Going Global

ADDRESSING THE CHALLENGES
OF BECOMING AN
INTERNATIONAL ENTERPRISE

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The financial, logistical and marketing resources companies need to become an international enterprise have been in place for decades, available to large and small companies alike. Yet the knowledge of how to leverage these resources isn’t instinctive for companies that don’t regularly sell to foreign buyers or import goods from abroad.

The good news is they don’t have to do it alone. Such enterprises, with assistance from a financial partner with the requisite experience and tools, can establish and expand their global footprint.

For exporters, issues that can require extra support generally include:

- **Sales and marketing**: Finding buyers in other countries can involve a new set of challenges.
- **Tariffs and trade regulation**: Globalization notwithstanding, complex rules and fee structures still govern international trade.
- **Currency exposure**: An adverse currency move, without protection, can strip the profit away from an export sale.
- **Logistics**: International shipment of goods features multiple hazards.
- **Working capital**: Production and inventory financing can involve longer terms and sophisticated credit analysis.
- **Payment security**: Ensuring receipt of funds, particularly from new customers, involves a particular form of risk management.

**Finding buyers**

A broad spectrum of resources exists to help American companies identify foreign buyers. They range from U.S. government agencies like the International Trade Administration’s U.S. Commercial Service (www.export.gov), to American Chambers of Commerce based in foreign countries, to export management companies – entities that act as a U.S. company’s “one-stop shopping” export arm.

U.S. Commercial Service officers are posted in more than 100 U.S. cities and 75 countries. Their duties include identifying sales and investment opportunities, as well as furnishing information about local economic conditions and import regulatory requirements.

The Commercial Service leads trade missions, organizes trade expositions, sponsors export education webinars and publishes trade data. Its officers also can help U.S. exporters combat illegal import restrictions as well as the “dumping” of subsidized competitive products in the U.S.

A financial institution with clients that conduct business in countries of interest to other bank customers also can link the two, possibly creating new trading relationships.
**Tariffs and trade regulations**

Determining tariff obligations can be a multistage process. For example, the valuation of goods as the basis for tariff calculation isn’t as simple as just arbitrarily assigning one based on your price. The process must conform to a country’s regulations based upon the World Trade Organization’s “Customs Valuation Agreement.”

Goods sold to customers abroad also can be subject to multiple charges. The European Union, for example, charges both a value-added tax (VAT) plus an import tariff. Bottom line: A clear understanding of these obligations is essential to building an international expansion strategy.

**Currency exposure**

An important consideration for exporters in efforts to win a sale is the allocation of currency exposure. For instance, if a sale is priced in U.S. dollars, the foreign purchaser bears the currency risk. If the value of the buyer’s currency drops relative to the dollar, more units of the buyer’s currency will be required to acquire the requisite amount of dollars to pay the purchase price.

A more competitive sales offer would price the U.S. product in local currency terms, leaving the exporter with the currency exposure.

Chances are, whichever party assumes the currency exposure will hedge it. Depending upon the currency involved and the duration of the hedging agreement, the U.S. exporter could find the cost of the hedge very manageable and simply incorporate that cost into its product pricing strategy.

Banks work with exporters to identify and implement the most efficient currency hedging mechanism to eliminate currency risk from the sales equation.

**Logistics and shipping terms**

Logistics considerations also weigh into the international sales process. This is the world of freight forwarders, the shipping agencies that specialize in international delivery. Shipping costs and related insurance costs can be significant, so special consideration is required to keep the total cost of the transaction competitive – whichever party bears that burden.

Because of the many nuances involved in international shipping, the International Chamber of Commerce issues and regularly updates a glossary of 11 international shipping terms, known as Incoterms, identified by three-letter symbols. For example, CIP is shorthand for “carriage and insurance paid to,” followed by the destination (e.g., CIP Hong Kong). Another Incoterm, DAT, refers to “delivered at terminal.” The glossary precisely delineates the tasks, costs and risks involved in each component of an international goods shipment.

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**Creative financing solution boosts exporter’s profitability**

Export financing is seldom cut and dried. A creative bank that looks beyond an exporter’s basic financial profile to gain a deeper understanding of its systems, procedures and strategic relationships can offer more competitive solutions.

Accounts receivable (A/R) can be used as collateral to support export financing. But, what if an exporter underutilizes an important segment of its A/R – international receivables – as a tool to meet working capital needs to fulfill export orders?

That was the situation with a privately held, high-tech equipment company when it invited a new financial institution to review its options. In the review, the new lender observed by adding the ability to produce A/R aging reports that segregated foreign and domestic receivables, the company could enable the bank to provide lending against each “bucket” of A/R as distinct assets. In other words, by improving its reporting capabilities, the company could start converting A/R from foreign sales into working capital.

