IndustryWeek
SEPT. 15, 2008
OnLine
WWW.INDUSTRYWEEK.COM

Recession Changes Trade Finance Picture

As credit becomes more scarce and deals become riskier, trade partners reconsider finance terms and agreements.

OCTOBER 2009

BY JONATHAN KATZ

Increasing skepticism among trade partners regarding each other's financial health along with tighter credit conditions have manufacturers rethinking the way they conduct global trade deals.

In some cases companies have switched back to contracts that are backed by letters of credit rather than less-burdensome but riskier open account or have extended payment terms to gain business. The restrictive climate has had an impact on worldwide trade volumes.

The trade-finance shortage has likely contributed to an expected 10% decline in world merchandise trade volume for 2009, according to a July World Trade Organization report. Credit has begun to somewhat loosen, but pricing is still higher than pre-crisis levels, says **Susie Shipley, North America head of the Royal Bank of Scotland's Global Trade Finance practice.**

The risk inherent with trade financing in a down economy has pushed more manufacturers to require their customers to seek letters of credit as a safety net, Shipley says.

"With the increase in economic volatility and private insurance failures, an increasing number of companies are using classic trade instruments, including export letters of credit and confirmed export letters of credit in order to reduce their international risk exposure," observes Shipley. "Our clients have been expressing concerns with private insurance coverage of their receivables and have been taking advantage of classic trade finance alternatives to reduce risk and days sales outstanding as opposed to less secure terms such as open account with longer tenors."

More U.S. manufacturers began demanding open account from Chinese suppliers over the past 10 years as technology advanced and an increasing level of trust developed between trading partners, says Lionel Taylor, chief operating officer for China Export Finance, an international trade finance provider for Chinese exports to Western markets.

"Western companies were going back to Chinese companies and saying, 'Using letters of credit is too expensive and it's an administrative burden, so we want you to go to an open account, which is what we would do with a normal domestic supplier,'" Taylor says.

Indeed, a report published two years ago by the Association for Finance Professionals showed 57% of organizations surveyed in June 2007 used open account for some or all of their trade activities and that the use of open account was growing, with 41% of organizations indicating they had increased their use of open account in the previous three years.

While the recession may have pushed more manufacturers toward letters of credit, most U.S. firms are still demanding open account from their Chinese suppliers, according to Taylor.

"A lot of this comes down to who is the dominant trading partner," he says. "If you are totally reliant upon that seller, I'm pretty sure they can demand a move back to letters of credit, but most of them have not done so."

In some cases, suppliers are offering longer payment terms to win business, Shipley says. In China, suppliers are finding that buyers are requesting anywhere from 45- to 90-day payment terms, compared with 30 days in the past, Taylor says.

One welcome development in the area of trade finance came nearly a year ago when the Export-Import Bank of the United States eased criteria for its working capital guarantee program, notes Shipley. The program provides a guarantee for a line of credit that a commercial bank provides to an exporter. Exporters can use the guaranteed financing to purchase finished products for export, pay for raw materials and other production costs for export orders and cover standby letters of credit and other payment guarantees, according to the Ex-Im Bank.

"This development, in effect, released the brakes that had constricted credit and encouraged banks to extend financing," Shipley says.

It's a common U.S. banking practice to exclude foreign trade receivables from qualifying as collateral, whereas under the Ex-Im Bank program, these receivables can now be used by commercial banks to provide a revolving line of credit for the production of goods that will be sold overseas, Shipley says.

RBS
The Royal Bank of Scotland

Copyright © 2009 by Penton Media, Inc.