INTERNATIONAL TRADE AND FINANCE MASTERCLASS

PART 06 OF 25 · SECTION II: PAYMENT METHODS AND TRADE FINANCE

PART 6

TRADE FINANCE — THE CORE INSTRUMENTS

How banks and financial institutions fund international trade — from the banker's acceptance to forfaiting to factoring. Every instrument explained from first principles with complete calculations.

IN THIS PART

- The trade finance gap and why it exists
- Banker's Acceptances — how a bank's promise becomes cash
- Forfaiting — converting long receivables into immediate cash
- Export factoring — recourse versus non-recourse
- Pre-export financing against purchase orders
- Choosing the right instrument for each transaction

CASE STUDIES

Each part includes fully worked case studies with detailed calculations, real-world context, and practical lessons for CFOs and finance leaders.

THE TRADE FINANCE GAP

Why One Point Five Trillion Dollars of Trade Goes Unfunded

There is a gap at the heart of international trade. Every year, approximately one point five trillion dollars of trade transactions fail to find financing. This does not mean the trade does not happen — some of it does, funded by the buyer's or seller's own cash. But much of it simply does not happen. Orders that could be placed are not placed. Factories that could be running are idle. Jobs that could exist do not exist. The trade finance gap is not an abstract financial problem. It is a development problem, a growth problem, and an opportunity problem for any company that understands how to bridge it.

The gap exists because international trade creates a timing mismatch that is fundamentally different from domestic commerce. In a domestic transaction, a buyer and seller can shake hands, inspect goods, and exchange money on the same day. In an international transaction, a manufacturer in Bangladesh might begin producing a garment order six weeks before it ships, spend three weeks in transit, and then wait sixty days for the US buyer to pay after receipt — a total cash cycle of approximately five months. The manufacturer needs to fund raw materials, labor, and

overhead for five months before seeing a single dollar of revenue. Most small and medium-sized manufacturers do not have that kind of liquidity. Trade finance instruments exist to bridge this gap.

Banker's Acceptances: When a Bank's Promise Becomes Money

A Banker's Acceptance is one of the oldest instruments in trade finance, and it remains enormously useful because it solves a very specific problem: the exporter needs to be paid now, but the importer cannot or does not want to pay until later. The Banker's Acceptance bridges this gap by substituting the bank's credit for the buyer's credit — and banks, unlike most buyers, have credit that the entire financial market trusts.

Here is how it works, explained step by step. An importer wants to buy one million dollars of goods but needs sixty days to pay after receiving them. The exporter needs payment now. The importer asks its bank to accept a time draft — a written order directing the bank to pay one million dollars sixty days from today. The bank stamps the word 'Accepted' on the draft and signs it. At this moment, the draft becomes a Banker's Acceptance — an unconditional obligation of the bank to pay one million dollars on the maturity date. The exporter can now hold the Banker's Acceptance until maturity and receive one million dollars, or — more commonly — sell it in the money market at a small discount to receive immediate cash.

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◆ BANKER'S ACCEPTANCE MECHANICS AND COST

BANKER'S ACCEPTANCE — COMPLETE CALCULATION
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TRANSACTION:
Import value: $1,000,000
Payment terms: 90 days after Bill of Lading date
BA maturity: 90 days
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STEP 1: Bank accepts the draft
Acceptance commission: 1.5% per annum
90-day acceptance commission:
$1,000,000 x 1.5% x 90/360 = $3,750
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STEP 2: Exporter sells the BA in the money market
Money market discount rate for 90-day BA: 5.2% p.a.
Discount amount: $1,000,000 x 5.2% x 90/360 = $13,000
Proceeds to exporter: $1,000,000 - $13,000 = $987,000
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TOTAL COST TO IMPORTER:
Acceptance commission: $3,750
Money market discount (absorbed by exporter): $13,000
(Often negotiated: importer pays discount too)
Total if importer pays all: $16,750 / $1,000,000 = 1.675%
Annualized: 1.675% x 360/90 = 6.70%
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BENEFIT TO EXPORTER:
Receives $987,000 immediately instead of waiting 90 days
Cost of early payment: $13,000 on $1,000,000 = 1.3%
Annualized cost: 5.2% — much cheaper than most
working capital facilities available to the exporter
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Forfaiting: Converting Medium-Term Receivables Into Immediate Cash

