Introduction

An international trade transaction, no matter how straightforward it may seem at the start, is not completed until delivery has taken place, any other obligations have been fulfilled and the seller has received payment. This may seem obvious; however, even seemingly simple transactions can, and sometimes do, go wrong.

There are many reasons why these things happen, but behind them all is the basic fact that the risk assessment of the transaction and/or the way these risks were covered went wrong. An example is the risk assessment of the customer, where exporters do not always fully realize that the larger countries may be divided into regions, often with different cultures, trade patterns and practices. In many countries, signed contracts are sometimes considered to be merely letters of intent, particularly if they have not been countersigned by a senior authorizing manager. Or it may be that the seller has agreed to terms that were previously used but are not suitable in a new situation.

Another reason may be that the parties simply did not use the same terminology or did not focus on the details of the agreed terms of payment. This would inevitably lead to undefined terms, which are potentially subject to future disputes, something that would perhaps not be revealed until delivery has been made – when the seller is in a weaker bargaining position. Even though such errors seldom lead to non-payment, it is more likely that they will lead to delays in payment, possibly with an increased commercial and/or political risk as a consequence.

Another common consequence of unclear or undefined terms of payment is that the seller may have outstanding claims on the buyer; or that the buyer is of the same opinion with regard to the seller and takes the opportunity to make unilateral payment deductions owing to real or alleged faults or deficiencies in the delivery.

Each area of international trade requires its own knowledge to be used, from the first contacts between buyer and seller to final payment. One area of expertise is how to develop professional and undisputed terms of payment and, if necessary, how to solve currency and trade finance questions in a competitive way. These areas are of vital importance both in the offer and in subsequent contract discussions, not just

Table 0.1 Leading exporters and importers in world merchandise trade, 2006 (billion US$)

Country	Export	Import
Germany	1112	909
United States	1038	1919
China	969	792
Japan	650	580
France	490	535
Netherlands	462	416
United Kingdom	448	619
Italy	410	437
Canada	390	358
Belgium	369	354
Rep. of Korea	326	310
Hong Kong	323	336
Russia	305	164
Singapore	272	239
Mexico	250	268
Taipei, Chinese	224	203
Saudi Arabia	210	66
Spain	206	316
Malaysia	161	131
Switzerland	148	141
Sweden	147	127
Austria	140	140
United Arab Emirates	139	98
Brazil	138	96
Thailand	131	129
Australia	123	139
Norway	122	64
India	120	175
Ireland	111	73
Poland	110	126
Indonesia	104	80
Czech Republic	95	93
World	**12.083**	

Source: WTO, World Trade statistics 2007
(http://www.wto.org/english/res_e/statis_e/its2007_e/section1_e/i08.xls)

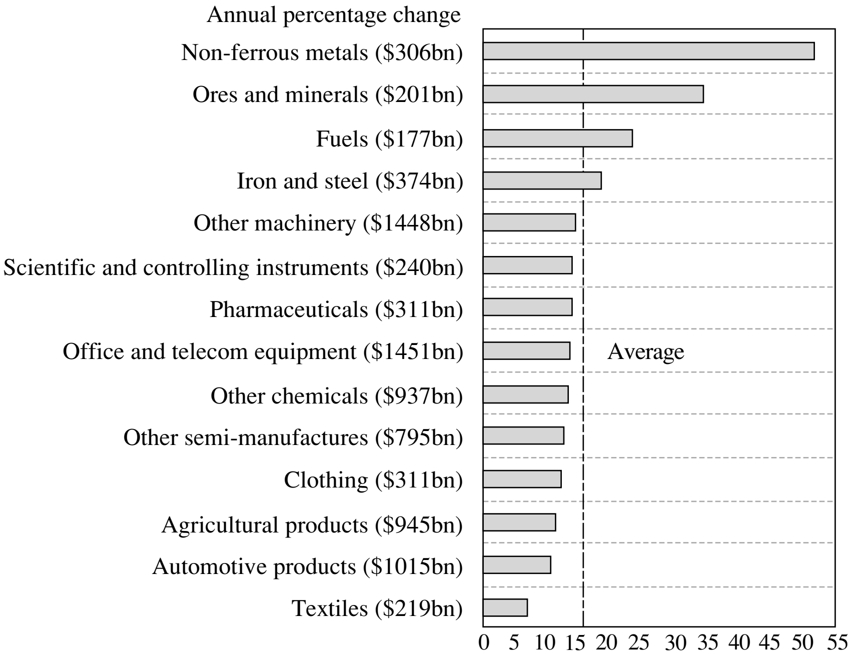

Figure 0.1 World merchandise exports by product group, 2006

Source: WTO, World Trade statistics 2007
(http://www.wto.org/english/res_e/statis_e/its2007_e/its07_merch_trade_product_e.pdf)

within difficult countries or markets or in larger, more complicated deals, but also in quite ordinary day-to-day transactions.

The choice of currency could be of great importance, particularly in an increasingly competitive market, and the ability to extend finance has become a major competitive factor in negotiations. But the terms of such credits have changed to the advantage of the buyer and, as a consequence, demand for longer periods and more advantageous terms has increased.

Terms of payment, currency and finance alternatives can, in some cases, and/or in similar and repetitive transactions, be developed as standard models but must, in other cases, be adapted to each transaction and its specific preconditions. This is even more obvious if one looks at Table 0.1 and Figure 0.1 and evaluates the basic structure of international trade.

There are more than 150 other countries, including many developing and emerging markets countries, which are not even listed, and in many of these, the structuring of the terms of payment is the key to more frequent and profitable business.

Every transaction contains many different preconditions, apart from aspects such as the buyer, the country, the nature of the goods, size, extent and complexity. This requires the seller to carry out an individual risk assessment and make decisions that ensure a profitable and secure deal, with a level of risk that is both defined and accepted at the outset.