The new lender also recognized the exporter was missing out on significant discount opportunities from its domestic suppliers because it relied heavily on them to finance its working capital needs. Specifically, it waited 60 days before paying them. The new lender pointed out that by employing a working capital line of credit, the company could pay certain key vendors in 21 days and earn prompt-pay discounts that would increase company profits by $250,000 a year after factoring in credit costs.
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Securing working capital

When all the costs the exporter will incur in conjunction with a sale are calculated, including most fundamentally the cost of producing the goods to be sold, working capital requirements become apparent. Typically, those requirements are greater than needs associated with domestic sales, due both to the extra costs noted above and a longer interval between the date of sale and receipt of payment.

Financial institutions that do substantial business with U.S.-based, globally oriented companies understand and accommodate those requirements. If they already have an established credit relationship with a company before it begins ramping up international sales, they generally have assessed its underlying risk profile and priced services accordingly.

International sales require a higher level of analysis. Questions to be answered to the satisfaction of the financial institution include some applicable to domestic sales and others unique to foreign sales:

- How reliable is the buyer? Might it cancel its order after the seller has incurred significant expense in the process of fulfilling it?
- How strong is the buyer’s balance sheet and income statement?
- What are the economic conditions in the buyer’s country and/or countries where the buyer’s own customers reside?
- What are the political risks? For example, could the buyer find its assets frozen by a mercurial dictatorial government? Could the government suddenly slap an embargo on U.S. goods? Could political instability spur a local banking crisis? Could the country devalue its currency before currency exposure has been hedged?

Lenders typically combine political risk analysis rankings from external sources like Moody’s and Standard & Poor’s with their own assessments to group countries into risk tiers. These rankings, constantly updated, enable prompt decision-making on credit decisions.

The risk assessment is made within the broader context of the exporter’s total financial picture. If, for example, a prospective export sale is determined to entail above-average risk, but in dollar terms is insignificant relative to the company’s domestic sales, working capital needs generally can be easily accommodated.

In the opposite scenario, however, external mechanisms exist to mitigate a bank’s risk, often enabling it to still provide needed funds. Two U.S. institutions have been established specifically for this purpose: The Export-Import (EXIM) Bank and the Office of International Trade for the Small Business Administration (SBA).

EXIM Bank’s various export financing support programs include working capital loan guarantees, export credit insurance and guarantees of loans to foreign importers financing up to 85 percent of purchases of U.S. goods. To qualify for this support, the goods being sold generally must be comprised of at least 51 percent U.S. sourced content.

Authorized SBA lenders receive credit support (up to a 90 to 95 percent guarantee, depending on the program) for loans up to $5 million. While fees are involved and lending criteria impose some limitations, this resource opens new horizons for smaller exporters.
Assurance of payment

Payment security services with or without support from EXIM Bank and the SBA are widely used to reassure exporters they will indeed receive payment according to contractual terms. The three most common mechanisms are the letter of credit, documentary collection and credit insurance.

A letter of credit represents a commitment by the purchaser’s bank to transfer funds to the exporter’s bank, which in turn credits the exporter’s account upon receipt of documentary evidence the goods have been shipped. The exporter’s bank assumes the risk of payment through its process of underwriting the importer’s bank.

A documentary collection functions similarly but does not come with an ironclad guarantee of payment from the buyer’s bank—although, in cases of non-payment, the exporter’s bank does block the purchaser’s ability to take delivery of the shipment. That might be of small consolation to the exporter, however, if it incurs storage charges from a warehouse in the importer’s country and the cost of shipping the goods back to the U.S. Documentary collection is considered more appropriate after an exporter and importer have established an ongoing business relationship.

Lastly, an exporter may desire to also investigate the use of international export credit insurance, a widely used product that, similar to an insurance policy, protects the seller against commercial and political defaults. Export credit insurance is sold by EXIM Bank and a variety of commercial insurers and allows exporters to sell more product by offering more flexible credit terms. BB&T Insurance professionals can work with you to determine the best export credit insurance provider for your needs.

Importing considerations

Being a truly global enterprise involves importing as well as exporting, whether in the form of finished goods, capital equipment or components. This puts the financial shoe on the other foot. For U.S. importers, there are multiple considerations, including payment terms, knowing your supplier (exporter) and currency exposure, if the purchase price is in a foreign currency.

An additional important consideration comes under the heading of working capital and inventory financing: The importer and its financial institution will need to have high confidence the foreign supplier will provide all it has promised, because contract fulfillment disputes become more complex and drawn out in a multinational setting.

Bank support is key

To grow and thrive in a globalized economy, few companies have any alternative but to tackle such challenges. Financial institutions with a strong international orientation can play a vital supporting role.