

P14

Doing Business Internationally

- An Overview of International Trade
- Risks in International Trade
- International Payment Methods
 - Documentary Collection
 - Documentary Credit (Letter of Credit)

School of
Engineering

E216 Distribution
& Transportation



International Trade Management



- Every country is dependent on each other for a variety of goods

Definition of International Trade

- It is the buying and selling of goods across countries and boundaries
- It involves the transportation of goods from one point to another
 - Import Trade: If goods are brought into a country
 - Export Trade: If goods are sent to another country

International Business Growth



- The rate of international trade growth is tremendous in recent years



International Business Growth



Factors Contributing to the Growth:

Market Expansion:

- Smaller economies/companies have to look beyond national boundaries for growth

Resource Acquisition:

- Organization/companies go to foreign sources because certain products or services are not available locally.
- Resources may be labor, capital, materials or technology
- E.g. Cheaper labor and materials abroad

International Business Growth



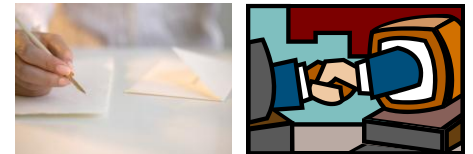
Competitive Forces:

- Competitors begin to grow by expanding into a new foreign markets; smaller firms have little choice but to follow suit.



Technological Change:

- Technological changes in transportations, information processing and communications
 - Sailing vessel vs. Container vessel
 - Pen and paper vs. Computer processing
 - Letter by sea mail vs. Electronic mail/ internet & facsimile



International Business Growth



Social Changes:

- Products & services too strongly identified with particular culture were once shunned in certain societies.

Changes in Government Trade & Investment Policies:

- In the past 50 years, countries have negotiated reductions in the import tariffs.
 - Relaxed trade and investment barriers.
- Example: ASEAN Free Trade Agreement



International Trade Transaction Procedure



In an international trade transaction, it comprises of :

- An Agreed Products or Services
- A Purchase and Sales Contract
- Shipping and Delivery Details
- Terms of Payment
- Documentation Requirements
- Insurance Coverage (if applicable)

