Export Finance Guide

A Team Canada Inc Publication

Overview

The Team Canada Inc (TCI) **Export Finance Guide** is a complement to existing TCI publications and resources. Its purpose is *helping Canadian entrepreneurs and SMEs understand and access export finance*.

This guide focuses primarily on export-related finance. It does however introduce certain general material related to Small Business Financing, but this is limited to a high-level discussion and to identifying selected sources of comprehensive information.

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GENERAL INFORMATION

What is Export Finance?

Finance for Exporting vs. Export Financing

Finance for Exporting involves funding a new export venture ? what will it take to move from a domestically focused business model, to one that's internationally oriented and export based? Finance for Exporting calls for creating and executing a financial plan for the successful conduct of international business.

By contrast, **Export Financing** (or Export Finance) relates directly to *transactions* and/or *export orders*. Export finance has a very specific meaning in international finance: it covers a series of financing mechanisms which are, typically, short term and involve well-known techniques that banks, government agencies and private-sector service providers use in support of Canadian exporters.

Requirements of Export Finance

Your requirements in seeking Export Finance will depend on some of the following questions:

- Do you require financing before being able to refine or adapt your product or service for export?
- Do you have a production and distribution process in place domestically, but require funds for market or feasibility analysis, fact-finding trips, international marketing or other pre-shipment activities?
- Have you opted to do business in a part of the world that is subject to political and economic uncertainty, and are you now in need of services that will help you optimize/mitigate risk?
- Have you shipped the goods, granting extended payment terms to your buyer, and now require short-term financing until payment is received?

Each of these situations requires a corresponding set of financing requirements, and will suggest a series of public and private sector financing options and sources.

In this guide, we discuss finance for exporting and export finance in two broad categories:

- Pre-Shipment Export Finance, and
- Post-Shipment Finance.

As well, **Pre-Shipment Finance will refer to the broad category**, including the financing of new export ventures, as well as specific, transaction-level export finance.

The Extra Challenges of Export Finance

Export Finance includes all the challenges and risks of domestic business finance, familiar to any SME or entrepreneurial venture, plus a series of extra challenges.

These extra challenges include:

- Longer delivery and payment time frames
- Exchange rate risks and exchange controls
- Limited and costly dispute settlement and legal recourse options

Financing international trade, specifically exports, can be accomplished in a variety of ways, using a broad range of public and private sector sources, in addition to any funds provided through internal financing, using your company's own resources. Certain export finance solutions can address or mitigate many of the risks noted above.

Financing exports can involve a number of scenarios and objectives. Typically, trade finance products and services focus on:

- Providing cash flow or working capital
- Facilitating or expediting the remittance of funds
- Obtaining financing based on the expected completion of an export sale or shipment
- Providing credit to a buyer, to make the transaction more attractive
- Mitigating against a variety of complex risks inherent in international trade, such as non-payment, political or foreign exchange risk, loss or damage of goods in transit, and many others

Understanding Risk

An overriding aspect of international trade, as well as the financing related to trade, is the significantly higher risk of pursuing business overseas. An awareness and understanding of export risk, coupled with the appropriate risk strategy, will determine the success or failure of your venture, and will largely shape your financing options.

Export-related risk is similar to domestic risk, but vastly different in scope. The many additional factors you need to account for in international commerce—and the techniques used to manage those risks—should be at the forefront of any well-considered export strategy and export finance approach you choose.

As an entrepreneur or SME, you may have a successful domestic business operation, and exporting an existing product (with the necessary modifications) may be a growth strategy. Or you may be in start-up mode, having identified a product or service that you believe will be attractive to international markets.

Identifying and Reducing Risk

It is critical to identify and seek ways to mitigate the major risks of conducting business internationally. A missed payment, even from a customer you know well, can irreparably damage your business.

The solution is a well considered approach to export finance, using all the mechanisms available to make sure that the risk of the proposed transaction is well and effectively managed.

Canadian SMEs are fortunate to have access to a strong export-oriented infrastructure and a wide range of trade financing options. This guide provides an overview of export finance options, as well as a comprehensive list and brief profiles of key public sector service providers in export finance.

EXPORT FINANCE – KEY ISSUES

Small Business Finance in Canada

Identifying Sources of Financing Options

An excellent starting point in identifying financing options for small business is the Business Development Bank of Canada (BDC). It offers a thorough overview of SME financing and several interactive tools, including a business planning tool, financial ratios calculators, and some introductory content on financing export ventures.

As an entrepreneur or SME pursuing business overseas, you are probably already aware of the importance of commercial credit to your business. If you need more details and related statistics on this topic, go to SME Financing in Canada (a report from Strategis Canada).

The Canada Business Service Centres offer a variety of information for small businesses, including several useful "fact sheets" (one of which deals specifically with financial planning for SMEs). The CBSC Fact Sheets may be helpful if you are looking for general tips on financing your small business.

Other Export Financing Programs Available

SMEs looking to secure export finance should consider the Canadian Commercial Corporation's (CCC), Progress Payment Program (PPP) as a valuable export finance option. The PPP provides small Canadian exporters with sufficient project-specific working capital to take advantage of specific export contracts, where CCC facilitates access to commercial sources of pre-shipment financing through arrangements with 19 partner banks and financial institutions.

Also, Export Development Canada offers a Working Capital Program, which can be a critical component of an SME's export financing strategy.

Getting Financing

Steps to Take Prior to Seeking Export Finance

Whatever your level of experience as an exporter, you need to be aware of the issues, complexities and options in export finance at a very early stage in your development of an export strategy or of a specific export marketing plan.

Remember that there is an important difference between Finance for Exporting, and Export Finance. This section deals specifically with considerations related to Finance for Exporting.

Assuming that you are already in business and able to operate domestically, your requirements will be related directly to export opportunities or transactions. If this is not the case, go to Small Business Financing in Canada for general suggestions and a list of alternate sources.

Dealing with Risk

Risk is a very important part of doing business internationally, perhaps even more critical to understand and manage than in domestic transactions, since there are so many more types of risk, and the consequences can be very costly, especially to novice exporters or SME's.

Seasoned exporters understand that risk is a reality to be optimized and managed, not necessarily avoided, because the same risk factors that make exporting a challenge, can make exporting profitable and attractive as a business strategy.

Because risk is such a critical aspect of operating internationally, there are tools and techniques available to help manage risk at nearly every stage of the exporting process. The same is true in Export Finance, and this site provides detailed information on risk mitigation techniques and programs available to SME's seeking to do business internationally.

Keep in mind that the biggest risk of exporting is lack of information and that risk, properly defined and calculated, has a cost attached to it. Risk has two cost components:

- the cost of the actual exposure to risk, and
- the cost of managing risk.

Both should factor prominently in planning for exports and in determining export finance strategies and needs. Effective planning and risk management "up front" will maximize the chances of success in international markets and, from an Export Finance perspective, will help to ensure that you are paid promptly and securely for your product or service.

Export Finance Options

Pre-shipment finance covers the requirements arising from the financing of new export ventures, to pre-production funding, through to the stage when the goods are ready for export but have not been sent to the buyer.

Post-shipment export finance refers to the period between the time the cargo has been sent and the payment from the buyer is received (or expected to be received) by the exporter. This web site also includes a high-level discussion of Medium-Term Export Finance and Project Finance.

Pre-Shipment Finance

Financing may be required under a variety of situations prior shipment. Here are two examples of the type of financing that may be required by an SME:

(i) Financing New Export Ventures

If you need funding to expand your activities to exporting, you will require a well-developed and well-researched export strategy or plan.

For your financing request or application, you must conduct an export readiness assessment, complete the necessary market research or product development, complete export pricing worksheets and complete financial projections.

Developing export business generally takes more time than closing domestic deals. As such, it may require financing solutions tailored to specific export objectives. Obtaining financing for new export ventures will likely involve:

- A cash budget to fund export development efforts
- An export financial plan, including key export costs
- A longer term capital budget, to fund the expansion of your operations to support export business
- Financial projections, detailing expected inflows and outflows of cash

Go to Financing New Export Ventures for more information.

(ii) Financing Prior to Shipment of Goods

If you have identified an export opportunity and require funding to produce the goods or services to be exported, you ought to be prepared to demonstrate that a deal has been closed or is nearly finalized with a foreign buyer.

As an exporter, you may also be required by a prospective customer to tailor or customize an existing product for local consumption in the export market.

In order to secure financing under this scenario, you should be prepared to provide information on:

- The export sale
- Buyer risk, including relationship history
- Contract terms
- Payment & financing arrangement
- Timeframe
- Recourse & risk mitigation plans
- Production plans & timeframes
- Contingency plans

The main focus in your preparations to the secure financing must be to provide prospective lenders with a sound understanding of the proposed transaction. Export finance providers will want to have a positive sense about the timely conclusion of the deal, and a well-secured payment and remittance approach.

In the pre-shipment stage, you may need financing to sustain operations or ensure adequate working capital between the time a deal is closed and the goods are shipped to the buyer. This type of requirement usually arises after a sales contract has been drafted or signed, and the terms of the export sale are well understood and documented.

Seeking financing for a specific transaction may be a matter of optimizing cash flow, and may depend heavily on the agreed terms of sale. Identify appropriate payment and financing options at the early stages of the sales effort, as you may be able to offer attractive financing options to your buyer, which will help close the deal.

Prior to seeking pre-shipment financing, you should:

- Ascertain the credit needs of the buyer
- Understand the shipment and insurance terms
- Identify any cash flow gaps that might affect your business in the course of this transaction

Go to Pre-Shipment Export Finance for more information.

Post-Shipment Finance

If you have completed production and shipped your product, or provided your contracted service to your foreign buyer, and require post-shipment financing:

- Identify which financing options offer features that can be triggered after shipment ? letters of credit issued on a term basis (payment due in the future) can often be discounted after shipment is sent
- Assess the rates and conditions attached, and determine which best supports your objectives while preserving your margins

Go to Post-Shipment Export Finance for more information.

Medium-Term Export Finance

Medium-Term Export Finance typically applies to periods ranging from 180 days to two years, and potentially up to five years.

Medium-term financing usually involves instruments such as promissory notes, or bills of exchange, upon which the financing is based, and is often obtained for capital equipment exports.

Go to Medium-Term Export Finance for more information.

Project Finance

Project Finance deals often involve international infrastructure projects or engineering or other support consulting activities, and may require complicated financing arrangements sometimes referred to as "structured trade finance".

Negotiating and obtaining export finance for large-scale projects becomes an integral part of the business development and contract negotiation process. As such, the steps to take upfront focus on education:

- Learn about the characteristics of the project or contract
- Secure professional advice early
- Identify financing structures and models that might apply, in order to offer the best possible terms to your buyer, and to maximize your return (and risk mitigation)
- Understand that providing financing to your customer is fundamentally a part of the export sale under such deals, which range from medium-term commodity exports, to capital goods exports and full-scale projects

Go to Project Finance for more information.

Developing Finance Relationships

The financial services relationships you develop for your export business will be critical. Whether you require relatively straightforward payment facilitation or complex structured finance, the **quality** of your **relationships with trade finance** experts and service providers **is key**.

For immediate sources of assistance, see Strategis Business Support & Financing (external link).

- Banks & Financial Services Providers
- Non-Bank Export Finance Providers
- Government Agencies & Organizations
- eCommerce & Internet-Based Service Providers

Banks & Financial Services Providers

In addition to the various government programs and departments that provide export finance assistance, you will likely require help from your bankers in securing and managing trade finance.

Given the highly specialized nature of export finance, it's useful to ensure that you have access to trade finance professionals as part of the services provided by your bank, and that your trade bankers understand the markets that you expect to operate in.

Banks committed to supporting Canadian businesses in export development will offer a suite of related services and will maintain a strong network on international banking relationships (referred to as correspondent banks), which directly affects your overseas ventures.

Centralize or Diversify?

