

# Finance of International Trade

## Content:

1. Financing Imports
2. Export Finance
3. Loan Finance
4. Other Forms of Finance
5. International Bonds and Guarantees
6. Forfaiting
7. Forward Exchange Contract. Currency Options
8. Country risk

## Objectives: The main objectives of this Learning Unit are:

- To familiarize the student with various methods of finance both for exports and imports.
- To analyze the fundamentals of foreign exchange markets, understand their functioning and examine some of the agents operating in these markets.
- To learn about different types of bonds and guarantees and how they operate.
- We will also look at different methods of managing exchange risk. Forward exchange contracts and currency options will be examined in greater detail.
- Gain a good understanding of Forfaiting, Factoring and Invoice Discounting.

## Learning Unit Summary

There are two basic forms of finance of international trade transactions: import finance and export finance. Both can be performed in the currency of the exporter (for example, Euros) or in any other fully convertible currency agreed by both parties. In the second case the company assumes certain risks as to the difference in exchange rates, however, it can also profit from trading in another currency if there is a rise in the value of the foreign currency. Financial transactions in international trade can be performed in the currency of the exporter, in the currency of the importer or in a third currency.

In many cases export companies must facilitate finance for their clients mainly due to the requirements of the market. In a foreign exchange market dealers trade in currencies. Exports of goods and services, foreign investments, foreign loans, etc. form currency supply whereas currency demand is formed by imports, investment abroad and other factors. These operations stimulate the buying and selling of currencies in a market governed by supply and demand. If payment for a service provided or goods delivered to a foreign client is in a currency other than in which the exporter usually operates, the exporter is exposed to the risk of exchange rate fluctuation.

**International Bonds and Guarantees.** In this Learning Unit on Bonds and Guarantees you will learn about different types of bonds and guarantees, their purpose, the parties involved and how they operate. We will also discuss how bonds or guarantees are managed by banks. Contents:

- 1- Introduction
- 2- Tender Bond
- 3- Performance Bond

- 4- Advance/Progress Payment Bond
- 5- Retention Bond
- 6- On Demand Bond
- 7- Conditional Bond
- 8- Managing Bonds and Guarantees

In this part you are going to:

- Learn what types of bonds and guarantees there are and how they operate;
- Analyze advantages and disadvantages of different types of bonds/guarantees for exporters;
- Discuss the parties involved and their responsibilities;
- Examine how bonds/guarantees are managed by banks.

**Forfaiting.** In this unit we will explore export finance products which are growing rapidly. We will explore Factoring, Invoice Discounting and work through the procedure for a Forfaiting transaction. Contents:

- 1- Introduction
- 2- Factoring
- 3- Invoice Discounting
- 4- Forfaiting

In this unit we will explore export finance products which are growing rapidly. We will explore Factoring, Invoice Discounting and work through the procedure for a Forfaiting transaction. In this part you be will:

- Become familiar with fundamentals of Factoring;
- Learn what benefits factoring offers to a growing business;
- Study fundamentals of Forfaiting;
- Discuss differences and similarities between Factoring and Forfaiting;
- What Invoice Discounting is and how it compares to Factoring.

**Country risk** is caused by political (unwillingness to repay) or economic (inability to repay) events in a particular country. Normally, country risk is measured as transfer risk or cross border risk, which are other terminology used to describe country risk. The central element of transfer risk is the possibility that the borrower may not be able to secure foreign exchange to service its external debt due to economic or political risks of a country, despite availability of local currency

Complementary articles:

- A Balance Sheet Crisis in India?
- NATIONAL INSTITUTIONS PROVIDING EXPORT CREDIT INSURANCE
- Structured trade finance, and its relevance to emerging markets
- Country Rankings

**Exercises:**

- 1- In any business transaction, there are risks. However, these risks are emphasized when dealing internationally. Please, define these risks:
- 2- What is a currency option?
- 3- Country Risk Evaluation. The models typically use micro- and macroeconomic variables that are considered important in explaining the probability of a country's credit rescheduling. Commonly used economic ratios are ...
- 4- What means "On Demand Bonds"?
- 5- The advantages of forfaiting can be summarised as follows ...
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