ADB

TFP
Trade Finance Program

Trade Loans

A less risky alternative to overdrafts!

Building Partnerships for Trade

Trade Loan Definition

A Trade Finance Loan is an advance in local or foreign currency enabling customers to finance trade commitments on a transactional basis. Trade Finance Loans will support transactions with an underlying flow of goods and/or services (can include Freight & Duties) and enables Importers and Exporters to obtain finance for their trade flows.

Trade Loan Purpose

Trade Loans are a specialised form of Working Capital Finance.

Trade Finance Loans are not an all purpose working capital tool such as an overdraft facility. It is individual loans that are created to support nominated trade flows for tenors that are aligned to the customers Cash Conversion Cycle for the goods being traded.

Trade Loan Applicability

Trade Loans can be used for either Imports or Exports.

They can be used at any time during the Trade Cycle where a need for finance arises.

For Imports they can be used to finance payments to suppliers, preferably via LC or Documentary Collection. However financing of TTs or invoices is also common.

It is important to control disbursement of funds to insure correct use of funds & reduce risk of double financing.

Trade Loan Applicability – cont'd

For Exports Trade Loans can be used for either pre-shipment or post-shipment financing.

For pre-shipment they are often used to pay local supplies or finance the manufacturing cycle.

Again it is important to insure correct use of funds & to make sure they are being used for the intended purpose.

Post-shipment finance can be used to finance LCs (aka LC negotiations or LC discounting) or finance Export Documentary Collections. Financing of Open Account transactions or invoices is also common.

Trade Loans - Other Considerations

Foreign Currency or Local Currency?

The general rule is that for Imports Trade Loans can be taken in either FCY or LCY.

For Exports Trade Loans are usually financed in the currency of the sales invoice (natural hedge) which is typically FCY.

Often there is a strong incentive to borrow in FCY as the interest base rate is usually much lower than the LCY base rate. ADB can provide FCY funding directly to Banks under the ADB TFP Credit Facility to enable banks to offer FCY Trade Loans.

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Trade Loans - Other Considerations

Interest. Fixed or Floating?

Typically Trade Loans are offered on a fixed rate basis for the period of the loan. Only if the loan was extended would the interest rate be adjusted. There may also be a penalty or break cost for early repayment.

Interest. In Advance or at Maturity?

Typically interest is collected in arrears upon repayment of the Trade Loan.

Trade Loans - Other Considerations

Tenor? 30 days, 60 days, 90 days, max 180 days.

Its important to match the maturity date of Trade Loan with the expected receipt of sales proceeds. You should also have control over the customers cash flow (trade transaction or operating account) so that there is no leakage of cash elsewhere.

An example. Motor Vehicle importer purchases 6 vehicles from overseas. He expects to sell 2 vehicles per month for next 3 months. Shipment time is 60 days.

Therefore you should split payment into 3 Trade Loans with maturity of 90, 120 & 150 days.

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Trade Facilities

Before putting a Trade Loan Facility in place you need to be able to answer these Basic Questions:

