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FINANCE FOR EXPORTS

J. T. GILBERT

A simple subject with a simple answer is one way of describing the subject matter of this paper but the only really simple part is being played by the speaker who was simple but honoured to accept the invitation of the Rhodesian Economic Society to be present today.

Where does the finance of exports start? When the seed is sown by the farmer? When the shaft is sunk by the miner? When the raw materials are purchased by the industrialist?

The answer could well be yes but for the purpose of this paper it is intended to approach the financial side of the subject by firstly examining the methods by which an exporter may arrange to receive payment for his goods and the likelihood in each instance of obtaining local finance prior to receiving proceeds from the purchaser. Bound up with this, is of course, the extension of finance to the importer by the exporter.

Before passing to finance however, it is important to stress the need for intending exporters to undertake preliminary investigations into the marketability of the product and of particular importance are the following points:

Quality and cost—competition from internal and other external sources of supply

Means of delivery and delivery time

Controls in force—import and/or financial in the importing country.

Although costs are rising in Rhodesia we are in the fortunate position that production can generally be expanded with a consequent reduction in unit cost and our pricing on external markets coupled with an increase in quality and the ability to supply expeditiously brings advantages which will assist in breaking in to new markets. This is of particular worth in the consumer field and the mere fact that delivery can be effected quickly may well be the selling point which secures an order in the face of competition from established suppliers.

Having assessed a market and decided to expand into it do not forget the home market, for as long as your product competes in quality and price on what is after all the bread and butter market for the vast majority of our manufacturing companies, this market will remain faithful, whereas in an export market you are quite often there by the grace of the particular government and its regulations pertaining from time to time. The grass may well be greener on the other side but it can turn sour very quickly and a company which gears itself to a high export percentage to turnover may well face serious problems unless the product is unique and likely to remain saleable under virtually all circumstances.

Finally, before passing to payment methods, the creditworthiness of the buyer must be assessed and apart from one's own enquiries your banks can obtain reports on companies from almost any country in the world. Once armed with this information, and bearing in mind conditions in the importing country, a decision may be made regarding the means of receiving payment for goods exported and the credit terms which are to be extended to the importer.

In this section we are considering the short term payment aspect of exports i.e. payment to be received within six months of export in order to comply with Rhodesian Exchange Control Regulations and there are broadly speaking, four main methods in use and these are detailed under appropriate headings:

Open Account

By employing this method of trading the seller dispatches the goods to his customer on a promise of payment and the payment will be made in terms of the sale agreement. There is, however, no documentary security and once goods have been dispatched the seller loses control. Therefore this method of trading is normally employed only where the importer is an established customer with a good credit record and where no payment problems are envisaged from the importer's country. A further consideration is the ability to raise credit on this type of trading where in fact there is virtually no security to offer the lender. It follows from this that the exporter himself must have a good credit rating with his bankers and easy access to bank credit to finance the exports during the elapsed period between expenditure on production or purchase and receipt of proceeds.

Consignment

Similar to the previous method in that payment is in no way guaranteed but having the advantage that the exporter retains title to the goods after dispatch but agrees that payment will be deferred until the goods have been sold in the country of import. This method has advantages if the exporter has a reliable agent abroad but generally speaking there are many inherent problems and the problem of financing is the same as in the previous example.

Collections

This is one of the two more common forms of securing payment for exports and the exporter employing this method would draw a draft, more widely known as a bill of exchange, on the buyer of the goods which he would hand to his local banker together with negotiable documents for transmission to the customer through a bank in the foreign country. The draft would be drawn at sight or at a usance i.e. payment would be due on acceptance by the buyer or at so many days after sight according to the terms of payment agreed upon between exporter and customer and documents would only be handed to the buyer if the terms of the transaction were complied with.

If the drafts are to be paid at sight a short period of credit may be required by the exporter and generally speaking this will be provided quite readily by one or other of the two types of banks operating in Rhodesia. Where drafts are drawn at a usance, thus extending credit terms to the buyer, the same conditions of raising finance will apply.

Letters of Credit

This is by far the most satisfactory way of receiving payment for exports; a letter of credit is an instrument which adds the credit of a bank to the credit of a buyer and provided the terms of the credit are met and the documents presented conform to the requirements of the credit, then payment is guaranteed and it is possible for the exporter to raise credit prior to the physical export of goods. As in the case of collections, credit can be extended to the buyer by agreement that the letter of credit established in the exporter's favour shall be drawn against at the expiry of, for example, 120 days.

