TRADE FINANCING & BEST PRACTICE B2B PAYMENTS

FX INTERNATIONAL PAYMENTS

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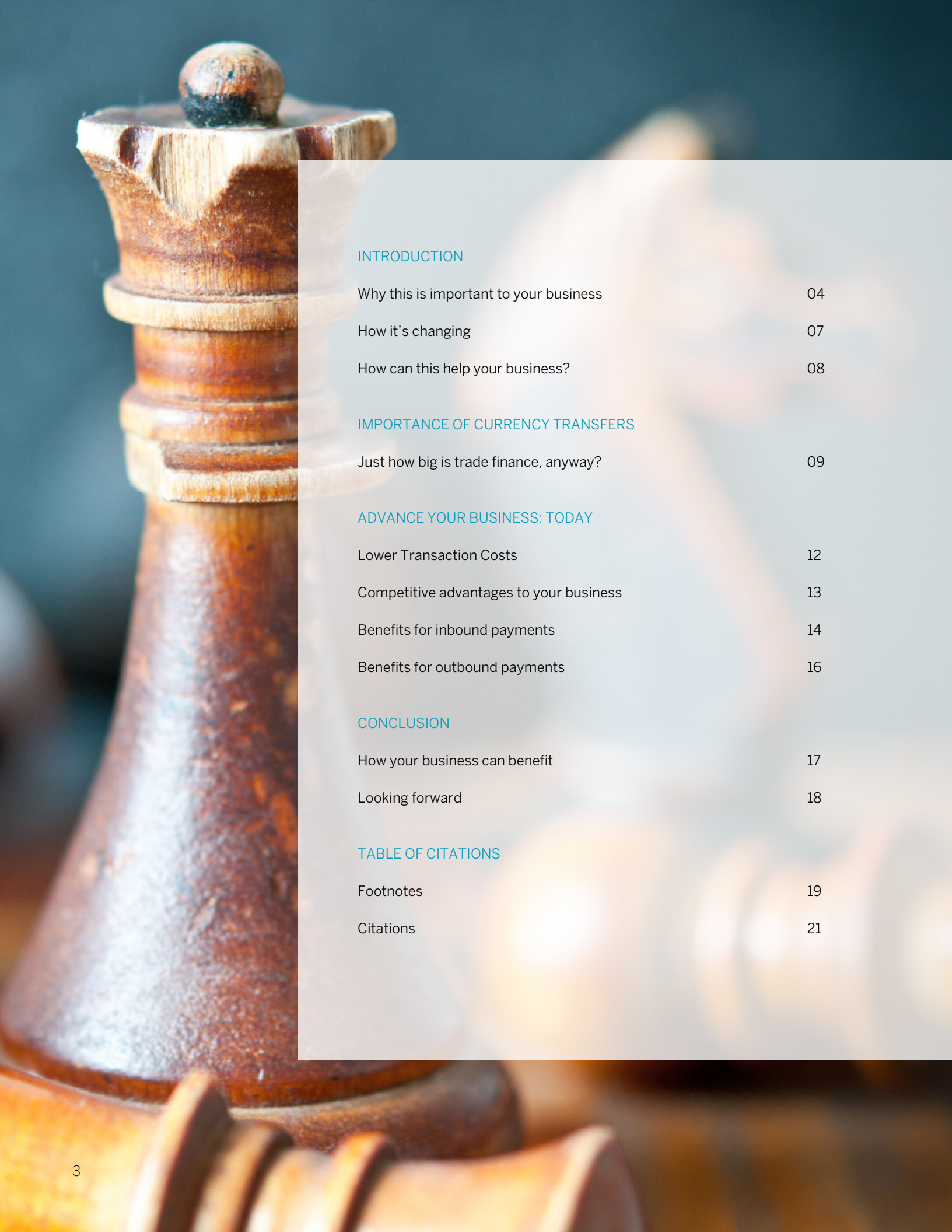
He has also been quoted in the Financial Times, Wall Street Journal, Barron's, BusinessWeek, CNBC, and numerous other publications. Phillip holds a B.S. in finance, a J.D. in law, and an M.B.A.



INTRODUCTION

Why this is important to your business.

How New Technology is Revolutionising FX Payments

The year is 1427, and it is a warm spring day in Florence, Italy. An excited merchant, the head of his rapidly growing import and export business, holds in his hand the crisp paper guaranteeing that he will be paid for his goods once they have been safely received by his buyer in Genoa, just two hundred kilometres away. That paper the merchant holds in his hands over half a century ago is a letter of credit, and it helped unleash global trade.[1]

Fast forward nearly six hundred years, and we find another merchant, sitting in her office in a high rise office in London, having just sold a shipping container's worth of aerospace components to a buyer on the other side of the world. She, too, is holding that same piece of paper, a letter of credit, virtually unchanged in over half a millennium.