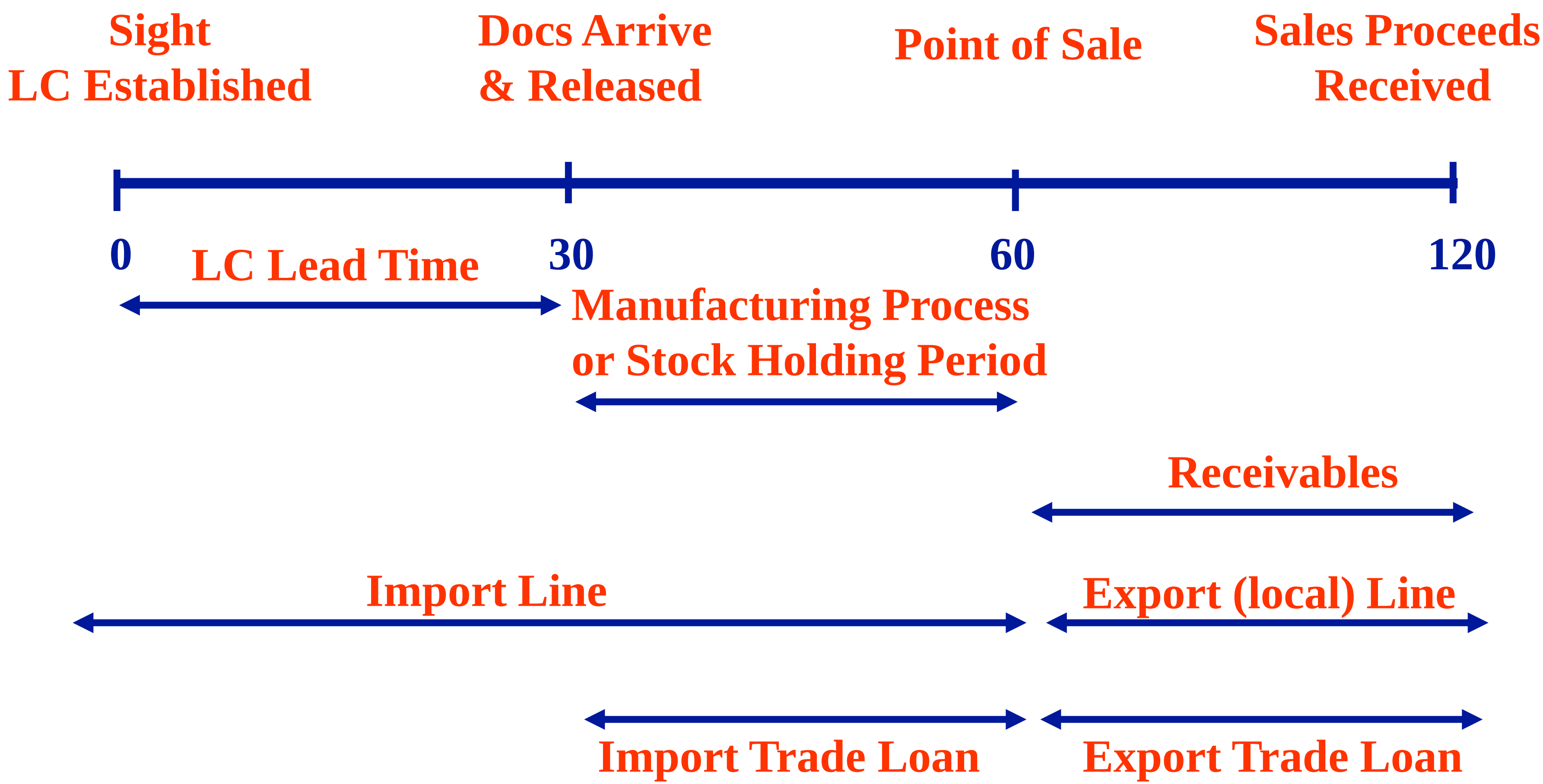
What For?

Hong Long?

How Much?

Solution is Trade Cycle Analysis.

TRADE CYCLE


Sight
LC Established
Docs Arrive
& Released
Point of Sale
Sales Proceeds
Received
0
30
60
120
LC Lead Time
Manufacturing Process
or Stock Holding Period
Receivables
Import Line
Export (local) Line
Import Trade Loan
Export Trade Loan

In Summary

Importers doing business with overseas companies find Trade Finance Loans beneficial as they can finance their imports for a period of time while their goods convert into cash if their supplier is requesting prompt payment or the importer needs funding to help produce their goods for a growing amount of contracts.

Exporters can utilize Trade Finance Loans to bridge the gap between when they have shipped the goods to when they receive payment, when they are able to finance the purchase of raw materials and repay when they receive in payment from the buyer.

Advantages of this Approach

High Visibility

Generally Priced below Overdraft

Opportunity to lend/borrow in FCY

More Disciplined Approach

Bank should have more Credit Appetite

For Customer more Working Capital/More Trade/

Grow Sales/More Profits

As Sales Increase Facility Increases

Reduces Risk of Fraud

Benefits to the Customer

Improves Cash Flow Management especially if Usance LC terms are used

Lower Borrowing Costs especially if borrowing in FCY

Reduces Risk of Fraud

Opens Up New Markets when combined with LCs

A WIN/WIN SOLUTION!