It is therefore of great importance, for both buyer and seller, to know how to structure practical terms of payment. In practice this often means that during negotiations the seller must be willing and able to compromise – even when it comes to specific questions related to guarantees, payments, currency and finance. In these situations, and often together with other difficult negotiations, it is important to understand the connections between these parts, what is essential to hold on to and what can be waived.

Any successful negotiation must take reasonable and equal consideration of the demands from both commercial parties in order to find a compromise and avoid unnecessary discussions or misunderstandings. The experienced seller will always try to avoid such situations, thereby strengthening the potential for future business transactions, provided that fundamental demands have been met to safeguard the transaction.

This handbook should be used as a reference manual in the practical day-to-day business of the international trading company within the sales, shipping, administrative and back-office departments. For small and medium-sized companies that do not always have the specialist finance functions in-house this is obvious. But this will also be the case even within the largest companies, where specialization often means that many employees have detailed knowledge in some, but not all, financial areas.

And that goes not only for the exporting company, but also within importing companies buying goods or services from abroad. Many comments have been made about the advantages of describing, in practical detail, the interactive negotiating process between the commercial parties in an international trade transaction; useful knowledge for both the seller and the buyer.

That is exactly the way these handbooks have been used for over 25 years.

Cash management

One important development over recent years has been the demand for capital rationalization, or 'cash management'. This has affected all aspects of business, not least the sections covered in this handbook. It is especially obvious within the areas of payment, currency and finance where every decision has direct consequences on the capital required during all phases of the transaction, until payment is received.

This handbook demonstrates primarily how the seller can act, within the framework of a defined risk level and with their competitive edge maintained, to optimize the profitability of international trade transactions. They can then also determine, with a high degree of accuracy, when, where and how payments will be made and therefore how to minimize the capital required. The concept of risk is directly connected to the probability of timely payment, the choice of currency related to the exchange rate when paid and the financing connected to the cost of the outstanding credit. The importer will use the same knowledge, but from their own perspective.

The expression 'cash management' is seldom explicitly used in the text, but most sections contain comments or advice that, directly or indirectly, has a bearing on the use and latent risk of capital. With this in mind, this handbook could be read as a manual for improved cash management in connection with international trade (more on this is explained in the final chapter concerning the practical structure and design of the terms of payment).

The main composition of this handbook

This handbook is intended to be a practical reference guide to help in the daily work – mainly seen from the perspective of the seller – within sales, shipping and administration. The contents have, therefore, been structured as follows:

- risks and risk assessment → (analysis);
- methods of payment
- guarantees, bonds and standby L/Cs
- export credit insurance
- currency risk management (alternatives);
- trade finance
- structured trade finance
- structure and design of practical terms of payment → (action).

To get a clearer picture of the focus of this handbook, please also consider this statement before browsing through the following pages.

From the seller's perspective... Why are some companies doing more frequent and successful export deals than others...?
... It is because they manage to cover even the most difficult export risks – only then are they in the best position to enter totally new markets.

Sell more – win market shares – enter new markets. Who doesn't want that? But the problem is often not making the sale but ensuring that you get paid.

Why do things sometimes go wrong in the export chain, from quotation to payment – or in the worst case, non-payment? The answer is that the seller often underestimates, or simply does not fully understand, the risks involved in the transaction. Or the seller does not get the terms of payment originally anticipated and, at that stage, does not manage to cover the transaction in some other way – or even abstains from the deal altogether. Basically it is a matter of learning how to cover the trade risks in a professional way – allowing the seller to manage transactions in most parts of the world.

Figure 0.2 Expanding exports into new markets can be very profitable – if you can control the risks

… However, the follow-up must also be done professionally at home. What is needed is effective handling of the transaction until shipment occurs – and thereafter, effective debt supervision. Time is money – look at the time arrow in Figure 0.3.

The follow-up starts immediately after the contract is signed. It can be a forward currency hedge, the issuing of guarantees, communication with the insurance company about an export credit risk policy or follow-up of the obligations of the buyer, for example the correct issue of a letter of credit.

To end up in the grey area of the time arrow is always risky; there the seller is more exposed – the goods have been shipped but without the payment being received in time.

Worst of all, if pre-shipment control is not in place, even the most secure letter of credit will be worthless if the seller is not able to comply fully with its terms later on. It is often in sales negotiations in foreign countries far away from the home organization that the details for a profitable transaction have to be decided. And once the deal is signed, it may be difficult to get changes to the advantage of the seller – not least regarding the terms of payment.

The follow-up is crucial and will ultimately decide the profitability of the transaction.

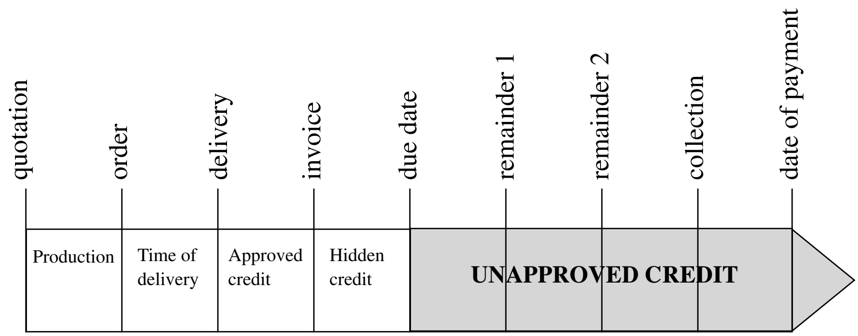

Figure 0.3 By shortening the time arrow within each segment, the risk situation can be improved – in the same way as liquidity and profitability.

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