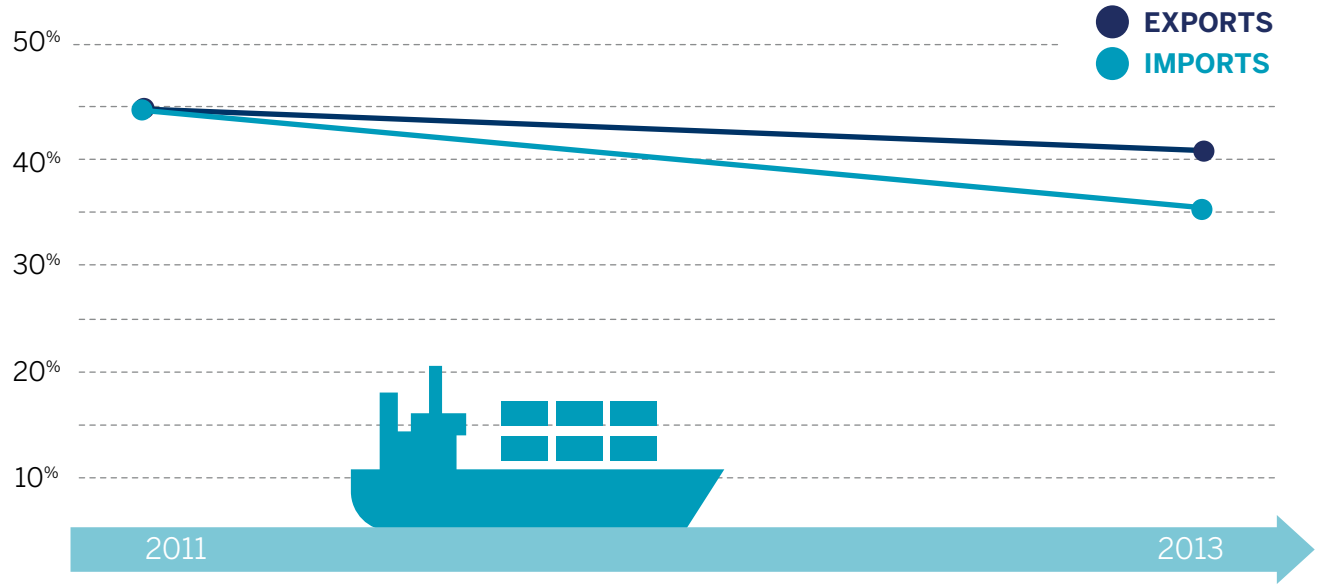
THE WORLD HAS EVOLVED

The world has evolved—transactions that took months to simply cross an ocean now occur in less than a day. Yet many businesses are still shackled to the old ways of doing things, using letters of credit (also known as documentary credits) when there are now better alternatives. Alternatives that are easier, faster, and—perhaps most importantly—more economical than letters of credit.

Letters of credit still serve an important function in trade financing and business to business (B2B) payments, especially in situations where your business does not yet have an established relationship with the counterparty (the person with whom your business is transacting). In cases where the counterparty is not yet trusted, or has exhibited unreliability in the past, a letter of credit is still a useful tool by which to protect your business's interests, by ensuring that a party purchasing your goods will make the payment as promised when the goods are received (and vice versa: that your business, as a buyer, will not deliver payment to the seller until the goods are received by your business).

HOWEVER THE USE OF LETTERS OF CREDIT HAS BEEN ON A STEADY DECLINE FOR SEVERAL YEARS.

On the export trade finance side, letters of credit constitute only **41%** of the export trade finance products handled by banks, down from **44%** in 2011.[2] In regards to import trade finance, there is an even more visible shift away from traditional products (such as letters of credit, and similar products such as guarantees and standby letters of credit). Banks report that letters of credit made up **44%** of their import trade finance products in 2011, but have been on a downward slide for several years, dropping to just **36%** by 2013[3]



CASE STUDY:

LETTER OF CREDIT

A letter of credit is a document issued by a bank at the importer's (or buyer's) request in favour of the seller. The buyer requests their local issuing bank to issue a credit document, which is then sent (either by post or by electronic confirmation) to the advising / confirming bank in the seller's country.

The confirming bank then informs the seller of the goods that a letter of credit has been confirmed—but the funds are not disbursed to the seller just yet; the seller must first ship the goods, with all the necessary documentation (i.e., a bill of lading). A copy of the bill of lading is then submitted to the advising bank, which is then sent to the issuing bank, while the goods are in transit. Once the goods are received in the buyer's country, the buyer transfers funds to the issuing bank, who then delivers the bill of lading document to the buyer, who can then take possession of the goods.