As a SME or entrepreneur, should you maintain a variety of banking and financial services relationships, perhaps even separating your domestic banking from your international and trade-related banking business?

The argument in favour of maintaining distinct domestic and international banking relationships tends to focus on two main issues:

- Financial flows are easier to understand, attribute and track if domestic and international banking are managed separately.
- Domestic business assets and receivables are less likely to be used as security against (typically) higher-risk export finance facilities.

While these arguments have merit, it can be advantageous to keep your banking relationship integrated, or centralized, for several reasons:

- In practical terms, your export business is not distinct from your domestic business, unless you have explicitly structured your company in that manner. A banker with an appropriately holistic understanding of your needs can be a strong ally.
- While the nature of export finance allows trade bankers to make credit decisions based on the characteristics of a specific transaction, more complex deals may be easier to close if you have an operating line of credit in place with your bank.
- Security or collateral requirements can be managed to mitigate exposure on your domestic business and assets.
- Managing working capital between export credit and domestic facilities may prove useful to your business.
- Exporting is a long-term business that requires commitment and a solid network of partners, service providers and business associates. An integrated banking approach will tend to encourage a relationship approach rather than a transactional approach from your bankers, and will likely benefit your business in the longer term. The Program for Export Market Development (PEMD) administered by DFAIT, for example, takes a holistic view of domestic and international operations, when considering applications for financing.

Taking an integrated approach to your domestic and international banking does not require that you centralize your banking with one financial institution.

As your exports grow over time, you may require the services of a global bank, or one that is based in a key market that you service, in addition to those of your primary financial institution. Diversifying your sources of export finance is prudent and wise.

Your primary bankers should understand your business holistically and provide a value-added combination of products, services and counsel, on domestic and international matters.

Should you determine that it is in your best interest to keep domestic and international business separate, there is the option of setting up a division, or a distinct legal entity, to manage your export operations. Generally, this option is not pursued by SME's and, in any event, the arguments in favour of a holistic, relationship-based banking approach remain relevant.

Non-Bank Export Finance Providers

In addition to banks and financial institutions, Canadian exporters can access export finance through several non-bank sources.

These organizations typically target their services at SME's and emerging exporters, and attempt to supplement the financing options provided by the banks.

Government Agencies & Organizations

Exporters of all sizes and levels of expertise can get help from several financial services providers through the Government of Canada.

The sources of support and export finance available through the public sector are complementary to those offered by private sector financial services firms.

Credit and finance-granting criteria will vary between public sector providers, as they would between banks and financial institutions. Accordingly, it is wise to be aware of the options available, and to identify those best suited to the requirements of your business.

The mandates of the various agencies and departments may lead them to provide certain specialized types of export finance. Once again, it is important for a Canadian SME or prospective exporter to be aware of and understand these issues and distinctions.

Most federal and provincial agencies maintain informative Web sites. See Links.

eCommerce & Internet-Based Service Providers

Various Internet-based trade finance service providers have emerged in recent years. Several are backed by solid credentials, have a viable business model, and will be at the forefront of the evolution of international trade.

Whether you require the services of such organizations or not will depend as much on your approach to exporting as it will on your firm's receptiveness to doing business via the Internet

Since this group of export finance providers is relatively new, Canadian exporters (particularly emerging exporters) should exercise caution and due diligence in selecting Internet-based export finance providers.

Exporting Your Services

Unique Challenges

Securing Export Finance is complicated enough when you want to export tangible products that can be assessed by conventional banking standards and are subject to long-established trade agreements, export regulations and familiar security arrangements.

The export of *services*, however, **brings its own unique set of additional challenges**, both from a general export-management perspective—there are some specific trade agreements and regulations which apply to services—, and from a financing perspective.

Financing Service Exports - Special Considerations

In Trade and Export Finance, we usually refer to "pre-shipment" and "post-shipment" financing. When referring to trade in services, this might be more appropriately "pre-delivery" and "post-delivery." For the sake of simplicity and to be consistent with the language used by bankers and financiers, we'll use *pre-shipment* and *post-shipment*.

There are two major challenges in financing the export of services:

1. The intangible nature of the export raises issues around financial security requirements;

2. The export regulation framework, which affects trade in certain services.

Exporting Intangibles

Commercial banks recognize the unique challenges of what are referred to as "knowledge-based" businesses or industries, and have special groups to assist businesses and entrepreneurs in these areas.

Businesses seeking to export their services should obtain the necessary support and counsel from such specialists, in conjunction with help from trade finance professionals.

Security arrangements related to services exports are especially important to understand and define up front. Service exporters must be prepared to provide appropriate security to their bankers, in support of export finance arrangements.

Professional Services Exports

Exporting professional services is an area in which Canadian businesses have enjoyed success in several international markets.

Engineering firms (especially consulting engineers), architectural firms, project and program managers, legal professionals and others have developed international markets, through small, short-term assignments, as well as large, multi-year international development or infrastructure projects.

Services exports cover a broad range of activities, from one-person management consulting SMEs to small professional practices, to large international organizations providing a full suite of services to domestic and foreign clients.

Export Finance is available for this full range of service exports:

- Strategis and Industry Canada have developed the International Project Development Roadmap, which includes a comprehensive discussion of Financial Structuring.

- Strategis also offers a detailed discussion of services exports, through the "Take a World View" site, including specifics on Financing Service Exports.

- Professional services exports may be supported through funding programs such as CIDA-INC, focused in the developing world (which specifically includes a *Professional Services Mechanism*).

- Projects sponsored by international financial institutions (IFIs) often come bundled with the financing required to execute the contract. Go to the IFInet site for more information on IFI-sponsored and funded export opportunities.

- If you need financing for export opportunities related to large-scale infrastructure or development work requiring Project Financing, go to our Project Finance page, then seek the appropriate professional help to close the deal and obtain the required financing.

- The Canadian Commercial Corporation may be able to assist in the contract negotiation and management, while Export Development Canada offers world-class expertise in the area of project finance.

Trade & Export Regulations

The trade regulation frameworks surrounding trade in services must also be taken into account in planning and securing financing.

Specifics such as the use of performance guarantees and the costs related to liability insurance may affect your ability to get export funding.

Trade regulations related to professional equivalencies may imply additional costs that must be incurred in preparing to export services. Such considerations may need to be addressed as prerequisites to Export Finance.

Regulatory Issues

Regulatory issues related to services exports are best addressed by reviewing current agreements on the export of services and obtaining detailed information about the service delivery requirements in the target market.

The impact of such considerations on export financing will likely require assessment on a case-by-case basis.

More Info…

For more information on **exporting services**, go to:

- "International Project Development Roadmap"; includes a comprehensive discussion of Financial Structuring;
- "Take a World View"; includes specific information on Financing Service Exports;
- CIDA-INC;
- IFInet.

STAGES OF EXPORT FINANCING

Overview

One way of determining your Export Finance needs is to look at the **stages of a transaction**. There are several categories of transactions, which can be separated into:

- **Pre-Shipment**
- **Post-Shipment**

Pre-Shipment

Financing New Export Ventures

Are you considering exporting a product or service? Are you involved in a start-up enterprise and seeking to fund export ventures from day one? Export Finance includes provision for new ventures in foreign markets.

Whether you are a novice exporter seeking to develop international trade opportunities or an experienced trader venturing into new markets, as a Canadian exporter, you have access to a wide range of support and financing in support of new export ventures.

Options for Financing New Export Ventures

Bank Lines or Facilities
Operating Line of Credit or Loan

- Familiar tool and application process
- Security requirements may be stringent
- Cost of borrowing may be significant

Government Facilities
Financing, cost-sharing and others

- May be longer term
- Often comes with complementary consulting or advice

Venture Capital
Equity Financing

- Financiers take ownership stake in your enterprise and may become actively involved in management
- Complex and competitive process

Pre-shipment export finance addresses financing needs for the production of new goods for export, or for the refinement/customization of existing products to ensure Acceptance by the target market.

Development or amendment of products for export purposes need not be funded through your domestic operations. As an entrepreneur or SME, you may benefit from several export finance options available.

Financing at this phase of business is usually needed for working capital requirements in support of the export venture or strategy. Funding may be secured from a variety of sources, such as financial institutions, venture capitalists and trade finance providers.

Often, however, funding new export activities can be successfully done through Government programs, given that a number of agencies and departments are mandated to proactively support Canadian SMEs pursuing export opportunities. The following are examples of the type of funding available for new export businesses:

Bank Lines or Facilities

Financing facilities provided by banks and financial institutions can be used to fund the development of export business. Whether you use generic operating lines, or seek transaction-specific funding, your financial institution can work with you to help you explore export opportunities.

The process of obtaining bank lines of credit may be familiar to you, depending on your specific circumstances as a SME. But given its risky nature, this type of financing may be more expensive to obtain than generic facilities.

Government Facilities

Government agencies are specifically mandated to assist Canadian firms pursuing business overseas. Several sources review proposals for funding activities that lead up to the close of an export transaction, and often precede the actual production of goods:

- The Business Development Bank of Canada (BDC) offers a variety of export finance solutions.
- CIDA-INC can provide financing for feasibility studies.
- Through its Program for Export Market Development (PEMD), the Department of Foreign Affairs and International Trade, can help defray certain costs related to development of new export ventures.
- ***More…***
  Go to Links for more sources of export finance available through the Government of Canada and certain provincial programs and agencies.

Venture Capital

While a thorough discussion of the complexities of Venture Capital (VC) funding is not an objective of this site, VC financing is an important funding option, particularly for innovative products involving moderate to high risk and proportional expected returns.

Typically, VC funding involves an exchange ? financing, for an ownership stake in your venture and a claim on future earnings. VCs will typically secure some form of management or board-level involvement in the enterprise and take an active hand in the management of the company.

"Angel" investors may also help. These are typically private individuals (or networks) seeking to invest funds in promising ventures, in exchange for equity. Angel investors typically fund smaller deals than VCs, and usually are less actively involved in running a firm.

Competition for VC funding can be quite intense, and the proposal presented to a venture capitalist must be rigorously validated.

In addition to private sector venture funding, you can obtain VC financing through:

- the Business Development Bank of Canada, and
- the Equity Program of Export Development Canada.

Pre-Shipment Export Finance

Have you identified an opportunity to do business in a foreign market, but require funding to initiate production? There are opportunities to secure financing for a promising export venture, specifically in support of your production or product customization/refinement efforts.

OR

You have entered into a sales contact with a foreign buyer, and produced the goods or identified the services to be delivered. But you need financing to conclude the transaction successfully. Consider pre-shipment funding.

You may need to seek pre-shipment export finance **after** having concluded a sales contract with a foreign buyer, and produced the goods.

You could require financing in order to conclude the transaction successfully, or simply to help manage financial flows until you have collected payment from the foreign buyer.

Options for Pre-Shipment Export Finance

Bank Lines or Facilities
Operating Line of Credit or Loan

- Familiar tool and application process
- Security requirements may be stringent
- Cost of borrowing may be significant

Government Facilities
Loan

- May be longer term
- Often comes with complementary consulting or advice

Payment in Advance
Cash

- Significant advantage in the case of new or risky export markets or untested trade relationships

Collections
Payment promise by a bank, in exchange for shipping documents

- Offers limited security, as well as financing opportunities and secure payment options

Letters of Credit
Payment undertaking by a bank, in exchange for shipping documents which are verified and found to be compliant with the credit

- Significant security for both trading parties
- Useful features related to financing and added security

"Red Clause" Letters of Credit
Advance on export receivables

- Transaction complexity

Pre-shipment export finance may refer to the full set of activities undertaken prior to shipping a product or service for export, from funding feasibility studies through to production and working capital requirements.

Pre-shipment export finance can also refer specifically to financing required or obtained immediately prior to shipping, for short-term cash flow or working capital needs, until payment is received. In this case, pre-shipment export finance is distinct from, for example, pre-production export finance, or the funding necessary to establish or launch an export venture.