Forfaiting is a trade finance technique that is less well known than the Letter of Credit or the Banker's Acceptance but that is enormously powerful for exporters of capital goods — machinery, equipment, infrastructure components, aircraft, ships — that are sold on medium-term credit of one to seven years. The word forfaiting comes from the French word 'forfait' meaning to give up a right. In a forfaiting transaction, the exporter gives up the right to collect a future receivable in exchange for immediate cash — without recourse. That last phrase is critical: without recourse means that if the buyer does not pay, the forfaiter bears the loss, not the exporter.

The mechanism works as follows. An exporter sells a two million dollar piece of manufacturing equipment to a buyer in Vietnam on credit terms of five years, with payment in ten equal semi-annual installments of two hundred thousand dollars. The exporter needs the cash now to fund new production. A forfaiter — typically a specialist bank or finance company — purchases all ten payment obligations from the exporter at a discount, paying the exporter an upfront lump sum. The discount reflects the time value of money, the credit risk of the Vietnamese buyer, and the political risk of Vietnam. The exporter receives cash today and has no further involvement. The forfaiter waits for the payments to arrive.

◆ **FORFAITING PRESENT VALUE CALCULATION**

FORFAITING — FIVE-YEAR RECEIVABLE CALCULATION

EXPORT TRANSACTION:

Contract value: $2,000,000

Payment structure: 10 semi-annual installments of $200,000

First payment: 6 months after delivery

Last payment: 5 years after delivery

FORFAITING DISCOUNT RATE COMPONENTS:

Base rate (6-month SOFR): 5.30%

Vietnam country risk spread: 1.80%

Buyer credit risk spread: 0.90%

Forfaiter margin: 0.75%

All-in discount rate (per annum): 8.75%

PRESENT VALUE CALCULATION (each $200,000 installment):

Payment 1 (6 months): $200,000 / (1.0875)^0.5 = $191,429

Payment 2 (12 months): $200,000 / (1.0875)^1.0 = $183,909

Payment 3 (18 months): $200,000 / (1.0875)^1.5 = $176,538

Payment 4 (24 months): $200,000 / (1.0875)^2.0 = $169,523

Payment 5 (30 months): $200,000 / (1.0875)^2.5 = $162,710

Payment 6 (36 months): $200,000 / (1.0875)^3.0 = $156,148

Payment 7 (42 months): $200,000 / (1.0875)^3.5 = $149,878

Payment 8 (48 months): $200,000 / (1.0875)^4.0 = $143,844

Payment 9 (54 months): $200,000 / (1.0875)^4.5 = $138,039

Payment 10 (60 months):$200,000 / (1.0875)^5.0 = $132,465

TOTAL FORFAITING PROCEEDS: $1,604,483

DISCOUNT (cost to exporter): $2,000,000 - $1,604,483 = $395,517

COST AS % OF CONTRACT: $395,517 / $2,000,000 = 19.78%

IS THIS WORTH IT?

Exporter receives $1,604,483 today

Alternative: wait 5 years, collect $2,000,000

But: exporter takes NO credit or political risk

And: $1.6M reinvested in new business at 15% return

$1,604,483 x (1.15)^5 = $3,230,020 in 5 years

vs. simply waiting: $2,000,000

Forfaiting is financially superior if reinvestment return exceeds the forfaiting discount rate

Export Factoring: Selling Your Receivables for Immediate Cash

Export factoring is a financing technique in which an exporter sells its international accounts receivable — the money owed by foreign buyers — to a financial institution called a factor, in exchange for immediate cash. The factor advances a percentage of the receivable face value immediately and remits the balance — less its fees and charges — when the buyer pays. Unlike forfaiting, which handles single large receivables from capital goods transactions, factoring is used for ongoing, short-term trade receivables — the invoices that a company generates from its regular export business.

There are two fundamental types of factoring. In recourse factoring, if the buyer does not pay, the factor returns the receivable to the exporter and demands repayment of the advance. The credit risk remains with the exporter. In non-recourse factoring, the factor accepts the credit risk. If the buyer does not pay due to insolvency or protracted default, the factor absorbs the loss. Non-recourse factoring provides both financing and credit protection — but at a higher cost.

