EXPORT FINANCING AND CREDIT INSURANCE

Trade is a key driver of economic growth and poverty reduction and drives the exchange of goods and services, capital movement, and fosters cultural links between people and between countries. It is an important catalyst for regional economic integration, economic growth and poverty reduction.

Banks and other financial institutions help companies engage in world trade, mitigating risks so that goods and services can flow across the globe in a smooth and secure manner. Trade finance is especially crucial for small- and medium-sized enterprises (SMEs), which may lack the resources to import or export valuable goods on their own.

However, in order to establish the amount of financing needed for an export transaction, it is important to identify the financial needs specific to the export transaction. This can be done by separating the financial needs of a specific transaction from the needs of permanent activities. First, the exporter should prepare a monthly cash flow statement based on expected cash inflows and requirements. Subsequently, a line should be drawn to show the weekly balance (positive or negative). Then, the exporter should determine the short-, medium, or long-term needs.

Short-term financing

If the funds are to be used for current operating activities, such as the purchase of goods or services, the payment of wages and interests on debt, or the extension of trade credit, short-term financing will be required. An analysis of the production cycle, from the purchase of raw materials to the delivery of finished goods will determine the amount of finance the exporter needs to borrow; and for how long. As a general rule, short-term financing needs should be met by short-term sources of financing, such as overdraft and short-term loans.

Medium- or long-term financing

Investments on such items as new machinery, modernising existing equipment or a new building, may require medium-term financing. The exporter can obtain this either by welcoming new shareholders to increase the equity of the firm, or by finding investors willing to buy preference shares or debentures, or by borrowing from banks or other financial institutions. Medium or long-term financial needs should be covered either by equity, term loans, or a combination of both. The more equity an exporter has invested in a project, the greater the level of financial protection against external events.

In order to avoid to weakening the firm's financial structure, it is critically important to maintain the overall credit exposure under a certain limit.

Sources of Export Finance

Commercial Banks and other Lending Institutions

Exporters may need a more permanent external source of financing to pay for goods and services; they can apply to financial institutions for short-term capital in the form of an overdraft, loan or letter of credit.

- **Overdraft.** The bank opens a current account in the exporter's name and allows the account to be overdrawn up to an agreed maximum level, over an agreed period of time.
- **Loan:** The lender grants a borrower a loan for an agreed period of time and repayments made either monthly or other periods agreed with the lender and tied to cash generation cycles of the business. A borrower could also get a loan whose repayment is in one lump sum at the end of the loan period, while interest could be paid periodically or at the end of the loan period.
- **Letter of Credit.** A letter of credit opened by the bank of the foreign buyer, enables the exporter to obtain an advance of up to 80% of a sales contract. The exporter can also ask for pre-shipment financing on the basis of a red clause letter of credit, or a green clause letter of credit.

With all forms of financing, exporters typically provide security in the form of assets to be pledged to a bank, together with legal documents, in order to obtain a revolving credit. At the end of the loan period, if both parties are satisfied, the facility can be renewed without major changes to the security or contracts.

Zambia Export Development Fund (ZEDF)

The Zambia Export Development Fund (ZEDEF) is a Fund managed by the Zambia Development Agency (ZDA) with seed funds from the European Union (EU) - Export Development Program. The objective of ZEDEF is to contribute to the expansion of Non-Traditional Exports through the provision of low interest loans.

In this article, ZEDF highlights some examples of different vehicles for creative financing mechanisms that could be secured through non-traditional sources, especially for non-traditional exporters.

Some of the different alternative sources of finance include: i) Leasing, ii) Factoring, iii) Purchase Order Funding, iv) Line of Credit, and v) Guarantees.

i) **Leasing** refers to a rental agreement between the lessor (owner) and lessee (user of asset) that extends for a year or more and involves a series of fixed payments. With a financial lease, there is a long-term relation between the lessor and the lessee. ZEDF working with its partners can use the leasing structure to support purchase of an asset used in production for non-traditional exports.

ii) **Factoring** refers to a method of raising short-term finance; a factor will manage the sales ledger of the business and will be prepared to advance sums to the business based on the amount of trade debtors outstanding. It means selling of receivables to a lending or financial institution so funds can be received earlier than the normal credit period. The business can receive between 80-90% funding of the invoice amount.

At the moment, ZEDF has an arrangement with a factoring partner for export of goods and services to Botswana and this service is readily available for Zambian businesses. In import factoring, the scheme can be used by foreign companies of factor´s services in a domestic country.

iii) **Purchase order finance** is for the purpose of Working Capital and is dependent on business cycle, type of product, clientele and for selected clients. A business could use this facility to access capital goods and to support long production processes. A borrower would be given a borrowing limit based on its business cycle, type of product, clientele etc. The payment from clientele will be received directly to non-bank financial institution/funder/bank, which will be transferred to borrower after deduction of requisite charges. This facility is available at ZEDF.

iv) **Letter of Credit** refers to a letter from a bank guaranteeing that a buyer's payment to a seller will be received on time and for the correct amount. If the buyer is unable to make a payment on the purchase, the bank will be required to cover the full or remaining amount of the purchase. Due to the nature of international dealings, including factors such as distance, differing laws in each country, and difficulty in knowing each party personally, the use of letters of credit becomes a very important aspect of international trade. ZEDF works with banks to support non-traditional exporters to use this type of financing structure to finance production and exports.

v) **Guarantee** refers to a legally binding agreement signed by a guarantor (e.g., ZEDF), on behalf of a borrower. It guarantees that, should the borrower trigger an event of default that cannot be remedied, the guarantor will make the lender whole on its credit exposure. ZEDF can guarantee borrowers seeking to borrow from banks or access to inputs and services from service providers for goods and services earmarked for export.

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