Bank Lines or Facilities

Banks and financial institutions provide financing facilities that you can use to fund the production of goods or services for export. Whether you use generic operating lines, or seek transaction-specific funding, your financial institution can work with you to provide pre-production export finance.

You may be familiar with the process of obtaining bank lines of credit. But given the purpose of pre-production funding, and the risks of losing a sale or somehow failing to complete the export transaction, bankers may demand full and liquid security, and/or require higher fees and interest to fund pre-production exports.

Whether you seek a generic financing facility, or support for a longer-term market entry/export strategy, or even "deal-specific" financing will depend as much on the nature of the opportunity, as on the type of relationship you have with your bankers.

Once a sale has been concluded and the transaction is in pre-shipment phase, it may be easier (and less expensive) to secure funding.

Government Facilities

Various federal and provincial government programs may provide financing throughout the various stages of a trade transaction. Several sources review proposals for funding activities that lead up to the close of an export transaction, and often precede the actual production of goods.

- The Business Development Bank of Canada (BDC) offers a variety of export finance solutions, including pre-shipment financing.
- CIDA-INC can also provide financing for feasibility studies and similar pre-shipment analysis.
- In addition to specific Crown Corporations and government departments, pre-shipment finance may be obtained through programs focused on specific market development objectives, such as NEXUS ? New Exporters to the U.S.
- The CCC's (Canadian Commercial Corporation) Progress Payment Program can help to bridge the cash flow gap to cover production costs during the pre-shipment phase when exporters won't receive payment until the product or service is delivered to the buyer.
- Export Development Canada provides a Working Capital Guarantee Program, which may prove helpful during this part of the export transaction. EDC's export credit insurance products may also be critical in securing financing during the pre-shipment period. Export credit insurance can reduce the cost of funding by significantly mitigating the risk to lenders.

Go to Links for more sources of export finance available through the Government of Canada and certain provincial programs and agencies.

Payment in Advance

In the event that you are entering high-risk markets or initiating trade with a new partner, you may want to negotiate payment in advance (or advance payment).

While competitive pressures may make this impractical, there are circumstances in which a Canadian exporter might have sufficient leverage to receive an advance payment.

Collections

Exports can be paid and financed using Documentary Collections, where banks will facilitate the exchange of shipping documents against the agreed payment.

Collections are somewhat secure in that the trading parties know that payment will not be made unless the required documents are provided, and that the shipment will not be released to the importer unless payment is made.

Letters of Credit

Letters of credit (or L/Cs) are also called documentary letters of credit. Banks issue L/Cs through their trade finance or international departments.

L/C's represent a payment promise or undertaking by the Issuing Bank guaranteeing the remittance of a specified sum, provided that all terms and conditions stipulated in the credit have been complied with. L/C's offer a variety of useful features, including financing and additional security for doing business in risky markets.

"Red Clause" Letters of Credit

“Red Clause” L/Cs include a specific provision (usually printed in red) for the exporter's bank to advance funds under the L/C, against the guarantee of the bank that issued the letter of credit on behalf of the buyer or importer.

While Red Clause Credits are not frequently used in Canada, you may wish to consult your trade bankers about their practices, and then consider asking your overseas buyer to have such a clause included in an L/C, to assist with pre-production financing.

If a Canadian exporter is actually an intermediary between the producer and the ultimate buyer, other options such as Back-to-Back or Transferable Letters of Credit may be worth considering.

Post-Shipment

Post-Shipment Export Finance

Having produced and shipped the goods to your overseas buyer, you may need short-term funding, perhaps to cover the time between shipment and receipt of monies from the buyer. It is possible for you to secure export finance to this end.

As an exporter, you may require financing to bridge the gap between the time goods are sent to the overseas buyer and the time you are paid according to your agreement with your client.

Given that the export transaction is at a fairly advanced stage, there are several financing options available to you in the post-shipment phase. Of course, the transaction is still subject to some risk while in transit ? from damage or loss, to refusal or repudiation of the goods by the importer once the goods (or the shipping documents) arrive. The cost of financing will vary according to the assessed risk.

Post-Shipment Export Finance Options

Bank Lines or Facilities
Operating Line of Credit or Loan

- Familiar tool and application process
- Security requirements may be stringent
- Cost of borrowing may be significant

Government Facilities
Loan

- May be longer term
- Often comes with complementary consulting or advice

Receivable Discounting & Factoring
Advance

- Banks or specialist firms ("factors") assess the quality of export receivables, and remit a discounted amount to the exporter

Acceptance Financing
Advance

- Banker's acceptances created under collections or letters of credit are discounted and paid prior to maturity

Countertrade
Trade Technique

- Buyer and seller agree to conduct business on the basis of a barter-like agreement

Bank Lines or Facilities

Financing facilities such as operating lines of credit or short-term loans can bridge the gap between shipment of goods and receipt of payment.

If these facilities are available based on an enterprise's credit standing, such financing may be quite cost-effective. Export finance that is made available specifically for trade transactions may involve a risk premium based on exposure to the dynamics of a trade transaction.

Banks may also provide buyer or supplier credit for a trade transaction.

Supplier credit involves an arrangement whereby an exporter contracts to sell goods and services to a buyer in another country. Credit terms are included in the supply contract. Supplier credit usually includes export credit insurance for commercial risks, such as default by the buyer, insolvency of the buyer, refusal by the buyer to take delivery of the goods, as well as political risks, such as the inability to transfer foreign currency, government action preventing payment being made, war and civil war.

Buyer credits are arrangements in which an exporter contracts with an overseas buyer to supply capital goods or services. There is a separate and parallel loan agreement between a lending bank (normally in the exporter's country) and a borrower (often a bank) in the buying country.

The exporter is paid by receiving disbursements under the loan ? such disbursements normally need the prior approval of the buyer/borrower or are made according to a pre-agreed drawdown schedule.

Government Facilities

As with all phases and types of export finance, the Government of Canada provides a variety of financing options which might apply in the post-shipment phase.

- Export Development Canada is probably the largest supplier of post-shipment export finance in the public sector.

Go to Links for a list of sources of export finance available through the Government of Canada and certain provincial programs and agencies.

Receivables Discounting & Factoring

When a shipment has been sent, typically, a commercial invoice and related documents of shipment and title are issued.

An exporter requiring short-term funding has the option of approaching a bank, or Factoring firm, and requesting that the receivable be discounted, or purchased by the factor and paid out to the exporter.

A bank may agree to purchase an export receivable and provide immediate funds to the exporter on a discounted basis. This is usually an expensive proposition for an exporter, due to the relatively high discount charges applied by financial institutions.

Banks will often be selective about the foreign buyer whose obligation they are prepared to discount in favour of an exporter, and they may retain recourse to the exporter in the event of nonpayment.

Alternatively, a bank or finance company may be prepared to provide financing secured by, but otherwise independent of, the export receivable.

A Factoring house, or simply a factor, will purchase a foreign receivable from an exporter at a fixed rate of discount, in exchange for immediate payment.

Typically, Factoring occurs without recourse to the exporter in the event of nonpayment, and the arrangement may extend to an ongoing process, where the factor manages many aspects of an exporter's business, from invoicing and accounting, through to debt collection.

For more information on Factoring or Receivables Discounting, go to Other Methods of Export Finance.

Acceptance Financing

Post-shipment funding can also be obtained in cases where a banker's acceptance is created under a letter of credit or a collection.

An acceptance is a promise by a bank to remit funds at a specified date. This instrument can be discounted and paid immediately to the exporter, if the risk is acceptable to a financial institution and the discount rate is agreed to by the exporter.

Whether an acceptance is created under a collection, or a letter of credit, it is done after the relevant shipping documents have been examined (meaning that the goods have been sent to the importer). For this reason, this option is typically available to exporters on a post-shipment basis.

For more information on acceptance financing, go to Letters of Credit and Collections.

Countertrade

Countertrade is a category of international trade that involves arrangements between buyers and sellers ranging from straight barter to various arrangements linking the export sale to some type of reciprocal purchase by the exporter, through the importer.

Countertrade is not a common practice in Canada, among SMEs and entrepreneurial ventures. But it is legitimate to consider as an export finance technique, given the variety of arrangements that may be entered into and the potentially favourable impact on cash flow and financing.

Countertrade is complex and risky to negotiate for those unfamiliar with its challenges. It tends to involve significant cost, both during the negotiation and structuring phase and during the actual execution of a countertrade transaction.

For more information on countertrade, go to Other Methods of Export Finance.

Medium-Term Export Finance

Obtaining export finance for the medium term (typically defined to cover funding for more than 180 days, up to two years, occasionally up to five years) is fairly common practice for capital goods exports.

In most cases, buyers expect this type of export to include a financing component. The risk associated with medium-term finance reflect the length of the exposure, as well as the risk associated with the trading parties involved.

Exporters seeking medium-term funding can access financing through a variety of options, such as:

Medium-Term Acceptance Financing
Acceptance under a collection or letter of credit, for a term in excess of 180 days

- Same as short-term acceptance financing
- Discount rate may be incrementally higher

Forfaiting
Receivable financing

- Medium-term, non-recourse financing, usually for capital exports

Buyer Credit
Loan

- Financing granted to the Importer, usually by the exporter's bank

Medium-Term Acceptance Financing
Exporters may obtain medium-term financing if the acceptances created under collections or documentary credits exceed a specified term (often 180 days).

An acceptance is a promise by a bank to remit funds at a specified future date. This instrument can be discounted and paid immediately to the exporter, if the risk is acceptable to a financial institution and the discount rate is agreed to by the exporter.

The mechanics of acceptance finance are identical whether they apply over the short term or the medium term (see Letters of Credit or Collections).

Forfaiting
Forfaiting is a type of medium-term, non-recourse financing that originated in Europe (hence the name, which comes from the French expression "*à forfait*", meaning, to "give up the right" of recourse). The relative drafts or notes are said to be "avalized" or stamped to demonstrate that there is no recourse to the exporter, and that the avaling bank carries an unconditional obligation to honour the debt.

Forfaiting involves fixed-rate financing, with interest charges deducted in advance when discounting the receivable or note. Promissory notes must be provided for each instance of payment over the life of the financing.

Given that the interest is deducted up front by the Forfaiting entity and that the interest is quoted on a discount rate basis, Forfaiting is usually more expensive to the exporter than straight discounting.

Buyer Credit
Buyer credit is financing provided directly to the foreign buyer, usually by the exporter's bank, in an effort to make the transaction more attractive to the importer.

This approach is effective if financing rates and conditions in the importing country are prohibitively expensive. Such credit is usually granted over the medium- to long-term, for export of large-scale projects or turnkey operations.

Project Finance

Have you secured a significant deal or a longer-term project that will require complex structured finance solutions, or funding over an extended period of time? Medium-term and project finance may be critical to the success and profitability of your venture.

While SME's do not usually pursue opportunities that require complex project finance, a number of Canadian firms—often professional services firms such as engineering and architectural consultancies—have successfully closed export sales in this area.

Whatever your involvement may be in an export transaction requiring project finance, as an entrepreneur or SME, you should strongly consider securing assistance from project-finance experts at the very early stages of assessing the opportunity.

What Does Project Finance Involve?

Project finance involves longer term funding, and often requires detailed and comprehensive structuring of the project, together with the financing techniques and mechanisms that will apply.

The outcome can be a package that amounts to financial engineering, using every traditional form of funding and some relatively esoteric types of international project financing techniques. Financing of this type is sometimes referred to as "structured trade finance".

These types of financing usually involve "deal teams" from financial institutions, with representatives from areas such as corporate banking, trade finance, loan syndications, and industry sector specialists.

Who Needs Project Finance?

Project finance applies to large-scale infrastructure or capital projects, and may arise under a variety of scenarios, in any part of the world.