Thus, although payment is guaranteed, such payment will not be received immediately negotiable documents are presented to the advising bank in Rhodesia but only after the expiry of the period for which credit is being extended. This does not preclude the exporter from raising credit however and

a letter of credit in favour of an exporter is a most acceptable form of security to a banker. One aspect which should not be overlooked is that of the Rhodesian advising bank adding its confirmation to credits which gives the exporter a further guarantee of payment.

The foregoing briefly covers the major payment methods employed in international trade but the title of this paper implies the actual financing of exports. Basically there is little difference in the source of finance whether it is to be used for local business, export business or import business and the limiting factor is usually the creditworthiness of the borrower.

The two prime sources of finance in this field are the commercial banks and the accepting banks, the latter more usually called merchant banks, and these two types of financial institution provide the bulk of all trading finance in Rhodesia today.

The cost of such finance is controlled by many factors but speaking generally the cost of export finance is more favourable to the borrower than finance obtained for local business.

The exporter is fortunate that the banking sector as a whole has moved with the times in Rhodesia and is able to offer or obtain specialised advice on export markets and on the peculiarities relating to individual countries. Any intending exporter would be well advised to take advantage of this knowledge prior to entering into sales commitments and besides seeking advice on the pitfalls which may exist, the opportunity could be taken to arrange appropriate finance at the same time.

From the brief examination of payment methods it emerges that there are varying periods during which the exporter is providing the importer with finance and this particular aspect is assuming growing importance.

In many instances the importer prefers a period of credit, depending upon his ability to pay, either from his own resources or by raising local finance and there may well be a borrowing cost differential in the two countries involved. This, together with the availability of credit, will have an important bearing on the success or otherwise of trading, for an importer who has an offer of credit to cover the delivery and selling period is often influenced by this factor in his choice of supply, whilst the offer of a discount for early payment may or may not be a factor in penetrating a market. The exporter who is in a position to extend credit is quite often able to transact business which otherwise would be lost.

There will invariably be countries where the risk factor on credit terms are greater and in some instances exports should only be dispatched against the establishment of a confirmed irrevocable letter of credit. This is advisable not only to ensure payment but also to ensure that there is no impediment to payment because of lack of foreign exchange or absence of an import licence if one is required. In all export transactions use the service of your bank which will gladly give advice and assist in clearing the way for a satisfactory business transaction.

Currency of Payment

This is obviously of great importance to exporters and may be resolved by quoting prices and requiring payment in Rhodesian dollars if the buyer is prepared to contract in Rhodesian dollars. This is rare however, and it is more likely that prices will be quoted in a trading currency or in the currency of the

importer's country. When quoting prices in foreign currencies it is important that the exporter ensures that the currency of choice is one which is normally traded on a future basis, such as the Swiss Franc, Deutsche Mark, South African Rand and United States dollar.

Export prices should, of course, be continually reviewed in the light of the latest foreign exchange quotations and the exporter should ensure that he receives a prompt acceptance or refusal. Once the exporter has quoted the price the full exchange risk is for his account and he can be sure that any movement in the exchange rate will seldom be in his favour. For example, if the exchange rate moves against him, he will probably get the contract but the profit margin will be reduced.

If the rate moves in his favour, a competitor will probably quote a more favourable price and the exporter will not get the contract.

Exchange Risk

When a quotation has been accepted in a foreign currency, the exchange risk is for the account of the exporter. During the period of contract negotiation he cannot eliminate this risk but once the contract has been accepted, he should take steps to eliminate the exchange risk by means of a forward contract concluded with a bank.

As an example the exporter concludes a contract to sell goods in U.S.$ or Rand for shipment two months after the date of order with payment three months after the date of shipment. There is then a period of five months during which the exporter is at risk should the existing exchange rates be adjusted against him. This period can be covered by selling forward to a bank at a cost which varies according to the period covered. The cost of a forward contract in relation to the cover provided is very reasonable and at current rates a five month contract to sell R20 000,00 to a bank would cost Rhodesian $96,22 or 1,32% per annum. Forward contracts may not exceed a period of six months in Rhodesia and must relate to genuine trade transactions.

Export Credit Insurance

This is a service which should not be ignored by exporters for it covers the risk of non-payment due to both commercial and political factors and is available irrespective of the final destination of exports. Naturally the Export Credit Insurance Corporation must be satisfied with regard to certain aspects of proposals put to them and a particularly useful service which is provided is that of their own credit assessment of buyers through access to a world wide network of information sources.

Briefly, insurance is available to provide cover of between 75% and 80% of export market value on a one year minimum contract basis at premiums ranging between 0,25% and 2,5% depending upon method of payment for exports, credit terms extended to the buyers and the country of destination.