◆ **EXPORT FACTORING COST ANALYSIS**

EXPORT FACTORING — COST AND CASH FLOW CALCULATION

EXPORTER PROFILE:

Annual export turnover: $8,000,000

Average payment terms: 60 days

Average outstanding receivables: $8M x 60/365 = $1,315,068

FACTORING FACILITY TERMS:

Type: Non-recourse (factor takes credit risk)

Advance rate: 85% of invoice face value

Factoring fee: 1.8% of invoice face value

Finance charge on advances: SOFR + 3.5% = 8.8% p.a.

CASH FLOW ON A $100,000 INVOICE (60-day terms):

Without factoring: receive $100,000 in 60 days

WITH FACTORING (Day 1):

Advance (85%): $85,000

Factoring fee (1.8%): $100,000 x 1.8% = $1,800

Finance charge: $85,000 x 8.8% x 60/365 = $1,228

Total cost: $1,800 + $1,228 = $3,028

Net advance to exporter: $85,000 - $3,028 = $81,972

At day 60 (when buyer pays):

Factor receives $100,000 from buyer

Factor remits balance: $100,000 - $85,000 advance = $15,000

Total received by exporter: $81,972 + $15,000 = $96,972

Total factoring cost: $100,000 - $96,972 = $3,028

Annualized cost: ($3,028/$100,000) x (365/60) = 18.45%

BUT: Non-recourse factoring also provides:

Credit protection (factor absorbs buyer default)

Collections management (factor chases payment)

Credit analysis on all buyers (factor sets limits)

If credit insurance alternative costs 0.5%/quarter:

$100,000 x 0.5% = $500 per invoice

Net financing cost: $3,028 - $500 = $2,528 = 15.4% p.a.

Pre-Export Financing: Funding Production Before You Ship

Pre-export financing solves the problem that occurs at the very beginning of the trade cycle — before the goods are manufactured, before they are shipped, and before any receivable exists to finance against. An exporter has received a confirmed purchase order from a creditworthy foreign buyer, but does not have the cash to buy the raw materials and fund the production. Pre-export financing allows the exporter to borrow against the value of the confirmed order, using the purchase order as collateral.

The key to pre-export financing is the creditworthiness of the buyer, not the seller. The lender is essentially lending against the buyer's obligation to pay rather than the seller's balance sheet. This makes pre-export financing available to small manufacturers who would not qualify for a conventional bank loan based on their own financial statements, as long as they can show a confirmed purchase order from a large, creditworthy buyer. The mechanism is particularly powerful when the purchase order is backed by an irrevocable Letter of Credit from the buyer's bank.

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CASE STUDY 1

Colombo Apparel Exports

Pre-Export Finance — Funding a $3.4M Production Run Against a Confirmed LC

Background

Colombo Apparel Exports is a Sri Lankan garment manufacturer with annual revenues of twelve million dollars. In September 2023, the company received its largest ever order — a confirmed purchase order backed by an irrevocable Letter of Credit from a major European department store chain for three million four hundred thousand dollars of winter clothing. The production run required the purchase of approximately one million eight hundred thousand dollars of raw materials — fabrics, threads, buttons, and zippers — before a single garment could be sewn. Colombo did not have sufficient working capital to fund this purchase.

◆ PRE-EXPORT FINANCE CALCULATION

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COLOMBO — PRE-EXPORT FINANCE STRUCTURE
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LC value: $3,400,000
Raw material requirement: $1,800,000
Available working capital: $420,000
Pre-export finance required: $1,800,000 - $420,000 = $1,380,000
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PRE-EXPORT FINANCE FACILITY TERMS:
Lender: Commercial Bank of Ceylon
Advance rate against LC: 70% of LC value
Maximum facility: $3,400,000 x 70% = $2,380,000
Amount drawn: $1,380,000
Interest rate: SOFR + 4.5% = 9.8% per annum
Facility period: 90 days (production + shipping)
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COST OF PRE-EXPORT FINANCE:
Interest: $1,380,000 x 9.8% x 90/365 = $33,387
Arrangement fee (0.5%): $1,380,000 x 0.5% = $6,900
Total cost of facility: $40,287
As % of order value: $40,287 / $3,400,000 = 1.19%
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PROFITABILITY OF ORDER WITH FINANCE COST:
Order revenue: $3,400,000
Production cost (including raw materials): $2,720,000
Gross profit before finance: $680,000 (20%)
Finance cost: ($40,287)
Net profit: $639,713 (18.8%)
Without pre-export finance, this order could not
have been taken at all. Finance enabled $639,713
of profit that otherwise would not have existed.
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CASE STUDY 2