Typical project finance models involve the repayment of financing through the expected revenue stream of the completed project over an agreed period. Such models are favoured in that they explicitly avoid relying on the balance sheet of the sponsoring organization.

The projects normally financed under such packages involve a large group of sponsors and stakeholders, including a syndicate of bankers and investors, the combined stake of which the project sponsors usually cannot cover.

Financing is provided on the basis that rigorous analysis of the project be done, to understand the risk and accurately estimate the revenue stream and timeline associated with the project.

Project finance is typically on a "limited recourse basis." The cost of financing depends on the rate of return objectives of the financiers, given the project's risk and timeline.

External Sources

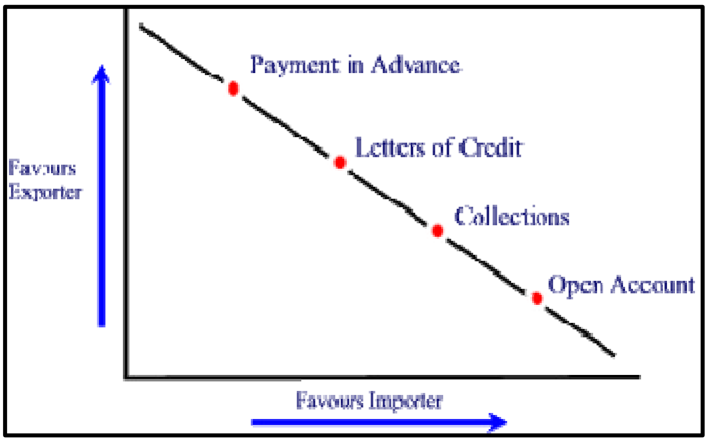
- Export Development Canada (EDC) is a leading provider of project finance in Canada and should be consulted if you are considering pursuing export business of this nature.

It may also be possible to secure contracts through international financial institutions, where the funding is bundled together with the contract. This is often the case in international development work. Go to IFInet for current opportunities in this area.

Types of Financing

Overview

Understanding export finance requires considering the **financing tool or option** and the **timeframe** attached to an export transaction.



A Reminder

Regardless of the type of financing you need or the features of the financing option you will select, the Term of Exposure directly affects the overall risk of the transaction.

Payment in advance

As an exporter, some circumstances will allow you to negotiate such favourable terms as payment in advance from your foreign buyers.

Securing an export transaction that includes **payment in advance** by the importer is the **ideal scenario** for an **SME or entrepreneur** engaged in exports.

Complexity = Minimal
Risk = Low to exporter
Trade Relationship = Higher-risk relationships or export markets
Features = Various options as to timing and proportion of prepayment
Cost = Low

A deal may be designed to require partial or full payment in advance. There are several ways in which advance payments can be structured. In any of them, the exporter avoids credit risk, since payment is usually received prior to the transfer of ownership of the goods.

While advance payments are generally to the advantage of the exporter, there are several situations where such arrangements add value to both trading partners.

Advance payment arrangements provide the greatest value from the financing and risk mitigation perspectives.

1. Payment facilitation
2. Financing
3. Risk mitigation

1. **Payment Facilitation**

Payment in advance is an export payment approach which focuses more on the timing of remittances, rather than the actual payment process. Once the terms of payment are agreed to, it is likely that the actual payment will be made through a bank, financial institution of government agency.

2. **Financing**

Advance payments can become a source of financing for an exporter if the payment is made far enough in advance. The exporter may then use such payments to source materials for production or to fund the export venture in another way.

Payment in advance may be defined with a variety of specific terms, including "cash with order" or "cash before shipment".

Advance payment terms may also apply in transactions involving the provision of specialized equipment. Such transactions may involve arrangements referred to as progress payments, and may extend throughout the period of construction of the equipment. Progress payments involve remittances at specified milestones in the trade transaction.

The Canadian Commercial Corporation's (CCC) Progress Payment Program (PPP) provides banks and financial institutions involved in the program with the assurance that the work they are financing is being monitored and that contractual risks are being minimized by the Government of Canada. CCC in effect provides a conditional indemnification to mitigate the risk for the financing institution.

In addition, payments in advance may be used between affiliated companies to finance overseas procurement.

From an overall transaction cost perspective, advance payments can help trading partners conclude deals in the most cost-effective way. If financing costs are lower in the country of the importer, it may be advantageous to conclude business through advance payment.

3. **Risk Mitigation**

Advance payments tend to involve minimal risk for the exporter. Irrespective of the timing of the payment, the exporter avoids credit risk and may benefit from a financing advantage.

Advance payments may also provide an opportunity for the importer to avoid exposure to unfavourable foreign exchange fluctuations.

Although the advance payment approach typically shifts the burden of risk nearly completely onto the importer, it is possible that an importer will agree to this option if the exporter provides a bank guarantee to protect against non-performance or the production of poor quality goods. Alternatively, some form of performance guarantee may be requested. Consult Export Development Canada for options related to performance bonds or surety guarantees.

A guarantee will allow the importer to recuperate funds paid by drawing on the guarantee, and provides motivation to the exporter to ensure that the goods shipped are consistent with the sales contract.

CCC offers support in this area as well. Acting as prime contractor on behalf of a Canadian exporter, CCC signs export contracts, providing a government-backed performance guarantee for buyers.

Letters of Credit

Letters of Credit (L/Cs) are among the most secure and financially flexible instruments available to international traders. Despite this, L/Cs involve significant complexity; use them with care to ensure the successful conclusion of an export transaction.

A Documentary Credit—also referred to as a Letter of Credit or L/C—is a payment promise or undertaking made by the Issuing Bank, which assures the exporter that payment will be made under the L/C, provided all the terms and conditions of the credit have been met.

Complexity = High
Risk = Low ? secure for both importer and exporter provided all terms and conditions adhered to
Trade Relationship = Applicable to all levels and types of relationships; may be a necessity in certain markets irrespective of the trade relationship
Features = Wide range of payment, financing and risk mitigation options
Cost = Relatively expensive in terms of transaction costs; labour intensive

L/Cs have been used for hundreds of years and have a wide range of features, benefiting importers and exporters alike. These instruments are among the most secure available to international traders and offer a variety of options for trade financing.

L/Cs are intended to offer a fairly secure means for transacting trade. But remember these kind of instruments assume there is a shared desire and the goodwill necessary to pursue and complete a trade transaction. While banks are required to carefully verify shipping documents against an L/C to ensure compliance, the banks do not become involved in underlying sales contracts. L/Cs do not necessarily protect against fraud. Exporters must be wary.

L/Cs are most often issued subject to the Uniform Customs and Practice (UCP) for Documentary Credits (currently the 1993 Revision, Publication No. 500 of the International Chamber of Commerce), a series of articles adhered to by most trading nations about the use and interpretation of letters of credit.

To paraphrase the UCP, letters of credit are arrangements whereby a bank, (the Issuing Bank) acting on behalf of the applicant, usually an importer or buyer, makes payment or authorizes payment to be made to the beneficiary or exporter against the receipt of stipulated documents, provided all the terms and conditions of the L/C have been complied with.

The full text of the UCP may be obtained from various sources, including the trade finance departments of the major Canadian banks.

Documentary Credits provide three critical functions in an international trade transaction:

4. Payment facilitation
5. Financing
6. Risk mitigation

4. **Payment Facilitation**

L/Cs offer an efficient and trusted means for importers and exporters to assure a timely transfer of monies in most currencies, in exchange for compliant shipping documents. Traders can use the banks' extensive international communication and authentication facilities to help complete a transaction, and can link an L/C payment to other bank services such as cash management and foreign currency conversions.

Under an L/C, the importer is assured that no payment will be made against non-compliant documents without the importer's consent. Similarly, an exporter has the security of knowing that payment is guaranteed once compliant documents are tendered.

5. **Financing (Acceptance Financing)**

Letters of credit can be structured with a variety of terms and conditions, including a number of options for the payment timeframe. This allows financing to be extended to several of the parties in a trade transaction.

A Documentary Credit which is available on a "term" basis may be payable, for example, 60 days after receipt of the shipping documents at the the bank specified in the L/C, or it might be payable 30 days after the shipping date of the goods.

As with domestic transactions, conditions that extend the payment timeline increase the likelihood that financing will be required. Term L/Cs (or the bank drafts which often accompany them) can be discounted for immediate payment to the exporter. The rate of discount will vary with the term of the discount, and in proportion to the risk associated with the transaction. These types of arrangements, where a draft has been accepted for payment, and then discounted, are referred to as "Acceptance Financing".

Term L/Cs allow the importer or buyer to delay payment, favourably affecting cashflow and payables management. A well considered export pricing formula may account for discount charges, if the exporter is aware that these will likely be incurred at some stage of the transaction. Alternatively, discount charges may be specified to be the buyer’s responsibility.

Term L/Cs also offer the opportunity for importers to avail themselves of financing, by having the Issuing Bank effect payment under the L/C and delaying the reimbursement by the importer to some agreed future date. Banks party to the transaction may also seek to delay their remittance obligations due to exchange controls or lack of foreign currency, and would seek financing from the other participating bank.

While L/Cs are typically not used to secure financing in North America, it is common in some parts of the world to use a Letter of Credit as collateral, to secure transaction-specific loans or short-term financing. This option may be available through certain banks or trade finance providers in Canada, and might be worth exploring.

6. **Risk Mitigation**

Letters of credit are a means of replacing the payment promise of a trading partner with that of a credible international bank. In effect, an L/C-based transaction offers credit enhancement, since the Issuing Bank's payment promise is independent of its relationship with the applicant or importer, and therefore based upon the creditworthiness of the bank, rather than that of the importer.

L/Cs are among the most secure of the traditional international trade payment and financing vehicles. They protect both trading parties to a significant degree. One of the fundamental, yet overlooked benefits of an L/C relates to fraud prevention, in that letters of credit are "advised" (i.e. transmitted or provided) to exporters only after the Advising Bank has verified that the L/C originates from the Issuing Bank, and has been issued in a form that will allow the trade transaction to be completed.

The use of L/Cs which are explicitly subject to the UCP provides a well-tested set of legal and regulatory guidelines that apply across multiple legal jurisdictions and financial systems. The rich case law related to Documentary Credits provides a measure of information and some security to trading parties in the event of a dispute or disagreement.

Besides the general characteristics of an L/C which can help mitigate risk, the terms and conditions of the credit may also contribute significantly to reducing risk in the trade transaction. Requirements to insure the shipment or to provide third-party inspection certificates are typical examples.

L/Cs usually include specific instructions, through the "Incoterms" used in international trade, which define the transport responsibilities, insurance requirements, and the transfer of ownership of the shipment between buyer and seller. The Incoterms trade terms specified in an L/C indicate where an exporter must deliver the shipment, what insurance cover is required, and at which point in the transport title to the goods (and hence risk) shifts to the buyer.

Perhaps less intuitively, the payment terms of an L/C can provide critical security to an exporter.

L/Cs negotiable or payable at the counters of a Canadian or U.S. bank, for instance, assure the exporter that payment decisions will be made according to familiar criteria and standards, and that funds will be available to pay for the export. Legal jurisdiction in the event of dispute could also be defined by the payment terms and might prove helpful to remedy the underlying disagreement.

It is possible to substantially mitigate the risk associated with letters of credit, by accessing third-party products or services designed for this purpose.

For more information, go to Insurance on this site, or access the Export Development Canada web site for details on their export credit insurance programs or for specifics related to L/C insurance provided in support of confirmed letters of credit.

Letters of credit can be structured using a variety of characteristics and conditions. The following features or types of L/Cs are particularly notable:

Revocable vs. Irrevocable

Letters of Credit can be issued as "Revocable", or "Irrevocable".

A Revocable L/C may be amended or cancelled by the applicant or importer at any time, without prior notice or consent. Revocable L/Cs are rarely if ever used in trade between arm's-length organizations. They are occasionally used between parent companies and their subsidiaries conducting business across borders.