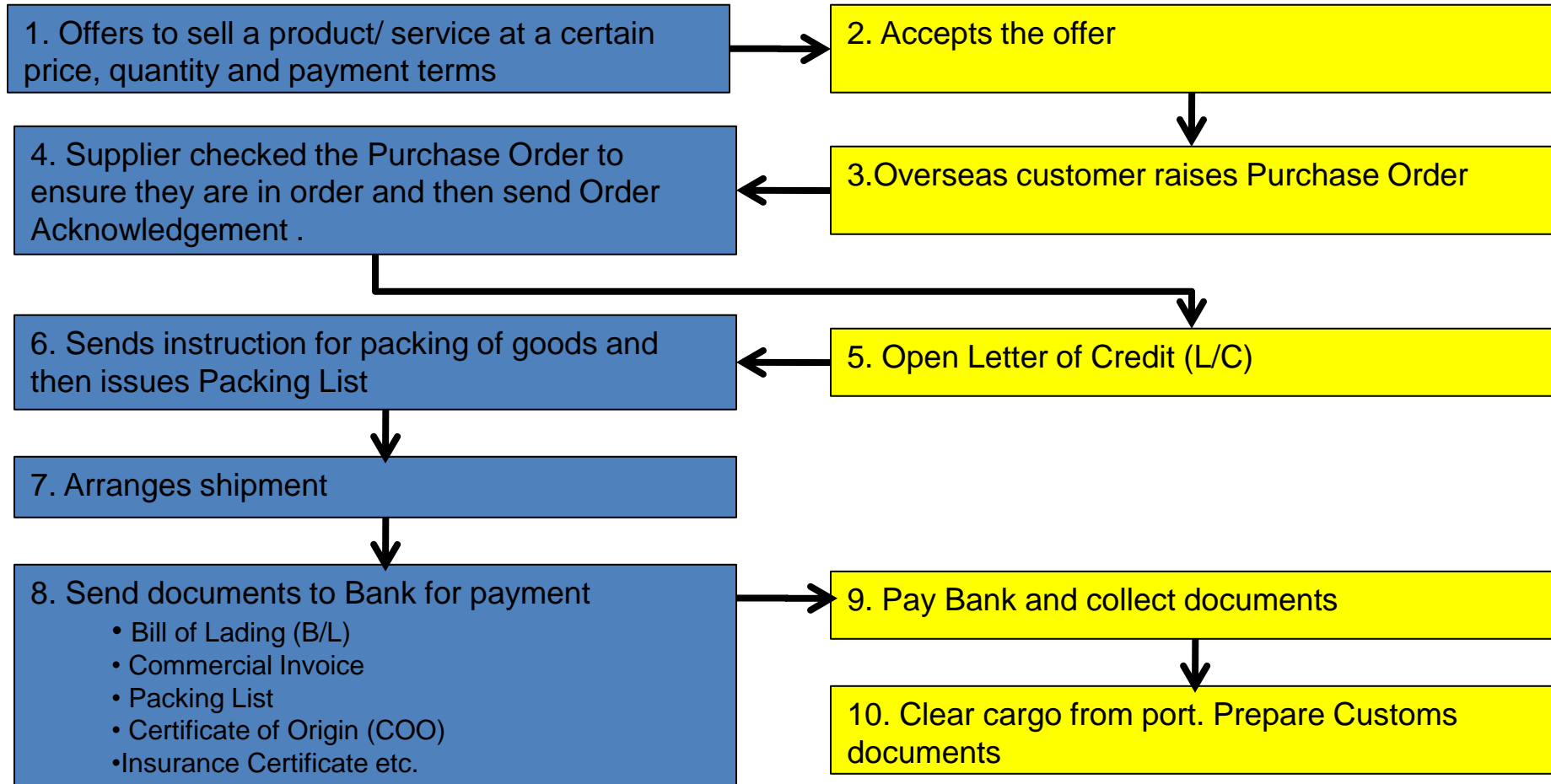


International Trade Transaction Procedure



SELLER

BUYER



International Payment Methods



- Payment in international trading can be made in a variety of ways depending on the **risks factors, circumstances** and **reliability of the party involved**
- Based on **mutually agreed terms** set forth by the buyer and seller
- It is normal that buyer and seller are keen to safeguard themselves against any financial loss

International Payment Methods



A. International Cheque

- Buyer issues international cheque to seller who would then present to his local bank for clearance
 - Seller's bank would send the cheque to buyer's bank for clearance before paying the seller
- Easy but the slowest method in settling payment
- (-) Cheque may be lost in mail OR it may “bounce” upon presentation





B. Banker's Draft

- It is a cheque drawn by one bank on its correspondent bank abroad
 - Payable upon presentation to the named beneficiary
- Buyer authorizes his bank to debit his account for the equivalent of the foreign currency plus commission for the issuance of a banker's draft
- Simple payment method but the draft may be lost in transit



C. Telegraphic Transfer (TT)

- The fund is transferred through inter-bank such as by SWIFT (Society for Worldwide Interbank Financial Telecommunication)
- The buyer applies through a signed written instruction to his bank to effect a telegraphic transfer of a certain amount of money to seller's bank
- Seller's bank receives the authenticated instruction, verifies and satisfies that the remitting bank has sufficient funds will then pay the seller



D. Documentary Collection

- The seller upon shipment of goods to the buyer's country, will then entrust all his shipping documents to his bank for collection of the proceeds, against specific instructions like:
 - Deliver Documents Against Payment (D/P)
 - Deliver Documents Against Acceptance (D/A)

E. Letter of Credit (Documentary Credit)

Documentary Collection Procedures



7. With shipping documents, importer clear goods

Importer



Exporter



1. Sales Contract

2. Ship Goods

6. Pays/accept and collect shipping documents



**Collecting/
Presenting Bank**

5. Present documents against payment/acceptance

3. Shipping documents



Remitting Bank

9. Credit payment to export's a/c

4. Forward Documents

8. Remit Payment

Bill of Exchange



- Also called a draft

Legal Definition of a Bill of Exchange

- An unconditional order in writing
 - Addressed by one person (drawer/seller) to another (drawee/buyer).
 - Signed by the person giving it (the drawer).
 - Requires the person to whom it is addressed (drawee who when signs become the acceptor)
 - To pay on demand, or at a fixed or determinable future time
 - A certain sum of money
 - To or to the order of , a specified person or to bearer (the payee).