Pacific Timber Exports

Forfaiting vs. Factoring Decision — Which Instrument Fits the Transaction

Background

Pacific Timber Exports has two distinct trade finance needs arising in the same month. The first is a one-off export of a sawmill installation to a buyer in Cambodia for one point two million dollars on three-year credit terms. The second is the

ongoing export of processed timber to buyers in Japan, South Korea, and Taiwan — approximately six hundred thousand dollars per month of short-term receivables on sixty-day terms. The CFO needs to decide which instrument fits each transaction.

◆ FORFAITING VS FACTORING — INSTRUMENT SELECTION

PACIFIC TIMBER — INSTRUMENT SELECTION ANALYSIS

TRANSACTION 1: Sawmill Installation — $1.2M, 3-year credit

WHY FORFAITING IS CORRECT:

- Single large transaction (not ongoing flow)
- Medium-term credit (3 years) — too long for factoring
- Capital equipment — standard forfaiting use case
- Cambodia country risk — forfaiter prices this in
- Non-recourse: exporter takes no credit or political risk

Forfaiting proceeds calculation:

6 semi-annual installments of $200,000

All-in discount rate: 9.5% p.a.

PV of installments: $200K x PV annuity (9.5%/2, 6 periods)

PV annuity factor: 4.9553

Forfaiting proceeds: $200,000 x 4.9553 = $991,060

Discount cost: $1,200,000 - $991,060 = $208,940

TRANSACTION 2: Ongoing Timber Sales — $600K/month, 60 days

WHY FACTORING IS CORRECT:

- High volume, ongoing, short-term receivables
- Multiple buyers (Japan, Korea, Taiwan — diversified)
- 60-day terms — typical factoring tenor
- Need for ongoing credit assessment on multiple buyers
- Continuous cash flow funding, not one-off transaction

Factoring facility:

Monthly invoice volume: $600,000

Outstanding at any time: $600K x 60/30 = $1,200,000

Advance at 85%: $1,020,000 immediately available

Annual factoring cost at 2.2%: $600K x 12 x 2.2% = $158,400

Benefit: $1,020,000 of continuous working capital

Credit protection on all three Asian buyer markets

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CASE STUDY 3

Horizon Electronics

Banker's Acceptance Program — $18M Facility Supporting Chinese Imports

Background

Horizon Electronics is a US importer of consumer electronics components. The company purchases approximately eighteen million dollars of components annually from Chinese manufacturers, with payment terms of ninety days after shipment. To reduce the cost of financing its import payables, Horizon's CFO established a Banker's Acceptance facility with its primary bank, allowing the company to issue BAs against each import transaction and sell them in the money market at a lower interest rate than its revolving credit facility.

◆ BA FACILITY VS REVOLVING CREDIT COMPARISON

HORIZON ELECTRONICS — BA FACILITY vs. REVOLVER COMPARISON

Annual import payables: $18,000,000

Average outstanding at any time: $18M x 90/365 = $4,438,356

OPTION A: REVOLVING CREDIT FACILITY

Interest rate: Prime + 2.25% = 10.75%

Annual interest on $4.44M outstanding:

$4,438,356 x 10.75% = $477,123

OPTION B: BANKER'S ACCEPTANCE FACILITY

BA discount rate (money market): 5.40%

Acceptance commission: 1.25% p.a.

All-in cost: 5.40% + 1.25% = 6.65%

Annual cost on $4.44M outstanding:

$4,438,356 x 6.65% = $295,151

ANNUAL SAVING WITH BA FACILITY:

$477,123 - $295,151 = $181,972

Saving as % of import value: 1.01%

On $18M of imports, 1% is real money.

BA facility setup cost (one-time): $8,500

Payback period: less than 3 weeks