As a Canadian exporter trading with foreign firms, any Letter of Credit received from overseas in your favour should be irrevocable, assuring that any changes to the terms of the L/C are done via formal amendment, subject to your agreement. Equally importantly, the credit cannot be arbitrarily cancelled once it has been issued.

Confirmed L/C

A Letter of Credit that explicitly includes the option of adding a "Confirmation" is particularly important and useful to exporters pursuing business in higher-risk markets.

Generally, the ultimate payment undertaking under an L/C rests with the Issuing Bank, which, from the point of view of the exporter, is a foreign bank.

When an exporter is operating in a high-risk market, where political upheaval, economic collapse, devaluation or exchange controls could put the payment at risk, the exporter will value the opportunity to shift the payment promise to a safer environment.

Adding a Confirmation to an L/C occurs when a bank (usually, but not necessarily the Advising Bank) adds its own, distinct and separate payment undertaking to a documentary L/C, in exchange for a Confirmation fee. An exporter will pay for the added security of Confirmation, when the market risk is high enough, or when the exporter lacks confidence in the payment promise of the Issuing Bank.

Generally, L/Cs may be confirmed only if the terms of the credit allow for this option. In some markets, it is possible for an exporter to request a "silent" or "blind" Confirmation ? one that is added without the knowledge of the other trading parties or banks involved in the transaction.

Silent Confirmations are rare in the Canadian market. But they do occasionally take place. A bank offering a silent Confirmation is arguably exposing itself to additional risk by operating outside the intended boundaries of the UCP, and therefore will likely charge a premium for this service.

Transferable & "Back-to-Back" L/Cs

Transferable and Back-to-Back Credits are typically used when an exporter is actually an intermediary, sourcing goods (in whole or in part) from a third party, and wishes to effect payment in a manner that is linked to the eventual sale of the goods.

When an L/C is issued as Transferable, the beneficiary or exporter may "transfer" the payment obligation under the credit to one or more "second beneficiaries" who will supply the goods under the same terms and conditions stipulated under the original L/C. Certain conditions under the original credit, such as shipping dates and unit prices, may be changed, to permit the shipment to be received by the first beneficiary in ample time for delivery in the timeframes defined under the original credit. UCP 500 specifies which terms and conditions may vary between the original credit and the transfer.

Under a transfer, the transaction is closely linked. Failure to comply with the terms of the transferred portion will usually result in the non-compliance under the primary Letter of Credit. Therefore, the exporter must make sure that the terms of the original credit will ensure a workable transfer.

Back-to-Back Credits are two independent Documentary Dredits, one of which is used as security or collateral to support the issuance of the second credit. Back-to-back L/Cs are complicated to structure appropriately, and are generally not encouraged by the banks.

Assignment of Proceeds

The proceeds (or funds paid) under an L/C may be assigned by the exporter to a supplier. An Assignment of Proceeds may be used in lieu of a transfer under an L/C, if the applicant refuses to allow the L/C to be Transferable.

In the case of an assignment, only the proceeds are assigned. The performance obligations, and the right to payment under the L/C remain with the exporter.

Assignments of Proceeds can be used by suppliers as security. They offer a useful option for exporters seeking to provide a payment promise to suppliers, in order to secure goods or help fund production.

Revolving Letters of Credit

Revolving Letters of Credit are used when an exporter has numerous shipments of the same merchandise over a specified period. Revolving L/Cs may be revocable or irrevocable. They are typically issued with specific terms, such as "$10,000 per month for 6 months", which means the credit is, in effect, for $60,000.

Revolving L/Cs may be issued as cumulative, meaning that funds not drawn down in one period can be carried over to the next period for subsequent drawdown. Non-cumulative credits are L/Cs where funds are available "per period" and monies not drawn down are no longer available.

Collections

Collections, whether "documentary" or "clean", offer export finance options for trading partners with established relationships doing business in relatively secure markets.

A collection is a transaction whereby the exporter or "principal" entrusts the collection of a payment to the remitting bank, usually the exporter's bank. The remitting bank sends documents to a collecting bank (usually the importer's bank), along with instructions for payment. Funds are received from the importer and sent to the exporter through the banks involved in the collection.

Complexity = Medium
Risk = Medium - Risk to the trading parties is higher than under L/C's, given that there is no verification process and limited recourse in the event of non-payment
Trade Relationship = Recommended for use in established and secure trade relationships and in stable export markets
Features = Limited flexibility and features; opportunity for financing
Cost = Moderate

Collections may be "documentary", where commercial/shipping documents accompany the request for payment and are sent to the importer via the banks, or "clean", where the exporter sends only a draft, promissory note or other financial document representing the underlying amount due. Commercial or shipping documents do not accompany a clean collection.

Collections have been in use for many years. They should be used between trading partners that have an established and trusted business relationship.

Documentary collections are somewhat more secure (overall) than open account or advance payment transactions, but considerably less secure than letters of credit. Although banks do act as facilitators for their clients under collections, the banks' role is very specific and provides limited security to either the importer or the exporter.

The banks involved in a collections transaction verify that the required documents have been provided by the exporter and that funds are remitted to the exporter in exchange for those documents. There is no expectation that the documents will be verified.

Documentary collections are most often issued subject to the Uniform Rules for Collections (URC) (currently the 1995 Revision, Publication No. 522 of the International Chamber of Commerce), a series of articles adhered to by most trading nations, about the use and interpretation of collections.

Collections are arrangements whereby a bank (the remitting bank), acting on behalf of the exporter, secures payment from the importer through a collecting bank, in exchange for documents presented by the exporter under the collection.

The full text of the URC may be obtained from various sources, including the trade finance departments of the major Canadian banks.

Collections provide three critical functions in an international trade transaction:

7. Payment facilitation
8. Financing
9. Risk mitigation

7. **Payment Facilitation**

Collections, whether documentary or clean, offer an efficient and trusted means for importers and exporters to assure a timely transfer of monies in most currencies, in exchange for documents or promissory notes/bills of exchange. Traders can use the banks' extensive international communication and authentication facilities to help complete a transaction, and can link a collections payment to other bank services such as cash management and foreign currency conversions.

Under a collection, the importer is assured that payment will be made only upon receipt of the stipulated documents. The exporter is assured that funds will be remitted as agreed upon presentation of the necessary documents.

8. **Financing (Acceptance Financing)**

Collections can be payable on receipt of the required documents (documents against payment, or D/P) or on acceptance (documents on acceptance or D/A) of a Draft or Bill of Exchange for payment at an agreed future date.

If the collection provides for acceptance of a draft or payment at some future date, there is an option to discount the related draft and offer immediate payment to the exporter. This is referred to as acceptance financing. The rate of discount will vary with the term of the discount and in proportion to the risk associated with the transaction.

Collections involving an Acceptance allow the importer or buyer to delay payment, favourably affecting cash flow and payables management. A well considered export-pricing formula may account for discount charges, if the exporter is aware that these will likely be incurred at some stage of the transaction. Alternatively, discount charges may be the responsibility of the buyer.

Collections also offer the opportunity for importers to avail themselves of financing, by securing agreement from their bankers to pay the collection and obtain reimbursement from the importer at some agreed future date.

9. **Risk Mitigation**

Collections provide some basic risk mitigation for traders.

The primary mitigation relates to the security for both trading parties of knowing that the required documents will be exchanged for the agreed payment or Acceptance, through a neutral third party.

In the event of non-payment or non-acceptance, collections instruments offer some structured legal recourse, including "protest". A Collection must include specific instructions for the banks to follow in the event of non-payment or non-acceptance. An exporter must also appoint a representative (called a "case-of-need"), whose authority and powers are to be defined in the collection order.

Ultimately, refusal or inability to pay on the part of the importer may require the exporter to warehouse and insure the shipment at the port of destination, which can represent a substantial expense. It may be necessary to dispose of the shipment through another buyer at substantial discount, or to incur the expense of returning the shipment to the point of origin.

The use of collections that are explicitly subject to the URC provides a well-tested set of legal and regulatory guidelines which apply across multiple legal jurisdictions and financial systems. The case law related to collections provides a measure of information and some security to trading parties in case there's a dispute or disagreement.

It is possible to substantially mitigate the risk associated with collections by accessing third-party products or services designed for this purpose. For more information, go to Insurance.

Open Account

Export financing on Open Account Terms is most favourable to the buyer or importer. As an exporter, the risks linked to open account terms must be carefully weighed in light of the trading relationship involved and the other payment or financing options which might apply.

Under open account terms, the parties agree that the exporter will ship the goods and transfer ownership to the importer, prior to payment.

This is the highest risk option for an exporter, given that the exporter is fully exposed to the importer's credit risk.

Complexity = Low
Risk = High for exporter
Trade Relationship = Recommended for use in the most secure trading relationships and markets only
Features = Payment vehicles and timing may vary widely
Cost = Minimal

Three aspects of open account transactions to consider are:

10. Payment facilitation
11. Financing
12. Risk mitigation

10. **Payment Facilitation**

Open account transactions can involve payments being made in a variety of ways, from cash and cheques, to electronic payments through the banking infrastructure.

Facilitating payments is not a major focus of an open account approach.

11. **Financing**

Open account terms are often extended to the importer due to competitive pressure in the market and a strong desire on the part of the exporter to conclude a given transaction or maintain a profitable and successful trade relationship.

Trade on open account often allows for 30 to 90 days or longer before payment is due. The exporter typically finances the entire transaction, over the agreed term, plus any payment delays that might arise.

There is an option for exporters to enter into arrangements with a bank (or a third party) to secure funds immediately on a discounted basis. An exporter may avail itself of invoice discounting services through a financial institution or of Factoring through an organization that specializes in providing financing against such receivables.

12. **Risk Mitigation**

As an exporter trading on open account, a Canadian SME faces significant risk, with little in the way of mitigation options arising directly from the arrangement.

In the event of non-payment under an open account transaction, an exporter may have to pursue collections through a local agency or legal action, both of which are expensive propositions in international jurisdictions.

It is strongly advisable under open account transactions to ensure that a comprehensive paper trail is created, and that the importer explicitly acknowledges the debt associated with each export shipment. Such documentation may prove critical in obtaining remedy in the event of a legal dispute or collection effort.

It is possible to substantially mitigate the risk associated with open account trade by accessing third-party products or services designed for this purpose. For more information, go to Insurance.

Other Methods

- Receivables/Invoice Discounting
- Factoring
- Buyer & Supplier Credits
- Countertrade

Receivables/Invoice Discounting

Exporters may obtain financing through arrangements that provide for the payment or advance of funds against export receivables.

Once an export receivable is created, through the shipment of goods to the overseas buyer and the issuance of an invoice, an exporter may approach a bank or finance company to secure receivable-based funding.

The financier may wish to approve the buyer up front, and may opt to set a ceiling on the receivables to be financed from a single buyer. You should consider the following factors:

1. Ownership of the Receivable

Receivable discounting may involve the outright purchase of an invoice (or invoices) by the financier, or merely the use of a receivable as security to fund a credit facility.

If the receivable is sold to a third party as a condition of the financing, the exporter is, in effect, free of any subsequent issues related to delayed payment, collections activities, or non-payment by the importer.

2. Recourse

Receivable financing may be concluded on a recourse basis or on a non-recourse basis. Recourse refers to the right of the financier to seek remedy from the exporter if the importer does not pay.

Non-recourse financing indicates that the financier accepts the risk of non-payment, as well as any costs related to the collection of the debt. Also, non-recourse financing shields the exporter from unfavourable fluctuations in exchange rates and interest rates which might occur over the life of the receivable.

In most cases, if the receivable is purchased, financing is on a non-recourse basis.

3. Where to go for Receivable Financing

There are a number of options for receivables or invoice financing.