Documents Against Payment (D/P)

- Requires the seller to draw a **sight bill of exchange** on the overseas buyer
- Seller ships the goods and hands the shipping documents to his bank, instructing that the documents be delivered to buyer after payment has been made
- Bank will withhold documents if buyer does not settle payment in full



Documents Against Acceptance (D/A)

- Requires the seller to draw a **tenor** or **usance bill of exchange** on the overseas buyer
- Seller upon shipping the goods and delivering the documents to the bank, allows the buyer to collect the documents from the bank to clear his cargo before payment
- Buyer will be given a period in which he must pay to the bank

Risks in International Trade



Payment/Acceptance Risk

- Buyer defaulting on contract and refusing to take up the documents
 - ✓ Financial difficulties
 - ✓ Found substitute supplier at lower price
- Buyer on maturity date, may abscond or refuse payment due to financial difficulties

Country Risk

- Importer's government may introduce laws /exchange controls which prevent payment from being made
 - ✓ Political reason or Third World debt problem

Risks in International Trade



Transit Risk

- Danger of loss or damage to goods on their journey from seller to buyer.

Exchange Risk

- When the exporter invoices is in foreign currency.

(Note: Hedging may be used by companies to overcome some of these risks)

Letter of Credit (L/C)



- An instrument issued by the importer's bank in which the bank promises to pay the exporter upon his presentation of documents as specified in the terms of credit
- A bank's promise is added to that of the importer's

(Definition from Singapore Logistics Association, "International Trade & Effective Handling/Processing of L/C" Course notes)

- Objective is to protect the trading partners in the transactions
 - ✓ The buyer can be assured of receiving all the necessary shipping documents giving full title to the goods and evidencing their existence
 - ✓ The seller can be assured of payment to his/her goods

Types of Letter of Credit, their risks & functions

Revocable Letter of Credit

- Under the terms of a Revocable Credit, anyone of the involved parties can instruct the issuing bank to amend or cancel the credit at anytime without prior notice to the other parties
- Not legally binding undertaking
- Rarely in use for financing international trade

Types of Letter of Credit, their risks & functions

Irrevocable Credit

- Issuing bank guarantees payment to the beneficiary subject to submission of documents in accordance with the terms and conditions of the credit
- Any amendment or cancellation of credit must be agreed by all involved parties

