting
bexa.co.uk/bexa-publications

UK Trade & Industry – from market research to in-country help
gov.uk/government/organisations/uk-trade-investment

The Institute of Export – useful courses and qualifications
export.org.uk/training

Banks

Barclays
barclays.co.uk/businessabroad

RBS/NatWest
natwest.com/international
rbs.co.uk/international

HSBC
business.hsbc.uk/en-gb/imports-and-exports

Lloyds Banking Group
lloydsbank.com/business/commercial-banking/international/trade-finance.asp

Bushells
6 Victoria Avenue
Harrogate
North Yorkshire
HG1 1ED

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ICAEW Business Advice Service

The ICAEW Business Advice Service (BAS) provides professional advice for start-ups and owner-run businesses.

As well as practical help online in the form of white papers, short PDFs and blog articles, we enable businesses to receive an initial consultation at no charge from an ICAEW Chartered Accountant.

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