Banks are generally cautious about providing receivable finance. But several are receptive to providing it for export receivables. They may, however, restrict the amount of financing extended based on the receivables from one foreign buyer. Also, banks will often retain recourse to the exporter in the event of non-payment.

Finance companies also offer funding based on export receivables. They may do so on a discount basis or by using export receivables to secure a credit facility.

Factoring

Factoring typically involves the outright purchase of export receivables by a Factoring house, at a discount and most often on a non-recourse basis (provided that the exporter has performed as required in the sales contract).

In these transactions, the exporter is shielded from non-payment risk, as well as foreign exchange and interest rate fluctuations. The factor assumes these risks upon purchase of the receivable, and reflects these risks by the discount rate applied to the value of the receivable.

In addition to specialized Factoring firms, several Canadian banks operate subsidiaries (usually tied organizationally to the trade finance area) provide export finance against foreign receivables, as factors.

Factors can offer their services on a transactional basis, or can provide a more comprehensive receivables management function, which covers such activities as accounting, detailed reporting, and collections.

Factoring can be expensive. But it does offer significant risk mitigation and effective financing.

Buyer & Supplier Credits

Supplier credit involves an arrangement whereby an exporter contracts to sell goods and services to a buyer in another country. Credit terms are included in the supply contract. Supplier credit usually includes export credit insurance for commercial risks, such as default by the buyer, insolvency of the buyer, refusal by the buyer to take delivery of the goods, as well as political risks, such as the inability to transfer foreign currency, government action preventing payment being made, war and civil war.

Supplier credit is most commonly used for short-term credit (up to 360 days credit) but can be used for the supply of capital goods with longer credit (up to five years).

Buyer credits are arrangements in which an exporter contracts with an overseas buyer to supply capital goods or services. There is a separate and parallel loan agreement between a lending bank (normally in the exporter's country) and a borrower (often a bank) in the buying country.

The exporter is paid by receiving disbursements under the loan. Such disbursements normally need the prior approval of the buyer/borrower or are made according to a pre-agreed drawdown schedule. The loan is repaid over the credit period, normally in half-yearly repayments of principal and interest.

Buyer credits are normally only used for medium- and long-term credits.

It is usually a standard feature of a buyer credit arrangement that the borrower has an obligation to repay the loan whatever may have taken place under the supply contract. The buyer must pursue or take legal action against the supplier under the terms of the supply contract.

Arrangements separating the loan repayment obligations and the supply contract non-performance are sometimes referred to as "Isabella clauses".

Buyer credits can help minimize the overall cost of a trade transaction, if they can be used to shift the financing to the low-cost market.

Countertrade

Countertrade is a category of international trade that involves arrangements between buyers and sellers ranging from straight barter, to various arrangements linking the export sale to some type of reciprocal purchase by the exporter.

Common types of Countertrade include:

- Barter ? straight exchange between exporter and importer, which raises a challenge in terms of assuring fair valuation of the goods or services involved
- Counterpurchase ? where the exporter undertakes to purchase goods or services from the importer, typically some agreed percentage of the export contract

Countertrade agreements can be established as part of larger capital or infrastructure development projects or procurement sales. In these cases, an exporter supplying such facilities or capital goods agrees to enter into offset or buyback agreements, tied to the original export sale.

Countertrade is not a common practice in Canada, certainly among SME's and entrepreneurial ventures. But it is legitimate to consider as an export finance technique, given the variety of arrangements which may be entered into and the potentially favourable impact on cash flow and financing.

Countertrade is complex and risky to negotiate for those unfamiliar with its challenges. It tends to involve significant cost, both during the negotiation and structuring phase, and during the actual execution of a Countertrade transaction. Accordingly, it is highly advisable for a SME or entrepreneur to obtain professional counsel prior to entering into such agreements.

RISK, INSURANCE AND REGULATORY ISSUES

Managing Risk

Whether you are an experienced exporter or a novice in international trade, **exporting involves risks** that can go far beyond those associated with conducting domestic business.

Optimizing Risk

While many experts talk of managing, mitigating, or eliminating risk, we prefer to refer to **strategies intended to optimize risk**. Optimizing risk involves determining the appropriate balance between accepting risk in anticipation of the related return, offsetting some portion of the risk, and incurring the cost of doing so.

Risk, perceived or actual, is what makes exporting a lucrative venture for those who succeed. A critical part of succeeding at exports involves having a strategy to address the key risk components in your export plan.

Export finance options, in addition to offering a wide variety of tools and techniques for funding export strategies and transactions, often include complementary risk management features or products, which are available to all levels of exporters through a number of sources.

Identifying Risks in a Transaction

Information is probably the single most critical aspect of an export risk optimization strategy.

Being properly informed, in a timely manner, and in practical terms, will ensure a solid understanding of the export risks involved in a particular relationship or transaction. Being well informed as an exporter also allows you to understand, select and access the risk optimization strategy best suited to your specific circumstances.

There are extensive and comprehensive sources of information on export-related risk. They range from Government of Canada agencies and departments (including embassies and the Trade Commissioner Service), to private credit information agencies such as Dun & Bradstreet, to banks and insurance companies, which can provide risk-related information without necessarily selling their insurance products or banking services.

In certain cases, you may be able to obtain raw data and to interpret its meaning for your specific circumstances. In other situations, expert opinions and interpretation may be critical, and the analysis can be more important to risk optimization than the underlying data.

Managing Risks

At its core, the main risk related to export finance is the risk of non-payment or of incurring some transaction-related financial loss.

Risk management or risk optimization strategies focus on ensuring timely and secure payment, as well as a reasonably predictable flow of funds over the course of an export transaction.

Assessing export finance risk typically involves a risk assessment of your trading partner. The key factors to consider include:

- credit-worthiness of the business
- commercial character
- financial strength of the enterprise
- business and political climate in which the buyer operates

Such assessments ultimately boil down to a judgment call based on a combination of factors. But the availability of comprehensive information, including extensive historical data, and the development of sophisticated analytical tools, means you can use credit scoring and develop fairly thorough risk assessment checklists.

Further information on foreign buyer risk assessments is available from Export Development Canada (EDC), or your financial institution.

Types of Risks and How to Manage Them

Engaging in and financing exports involves a number of common and well-known risks, which can be addressed in the financing phase. While some of these risks relate broadly to international trade, rather than specifically to export finance, certain financing options and payment techniques do allow for the mitigation or optimization of such risks. These risks can be viewed in three broad categories, as described in the course material for Forum for International Trade Training/TCI - Going Global Workshops. We also include a fourth category, other risks, to cover things like fraud and damage to goods during transit.

1. Commercial (Buyer) Risks
2. Political or Country Risks
3. Foreign Exchange Risk
4. Other Risks

1. **Commercial (Buyer) Risks**

These relate to a foreign buyer's or supplier's performance under a commercial contract. These include risks related to payment or performance according to the terms of the commercial contract. Buyer risk includes the risk of devaluation of the importer's currency, which may be so severe that it results in default on a payment.

Managing Commercial (Buyer) Risk
Your assessment of foreign buyer risk may lead you to a variety of risk management strategies. At the extreme, you may choose not to pursue business with a particular buyer. Alternatively, some form of insurance scheme or secured payment option may be required. Or, the results of your risk assessment may suggest that this is a fairly secure and low-risk trading partner, and that a straightforward, usually less costly transaction structure may be acceptable.

2. **Political or Country Risks**

refer to the risks of doing business in a particular country or region. These include the possibility that import or export permits may be revoked, that war or civil unrest may break out, or that the free flow of funds may be disrupted as a result of exchange controls, boycotts, or international payment moratoriums. For exporters operating overseas, this category includes the risk of expropriation by a foreign government.

Country risk assessments are most important for exporters dealing in higher-risk countries, where risks or losses could result from political actions or circumstances such as civil unrest, war, economic crisis, or restrictions in the flow of foreign exchange or international payments.

Besides country risk assessments, you should also consider overall political and economic stability, the strength of democratic institutions, protectionist tendencies, as well as basic economic factors such as GDP growth, inflation, and unemployment.

Due to the wide variety of factors, and the complexity involved, country risk analysis is part art and part science. Seek the opinions of experts at government agencies, banks, credit agencies and other sources.

The Government of Canada offers country risk analysis through:

- The Canadian Trade Commissioner Service
- Export Development Canada
- The Department of Foreign Affairs & International Trade

Managing Country Risk
As with buyer risk, the options related to country risk range from deciding not to export to a particular area, to obtaining appropriate insurance and mitigation assistance from your export finance service providers.

Exporters focusing their trade activities in the U.S. or Western Europe are more likely to be concerned about commercial risk, whereas political and country risk is likely to take on more urgency for companies trading in less familiar and less stable parts of the world.

3. **Foreign Exchange Risk**

This type of risk involves transactional exposure resulting from (sometimes volatile) fluctuations in exchange (FX) rates. Significant currency rate fluctuations can have adverse effects on foreign receivables and can easily affect profit margins.

Foreign exchange risk (or “FX risk”) involves the fluctuation of the value of one currency relative to another. This can occur due to a variety of factors and may happen over short periods of time. When transactions are based on foreign currencies, these fluctuations can represent significant risks (or opportunities), which must be well understood and appropriately managed.

See the Bank of Canada Backgrounder on the Exchange Rate.

As a Canadian exporter, you may find yourself negotiating a contract payable in U.S. dollars, 60 days after the shipment of merchandise. If the Canadian dollar decreases in value relative to the U.S. dollar, your export receivable will be worth more to you once converted to Canadian dollars.

If the Canadian dollar appreciates, or increases in value, however, the U.S. dollar payment will be worth less in Canadian dollar terms. If the exchange rate fluctuations are significant, they may seriously cut your profits.

There are three main kinds of risks with foreign currency exposure:

- **Transaction exposure** relates to the effect of FX fluctuations on transactions that have been initiated but not completed. This type of risk affects cash flow and occurs when, for example, an exporter holds a foreign-currency receivable and finds that the currency of the receivable has devalued against the Canadian dollar.
- **Translation exposure** refers to the effects of foreign exchange fluctuations on financial reporting, for your taxes and financial statements. Foreign currency accounts may be "translated" or converted into Canadian dollars using historical FX rates and/or current rates, thereby generating paper gains or losses for the exporter.
- **Economic exposure** relates to the impact of economic conditions on future cash flow. A Canadian exporter may be severely affected by a significant appreciation of the Canadian dollar against foreign currencies, given that the relative cost of the goods increases in the foreign market.

Managing FX Risk
A variety of tools and techniques are available to manage and optimize foreign currency exposure. The most common include:

- **Forward contracts** are contracts with commercial banks, in which an exporter agrees to sell a fixed amount of foreign currency at a fixed price, at a mutually agreed future date. Such contracts eliminate the uncertainty associated with FX fluctuations. But the exporter also does not benefit from any favourable "upside" in the foreign currency rates. Forwards are entered into independently of the export contract.

- **Exposure netting** relates to the practice of matching foreign currency inflows with outflows in the same currency, to eliminate or "net out" the exposure. Depending on the nature of the transactions and the financial facilities used, traders may achieve near-perfect netting.

- **Currency options** are contracts that confer the right (but not the obligation) to buy or sell foreign currency at a specified price, within a defined time period. Unlike forward contracts, options offer the possibility for exporters to benefit from favourable fluctuations in FX rates. They are also useful in the event that an exporter wishes to mitigate a potential (or contingent) FX liability.

You can obtain FX rates from a variety of sources, including the Bank of Canada Currency Converter.

4. Other Risks

Other risks Canadian exporters face include the risk of being the target of fraud, as well as the possibility of loss or damage of exported merchandise while in transit overseas. The risks related to legal jurisdictions governing the terms of an export contract are critical in the event of a disagreement or dispute. These risks are best addressed up front by the trading partners and their legal or trade advisors.