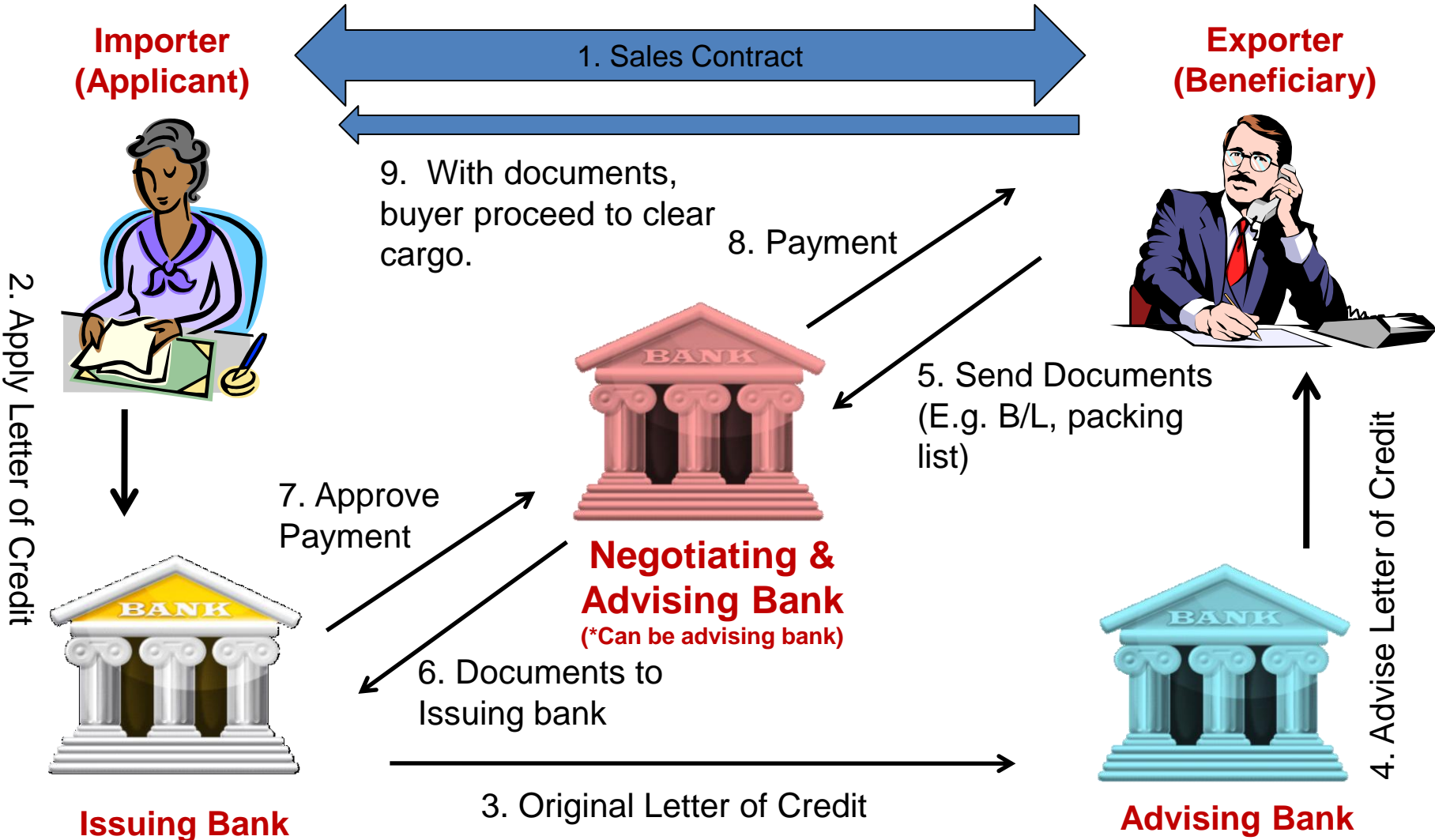
Types of Letter of Credit, their risks & functions

Confirmed Irrevocable Credit

- An irrevocable credit is regarded as confirmed when the advising bank at the request of the issuing bank has added its confirmation to the credit as follows:

“This credit bears our confirmation and we hereby engage to negotiate without recourse on presentation to us drafts drawn and presented in conformity with terms of credit.”

Letter of Credit Procedures



Credit Application Checklist



- Instructions for the issuance of a Credit **must be complete** and **precise**
- Applicant/buyer to ensure the following:
 - The full name and address of the beneficiary/seller.
 - The amount of the credit
 - The type of credit (i.e. revocable, irrevocable or confirmed irrevocable)
 - Whether the credit is to be available by payment, acceptance or negotiation.
 - A brief description of the goods (including quantity and unit price)
 - The party on whom drafts are to be drawn on
 - Whether the freight is prepaid or not
 - Details of the documents required
 - Whether transshipment is allowed or prohibited
 - Whether partial shipment is allowed
 - The latest date for shipment
 - Latest documents presentation date
 - Letter of credit expiry date

Today's Problem



- There are various types of payment which can be arranged between the buyer and seller
- Sophia needs to understand the processes in documentary collection and documentary credit
- She may develop and use credit application checklist to ensure that her Company (applicant/buyer) gives clear instructions to the issuing bank

Going Further...

Banker's Requirement for L/C

When the bank is in doubt of the customer's financial standing, the bank may require one of the following forms of securities to support the opening of a Letter of Credit (L/C)

- **Cash Payment in Advance**

- ✓ Either partial or full payment of the credit amount is required and held as margin on credit at the time of opening the credit

- **Fixed Deposit Receipts**

- ✓ Stock and share, title deed or a letter of guarantee from a valued customer of the issuing bank

- **Export Credit**

- ✓ Also known as back-to-back credit which is opened by another bank of the buyer in favor of the applicant for the proposed credit



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