Capital Goods and Service Exports

The foregoing covers exports which by their nature will be paid for on normal commercial terms i.e. a maximum credit term of six months. But what, you may well ask, is the position with regard to entering the fiercely competitive world of capital goods and service exports?

This is a subject of a different nature and, with the industrial potential of

Rhodesia expanding as it is today, is a field which could bring the country great benefit. What, then, is involved and what methods of finance are open to exporters both existing and potential?

An exporter of capital goods will generally secure a contract only if payment terms can be spread over a number of years possibly three to five years or, in some cases, an even longer period. Finance of this nature would not usually be carried by the exporter as it is unlikely that resources would exist in a company to tie up capital for so long a period nor would it be earning a sufficient return to render it a commercial proposition. It is then to the banks that an exporter must turn for such finance and the term "export credit" comes into play.

At this point it should be noted that "export credit" and "export credit insurance" are two completely different things but where there is the one there should always be the other. The first is the granting of credit and the second is the insurance of certain risks inherent in the granting of credit.

An export credit is a credit or loan granted to the foreign **buyer** by the Rhodesian principal or by a Rhodesian financial institution and the institutions which one would approach would be the commercial or merchant banks for the initial financing period of construction or manufacture and thereafter the merchant banks are generally in a position to provide the longer term finance either directly to the foreign buyer or through the Rhodesian principal. This may be done by a single merchant bank or, if the amount is very large, by a syndicate formed by a merchant bank.

Although we are fortunate in Rhodesia in having a low borrowing rate structure it is generally accepted that export credits are granted at a lower rate of interest than the minimum overdraft rates pertaining in the exporting country and as an example, in South Africa where interest rates are higher than Rhodesia, a rate approximately 2% per annum below the minimum fine overdraft rate is applied to export credits. An important difference in South Africa however, is that export credit is provided by the Industrial Development Corporation of South Africa Limited which is a government agency drawing its funds in part from the private sector.

This then would appear to be a necessity in Rhodesia and it is to be hoped that such a scheme will be introduced in the not too distant future thus enabling Rhodesian capital goods exporters to compete with other sources of supply on credit periods and at competitive interest rates.

There would obviously have to be guide-lines laid down, possibly similar to the South African export credit scheme which is in its turn similar to other such government backed schemes and an important prerequisite of any export of capital goods is the percentage of local content in manufacture. This would have a bearing on the matter whatever the source of finance as Rhodesian Exchange Control approval is necessary before credit terms beyond six months can be granted. As a high import content implies an initial outlay of foreign exchange within a very short time of purchase this could seriously affect our foreign currency position if credit terms are extended over a protracted period.

To provoke thought and discussion let us examine the basic requirements of the South African scheme.

1. Export credit insurance must be obtained;
2. Exchange Control must approve the extension of credit to the foreign importer and the terms of the Contract;

3. The exporter must be able to finance the intended export contract until completion or have a firm offer of facilities from a private sector source as the I D C does not provide funds for "in process" financing and advances under the Export Finance Scheme are only made after completion of the export contract.
4. The Exporter shall receive from the purchaser promissory notes for the full amount of credit extended plus interest and such notes shall be payable in Rand in Johannesburg, free of exchange and all other charges. (This effectively safeguards the exporter against the possibility of an exchange risk.) Such notes are endorsed over to I D C by the exporter who receives payment from I D C.
5. The scheme is restricted to the export of capital goods.
6. There must be a direct South African content in the export contract of at least 60% by value.

The foregoing is obviously a very brief resume of the scheme but provides food for thought when considering a similar scheme for Rhodesia.

Mention has been made previously that the I D C in South Africa draws on the private sector for a proportion of its funds and similarly this could be the practice in Rhodesia. Whatever "Body" is formed to extend export credit finance could make available to the various types of financial institutions deposit receipts or similar instruments for periods of twelve months or more, bearing interest at a rate which would be attractive to the investor, but at the same time providing sufficient cover for a suitable return to accrue to the "Body". These instruments might well be classified as liquid assets in the hands of the financial institutions thereby being especially attractive.

Possibly the scheme appears simple to put into practice but obviously a great deal of investigation and preliminary groundwork needs to be carried out, bearing in mind many factors which would include the effect on present liquidity in Rhodesia and the drawing off of funds which are presently gainfully employed. However, in the initial stages the extent of capital goods and service exports would probably not be large and any scheme implemented would grow as Rhodesia grows.

Gentlemen it is hoped that the content of this paper will promote discussion and question and if this end is achieved then a step forward in the continuing quest for exports may well result.

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