Certain tools and techniques of export finance, such as the use of payment terms which specify remittance in a U.S. or Canadian jurisdiction, can assist in managing such risks and optimizing the likelihood of a fair resolution to a dispute.

Insurance

Understanding the Risks

Export risks exist whether goods and services are sold for cash or on credit. As soon as a company begins to produce for export, events may arise which either prevent the export of the goods or services or their import into the buying country, or the buyer may cancel the order.

Other risks can occur after the goods have been shipped or accepted by the buyer, meaning that the exporter does not receive timely payment.

This means that even though the bulk (over 90%) of world trade may take place on the basis of cash or very short credit terms, exporters are still faced with risks that could threaten not only their ability to make future exports but also their very existence. Insolvency is frequently caused by a single bad debt.

Companies must be able to access finance for both the production for export and for any credit while they wait to be paid. It is rare for exporters to be paid in cash with the order. And for exporters to seek cash with order or very short credit terms or payment under letters of credit can often make them uncompetitive with exporters in other countries.

Insurance Is Critical for Exporters

The use of export credit insurance often makes it easier and less expensive for exporters to obtain financing ? directly enhancing competitiveness and resulting in higher chances of success in export activities.

Export credit insurance is critical for both OECD and emerging markets. Insurance allows exporters to concentrate on producing and selling with the confidence that they have protection against many of the risks associated with exporting, many of which do not exist in domestic sales. Insurance also provides useful security for banks providing working capital and financing exports.

Export credit insurance normally provides cover against commercial risks and political risks (e.g., inability to transfer foreign currency, government action preventing payment being made, war and civil war, among others).

A useful variant of this arrangement is for the exporter to use export credit insurance as security to obtain bank financing. This is normally done by the exporter assigning the insurance policy or the right to claims payments under the policy to the financing bank.

Pre-shipment Versus Post-Shipment Risks

- Pre-shipment or pre-credit period: covers the time a contract is signed and the time the goods/services are shipped (or accepted by the buyer).

- Post-shipment or credit period: includes risks that can arise between the time goods and services are shipped (or accepted by the buyer) and the time any credit is fully repaid. Thus credit normally begins from the time goods and services are shipped/accepted.

Separate insurance policies are sometimes issued for the two periods (especially in the area of short-term business). Separate premiums are almost always charged for the two periods. The primary public sector source of export credit insurance is Export Development Canada (EDC), Canada's official export credit agency. EDC does not issue two separate policies. Instead it offers exporters the option of selecting the appropriate coverage (pre-and post shipment, or post-shipment only), and charges the applicable premium.

Canadian banks will often refuse to add their confirmation to a Letter of Credit from a high-risk market, unless EDC is prepared (for a fee) to insure some percentage (commonly 85%) of the transaction against default or non-payment. Go to Letters of Credit for more information on L/Cs, confirmations and the use of export credit insurance.

See EDC's export credit insurance products.

Regulatory and Tax Issues

Exporters must consider a variety of **issues related to taxation** and the **regulatory context** of international trade. Here are the main aspects of taxation and export regulation related to Export Finance.

Regulatory Considerations

In broad terms, in the course of seeking Export Finance, you may need to demonstrate that all of the relevant regulatory requirements and prohibitions have been respected.

Export restrictions (of strategic goods, or other goods to embargoed countries) may prevent you from concluding a transaction or obtaining financing, even if your exported goods are routed to an embargoed country en route to their final destination.

Shipment through a third country that may have its own embargo on the country of destination (even if Canada does not) may pose significant risk to your transaction and the associated financing.

In the case of service exports, your activities may be regulated or restricted by professional equivalency requirements in the export market and may be restricted under embargo limitations, just as certain goods are restricted.

The Canada Customs & Revenue Agency provides the Handy Customs Guide for Exporters, focusing on the export reporting issues, and the new AMPS program (Administrative Monetary Penalty System).

Taxation Issues

Tax Strategy

As with any process of financial planning and management, including securing additional funding, a significant issue to consider relates to tax obligations and liability.

Taking a strategic view of your tax situation, across the various markets and jurisdictions that relate to your export business, is an important aspect of your overall export finance situation.

Structuring your business and adopting the optimal strategy for local distribution of your product, as well as securing tax advantages from your export business, should form part of your tax optimization strategy between your domestic business and your export activities.

Transfer Pricing

Transfer prices are prices established between affiliated companies operating in different markets, at which one company will provide goods to the affiliate or parent company. The most common objective is to minimize the overall (global) tax liability of an enterprise, by maximizing revenue reported in low tax jurisdiction, within limits which will be seen as reasonable by the tax authorities.

Transfer pricing is a complex aspect of international taxation and may not be immediately relevant to a novice exporter or SME. But the mechanics and advantages of transfer pricing should be reviewed with a qualified professional if appropriate to your business.

Duties & Tariffs

Exporters may be subject to duties or tariffs in certain markets and for certain goods or services.

The tariffs applicable are most commonly determined by a combination of product classification and country of origin. Also, importing nations may have tiered tariff schedules, and it may be advantageous to be aware of the status of your exports in order to assess the financial impact of such tariffs.

If your export contains components that are sourced overseas, the rules of origin may result in unfavourable treatment of your export due to the rates applied to the foreign component.

MARKET-SPECIFIC FINANCING

Exporting to the U.S.

The majority of Canadian exports go to the United States. Most SMEs, particularly those considering exports for the first time, tend to look immediately south of the border for international trade opportunities.

In general, exports to the U.S. are conducted on Open Account Terms, usually with a 30-day credit period.

Under Open Account Terms, the parties agree that the exporter will ship the goods and transfer ownership to the importer, prior to payment being effected.

This is the highest risk option for an exporter, since the exporter is fully exposed to the importer's credit risk. But it's also considerably less complicated and expensive than, for example, using a Documentary Letter of Credit for payment.

Complexity = Low
Risk = High for exporter
Trade Relationship = Recommended for use in the most secure trading relationships and markets only
Features = Payment vehicles and timing may vary widely
Cost = Minimal

There is some level of security in dealing with doing business in the United States compared to other markets, given the familiar business environment, legal and technological infrastructure and similar cultural environment.

But these factors can cause novice exporters to underestimate the risk of conducting cross-border business. Despite the similarities between Canada and the U.S., exporting to the U.S. still presents risks (sometimes quite significant ones) to Canadian exporters.

Because of the large volume of trade conducted between Canada and the U.S., there are a number of programs available to support entrepreneurs and SMEs pursuing exports to the U.S. These include:

- contract negotiation, management and financing through the Canadian Commercial Corporation, and
- market development funding through the Program for Export Market Development (PEMD).

More info…

For further information on assessing and securing appropriate financing for U.S. exports, go to :

- Open Accounts;
- Insurance;
- Other Methods of Financing (more specifically, review the sections on *Receivables Discounting* and *Factoring*).

OTHER INFORMATION

Glossary

Acceptance

A commitment to pay the face value of a draft to a "bona fide" holder, at the agreed future date. Acceptances are negotiable instruments and may be sold or discounted.

Advising Bank

The bank through which a letter of credit is advised to the beneficiary or exporter. Advising is a role that includes authentication of the letter of credit as having originated from the issuing bank.

Assignment of Proceeds

An instruction to a bank to pay a portion of proceeds earned under a letter of credit to a third party, usually a supplier.

Back-to-Back Credit

A transaction in which the existence of one letter of credit serves as collateral/security to support the issuance of a second, though independent letter of credit (called the counter-credit).

Confirmation (of a Letter of Credit)

In Letters of Credit, a separate and distinct payment undertaking added to that of the issuing bank by the confirming bank, in cases where a beneficiary does not consider the undertaking of the issuing bank to be sufficiently reliable.

Countertrade

A form of trade (including barter, counterpurchase, offset and others) where one commodity is exchanged or used in payment for another. This is a type of transaction requiring specialized skills, particularly in determining relative value of the goods involved. This approach may be useful in trade between affiliated companies engaged in cross-border business.

Discounting Receivables

Procedure whereby an exporter sells to an approved foreign buyer, creating a receivable, then sells the foreign receivable to a bank, at a discount to the value of the invoice or receivable.

Documentary Credit (Letter of Credit)

A payment undertaking by the Issuing Bank on behalf of the applicant (buyer or importer), which is honored subject to the terms and conditions of the Letter of Credit being fully complied with by the beneficiary (seller or exporter).

Documentary Collection (Collection)

An instrument in which a bank or banks act as collecting agents on behalf of the exporter, effecting payment once the stipulated set of documents have been received. Banks do not verify documents under a Collection, so Collections are less secure than Letters of Credit.

Documentary Discrepancy

Occurs when one or more of the terms or conditions stipulated in a letter of credit have not been met. In the event of discrepancy, the importer may refuse the shipment, or waive the dsicrepancy and proceed with the transaction.

Draft or Bill of Exchange

An unconditional order to pay, on demand or at some fixed and determinable future date, a specified sum. Drafts are usually required under Documentary Credits or Collections, and their existence offers additional legal protection of the underlying financial obligation.

Export Credit Agency

Government agencies or departments that promote, facilitate, financing and generally support export activities by local companies.

Export Finance

Export Finance has a very specific meaning in international finance. It refers to the transactional aspects of export funding. It covers a series of financing mechanisms which are, typically short term, and well-known to bankers and trade financiers.

Factoring

Financing technique in which an exporter enters into agreement with a "factor" to sell foreign receivables to the factor, at a fixed interest rate, and usually without recourse to the exporter in the event of non-payment.

Forfaiting

A form of financing in which medium-term financial obligations (notes) are sold at discount and usually on a non-recourse basis, at a fixed rate of financing.

Finance for Exporting

Finance for Exporting involves funding a new export venture ? what will it take to move from a domestically focused business model, to one that's internationally oriented and export based? Finance for Exporting calls for creating and executing a financial plan for the successful conduct of international business.

Incoterms

Shipping terms which convey the price basis and the passage of title of a shipment. Common examples are:

- F.O.B. (Free on Board) requires the seller to deliver the goods to the ship, airline or other agreed mode of transport, at which time title (ownership and risk) passes to the buyer.
- C.I.F. (Cost, Insurance & Freight) requires the seller to cover the cost of transport to the port of destination, and to provide appropriate insurance coverage.

Issuing Bank

Typically the applicant's (importer's or buyer's) bank, which issues a letter of credit to the beneficiary or exporter through a bank in the exporter's country.

Open Account Terms

Payment terms under which the exporter extends financing to the buyer, funding the entire transaction.

Red Clause Credits

Letters of Credit (L/C) issued with special provisions or clauses which allow the beneficiary to secure financial advances based upon the L/C, typically to assist in the production, acquisition and/or shipment of the goods involved.

Revocable L/C

A letter of credit which may be cancelled or amended unilaterally at the behest of the applicant or the issuing bank. Rarely used and not recommended in support of "arms-length" trade transactions.

Revolving Letter of Credit (Cumulative or Non-cumulative)

A Revolving Letter of Credit (L/C) provides for multiple drawings under the L/C, for specified amounts over a specified time period. This type of L/C is issued in place of multiple, similar credits to the same beneficiary.

Sight/Term Credit

Letters of Credit may be issued with a variety of "tenors" which determine the timing of payment. A "sight" credit is payable literally upon receipt at the counters of the appropriate party (allowing reasonable time for verification of documents), whereas a "term" credit involves payment at some future date, such as 60 days (after) sight, or 30 days after the shipment date, as agreed between the buyer and seller.

SME

Small and medium enterprise (or small to medium-size business).

Term of Exposure

The length of time over which financing is provided.

Term Sheet

A contractual document typically issued by a bank, to outline the terms and conditions of a Financing arrangement. Trade banks often issue Terms Sheets for short-term financing backed by export credit/insurance agency cover.

Transferable Credit

A Letter of Credit (L/C) may be partially or fully transferred to one or more third parties referred to as "second beneficiaries". A transferable L/C is often used in cases where the seller is acting to bring the buyer and producer of a product or service together, or where some component of the final product is produced by a third party.

Venture Capital

Financing provided (usually in higher-risk ventures) in exchange for an ownership stake in a business or project. VC funding is expensive and requires ceding some measure of control to the investor, but can be an effective source of financing.

Checklist

Have You…

1. Completed a cash flow projection?

2. Assessed your banking relationship and determine the best source of trade finance for your business?

   If not, see:
   - Developing Finance Relationships
   - Types of Financing

3. Reviewed the Government programs and sources pertaining to your product, service or target market?

   If not, see:
   - Selected Links to Export Finance

4. Acquired a sound understanding of your customer's financing requirements, and should those be a consideration to enhance your competitiveness?

5. Identified a need for assistance with the contracting and contract management process?

   If not, see:
   - Canadian Commercial Corporation (www.ccc.ca)

6. Acquired some basic familiarity with the mechanics of common Export Finance techniques?

   If not, see:
   - Types of Financing

7. Looked into the major risk mitigation options related to financing exports?

   If not, see:
   - Other Key Financing Issues - Managing Risk

8. Specifically reviewed options related to Export Credit Insurance?

   If not, see:
   - Other Key Financing Issues – Export Credit Insurance
   - Export Development Canada (www.edc.ca)

9. Availed yourself of the assistance available through PEMD and/or CIDA-INC for developing market exports?

   If not, see:
   - www.dfait-maeci.gc.ca/pemd/menu-en.asp

- www.acdi-cida.gc.ca/inc.htm

10. Accounted in your financing needs for the possibility of joining a Team Canada trade mission in your target market or region?

    If not, see:

    - www.infoexport.gc.ca/busdev/menu-e.htm

Links

General Sites

- **Strategis** (www.strategis.ic.gc.ca)

Government of Canada Web site with extensive information for SMEs and entrepreneurs.

Telephone: **1-800-328-6189**
email: strategis@ic.gc.ca

Includes a tool to locate Sources of Financing.

- **FITT** (www.fitt.ca)

Forum for International Trade Training

Telephone: **1-800-561-FITT (3488)**
email: corp@fitt.ca

Export Finance Sites

- **Aboriginal Business Canada** (www.strategis.ic.gc.ca)

Industry Canada program which promotes the growth of commerce as one means towards economic self-sufficiency for all Aboriginal people.

Telephone: **1-800-328-6189**
E-mail: strategis@ic.gc.ca

- **Agriculture Canada** (www.agr.gc.ca)

Agri-Food Trade Service (ats.agr.ca)

Agri-Food Industry Market Strategies (AIMS) (www.agr.gc.ca)

Farm Credit Corporation (www.fcc-sca.ca)

Telephone: **1-888-332-3301**
E-mail: csc@fcc-fac.ca

- **Business Development Bank of Canada** (www.bdc.ca)

"(…) BDC plays a leadership role in delivering financial and consulting services to Canadian small business, with a particular focus on technology and exporting."

Telephone: **1 877 BDC BANX (232-2269)**
E-mail: info@bdc.ca

- **Canadian Commercial Corporation** (www.ccc.ca)

"CCC is a Crown Corporation mandated to facilitate international trade, particularly in government markets."

Telephone: **1-800-748-8191**

- **Canadian International Development Agency**

Telephone: **1-800-230-6349**
E-mail: info@acdi-cida.gc.ca

CIDA-INC Industrial Cooperation Program (www.acdi-cida.gc.ca)
"The CIDA Industrial Cooperation Program can provide financial support and advice to Canadian businesses planning sustainable business activities in developing countries in a variety of sectors."

- **Canada Mortgage & Housing Corporation**

Exporting Canadian Products & Expertise (www.cmhc.ca/international)

"CMHC is taking the lead in sharing Canada's housing expertise with the world."

Telephone: **1 800 668-2642**
E-mail: chic@cmhc-schl.gc.ca

- **Export Development Canada** (www.edc.ca)

"EDC is a Canadian financial institution devoted exclusively to providing trade finance services to support Canadian exporters and investors in some 200 markets, 130 of which are in developing markets."

Telephone: **1-866-283-2957** (export sales up to $1 Million/year)
1-866-278-2300 (export sales over $1 Million/year)
E-mail: export@edc.ca

- **Canadian Trade Commissioner Service** (www.infoexport.gc.ca)

"(…) access to hundreds of sectoral market studies and country-specific reports (…) intended to help you, Canadian companies, identity foreign business opportunities and learn more about your target market."

Telephone: **1-800-551-4946**
E-mail: infoexport@dfait-maeci.gc.ca

Program for Export Market Development
http://www.dfait-maeci.gc.ca/pemd

Telephone: **1 800 267-8376** (DFAIT General Enquiries)
E-mail: engserv@dfait-maeci.gc.ca

"PEMD's goal is to increase the prosperity and competitiveness of Canadian businesses in the international marketplace. Canadian companies with annual sales between $250,000 and $10 million are eligible."

Federal Financing Programs

- **Atlantic Canada Opportunities Agency** (ACOA) (www.acoa-apeca.gc.ca)

Business Development Program

- **Canada/Atlantic COOPERATION Agreement on International Business Development** (www.acoa-apeca.gc.ca/e/ibda/index.shtml)

Strives to increase exporting in Atlantic Canada by funding projects designed to help small and medium-sized companies explore, enter and succeed in international markets.

- **Enterprise Cape Breton Corporation** (www.ecbc.ca)

ECBC is the principal federal Government of Canada organization for economic development in Cape Breton and Mulgrave.

- **EDC Export Financing Services** (www.edc.ca/financing)

Provides export financing to buyers of Canadian capital goods and services.

- **My Project: Exporting** (www.bdc.ca)
  (BDC Consulting Services)

An export specialist can help your business become export-savvy: assess global opportunities, increase your production capacity, establish international trade contacts and distribution, and conform to international regulations.

- **Program for Export Market Development** (www.dfait-maeci.gc.ca/pemd)

A repayable grant made to companies to meet the costs of developing a new foreign market.

- **Progress Payment Program** (www.ccc.ca/services/eng)

This CCC program facilitates access to commercial sources of pre-shipment financing for specific export contracts.

- **IFINET** (www.infoexport.gc.ca/ifinet)

Gateway to procurement business with the International Financial Institutions (IFIs) and United Nations (UN) agencies markets.

- **Industrial Cooperation Program** (INC) (www.acdi-cida.gc.ca/inc)

Provides financial support and advice to Canadian businesses planning sustainable business activities in developing countries in a variety of sectors.

- **Getting funding from CIDA and its partners** (www.acdi-cida.gc.ca)
  (Canadian International Development Agency)

Funding sources for:
- Multilateral and International Organizations
- Canadian Non-Governmental Organizations
- Canadian Universities and Colleges
- Canadian Private Sector
- Consultants
- Individuals

- **Trade Routes** (www.canadianheritage.gc.ca/routes)

Trade Routes facilitates access to international business opportunities for the arts and cultural sector.

- **Farm Credit Corporation** (www.fcc-sca.ca)

FCC offers: on-farm processing of loan applications; extensive choice of interest and repayment terms, open or fixed, or long-term financing up to 29 years; repayment plans that fit your operation; optional life insurance; and access to agricultural experts who can do a complete financial analysis of your business at your request.

Provincial/Territorial Financing Programs

Alberta

Alberta Economic Development (www.alberta-canada.com/export)

Business Financing for Western Canada (www.wd.gc.ca)
"Western Economic Diversification Canada (WD) has created (…) loan programs [that] target industry sectors important to Western Canada and provide patient and flexible debt capital on terms especially suited to the unique needs and cash flow requirements of these small businesses."

British Columbia

Ministry of Competition, Science and Enterprise (www.gov.bc.ca/cse)

Business Financing for Western Canada (www.wd.gc.ca)
"Western Economic Diversification Canada (WD) has created (…) loan programs [that] target industry sectors important to Western Canada and provide patient and flexible debt capital on terms especially suited to the unique needs and cash flow requirements of these small businesses."

Manitoba

Manitoba Trade & Investment Corporation (http://www.gov.mb.ca/itm/trade/)
Toll Free: 1 800 529-9981

Business Financing for Western Canada (www.wd.gc.ca)
"Western Economic Diversification Canada (WD) has created (…) loan programs [that] target industry sectors important to Western Canada and provide patient and flexible debt capital on terms especially suited to the unique needs and cash flow requirements of these small businesses."

New Brunswick

Business New Brunswick (www.gnb.ca/0398)
Toll Free: 1 506 444-5228

Newfoundland And Labrador

Investing in Newfoundland and Labrador (www.nlbusiness.ca)
This site provides links to numerous programs and incentives, including the Economic Diversification and Growth Enterprises Initiative (EDGE) tax incentive program.

Industry, Trade & Rural Development (www.success.nfld.net)

Northwest Territories

Investment and Economic Analysis (www.gov.nt.ca/RWED/iea/index.htm)

Nova Scotia

Nova Scotia Business Inc. (www.novascotiabusiness.com)
Toll Free: 1 877 297-2124

Nunavut
Department of Sustainable Development (www.gov.nu.ca/sd.htm)

Ontario
Ontario Exports Inc. (www.ontarioexportsinc.com)
Toll Free: 1 877 46-TRADE

Prince Edward Island

Business Support Program
(www.peibusinessdevelopment.com/index.php3?number=63540&lang=E)
Program designed to assist Island businesses go from start-up through to international exporting.

Entrepreneur Loan
(www.peibusinessdevelopment.com/index.php3?number=63540&lang=E)
Program provides entrepreneurs with up to $25,000 to invest in eligible new and expanding businesses.

Prince Edward Island Business Development (www.peibusinessdevelopment.com)
Toll Free: 1 800 563-3734

Quebec

Impact PME Program (available in French only) (www.formulaire.gouv.qc.ca)
Information about the Impact PME Program and ACTIM-Québec.

IDEA-SME (www.dec-ced.gc.ca)
Financial assistance program that facilitates and improves the development of small and medium-sized enterprises (SMEs) in every region of Quebec.

Ministère du développement économique et régional (www.mic.gouv.qc.ca)
Toll Free: 1 866 INFOMIC

Saskatchewan
Saskatchewan Trade and Export Partnership (STEP) (www.sasktrade.sk.ca)
"(…) non-profit, membership-driven organization designed to promote the growth of Saskatchewan's export industry."

Toll Free: 1 877 313-7244

Business Financing for Western Canada (www.wd.gc.ca)
"Western Economic Diversification Canada (WD) has created (…) loan programs [that] target industry sectors important to Western Canada and provide patient and flexible debt capital on terms especially suited to the unique needs and cash flow requirements of these small businesses."

Yukon
Yukon Economic Development (www.economicdevelopment.gov.yk.ca)

Other Sources of Assistance

Are you looking for something other than export finance information and assistance? Consider the following options:

Are you…

Looking for help to pursue international project opportunities?

- International Project Development RoadMap (www.strategis.ic.gc.ca/SSG/ce01276e.html) (Industry Canada & Strategis)

Planning to export professional services?

- Take a World View – Export Your Services (www.exportsource.ca/worldview) (Industry Canada & Strategis)

Completing research on a selected market?
- The Canadian Trade Commissioner Service (www.infoexport.gc.ca)

Ready to undertake a feasibility study (in the developing markets)?
- CIDA Industrial Cooperation Program (www.cida.gc.ca/inc)

Ready to travel to your export market for business development?
- Program for Export Market Development (www.dfait-maeci.gc.ca/pemd)

Prepared to negotiate an export contract?

- Canadian Commercial Corporation (www.ccc.ca)

Ready to discuss risk and insurance options?

- Export Development Canada (www.edc.ca)

Looking to bid on a project funded by an international financial institution (IFI)?

- IFINet (www.infoexport.gc.ca/ifinet)