Despite these complex safeguards, problems can (and do) arise; a buyer requesting a letter of credit may encounter a number of problems. There is the risk that the buyer's bank will execute payment when presented with documents which are incorrect or not specified in the letter of credit (i.e., an incorrect or defective bill of lading); or worse: the buyer's bank is presented with the correct documents, but because of their own error refuse to execute payment. More common, however, is that all the parties involved (the seller, the buyer, the issuing bank, the advising bank, the freight forwarder, stevedore or another party) all fall into disagreement, resulting in gridlock, with the goods sitting idle, and none of the parties being paid.[4]

HOW IT'S CHANGING

Not long ago, conducting business internationally meant sending letters and documents through the postal system. Deals often took weeks or months to sort out. Today, your business may have new orders (or a need for supplies) that could not have been foreseen when you were having your morning coffee. Deals are developed and orders fulfilled faster than ever, sometimes in just days, or even hours. Making or receiving the payments for those deals is also happening faster, and the old way of making those payments is often no longer the best way to execute payment. Modern electronic payment systems are coming to the fore, allowing businesses the means to transfer funds internationally much more rapidly and easily, at a lower cost than banks can offer. Today a business can easily set up an account with an international payment service, and quickly and inexpensively send funds to a party in another country, without the rigmarole long associated with doing the same transfers through a bank.

HOW CAN THIS HELP YOUR BUSINESS?

A business involved in cross border trade is no longer limited to only one channel by which to transfer funds. With the freedom to select from a wide variety of foreign exchange / international payment services, an executive in a business has a much greater range of flexibility at their disposal: if an urgent payment is due to a supplier in Malaysia, in order to get the parts delivered immediately to keep the business running, it is no longer a threat that your operation will grind to a halt.

This flexibility gives a business the freedom to be more agile, to source supplies from new or smaller vendors, to develop sales relationships with new clients—all of which may have not been as easily accessible due to the constraints of traditional bank based international payments.

The executive now has the choice of various international payment services, all competing for his business, offering faster and cheaper alternatives. Some services even have the added bonus of reward points for transfers, as well as settlement of the currency transfer directly on a card (e.g., American Express AccessLine™)

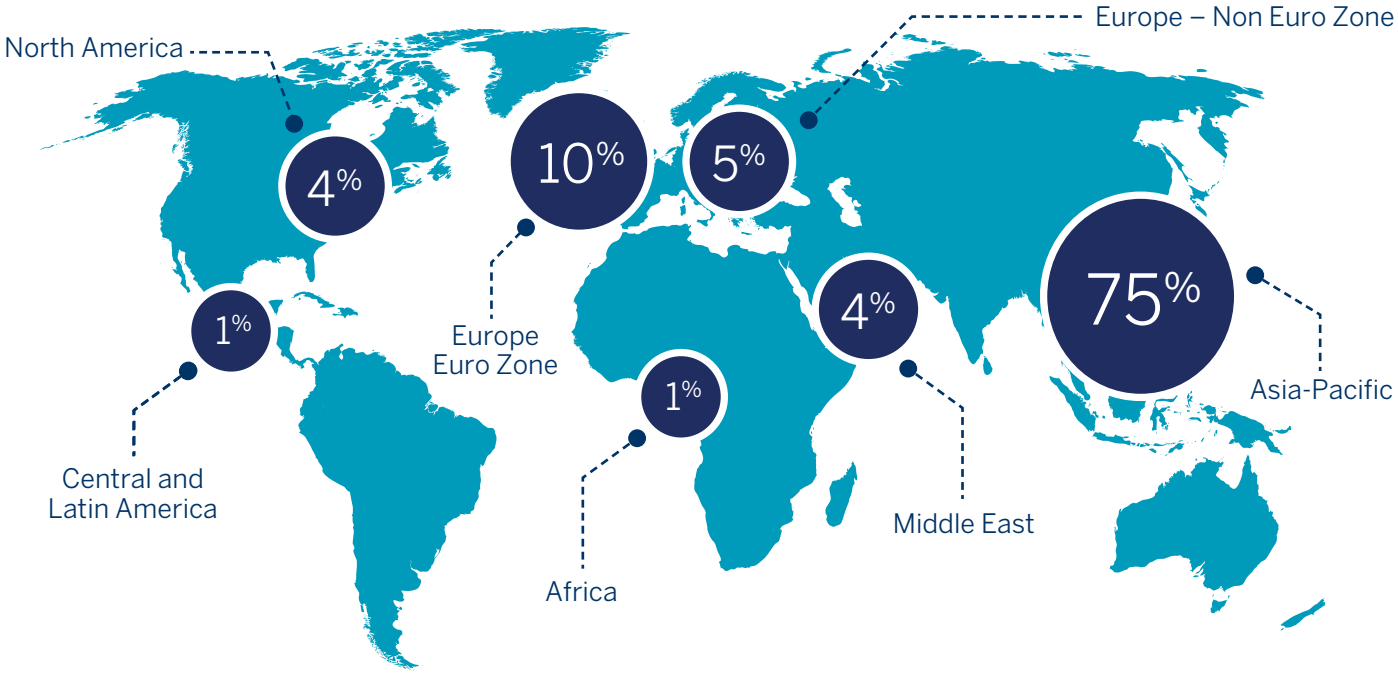
IMPORTANCE OF CURRENCY TRANSFERS

Just how big is trade finance, anyway?

Global trade volume has slowly crept back up, after the doldrums of the financial crisis; growth is at **4.1%** year over year, and is expected to increase to **5.1%** through 2016.[5] It is interesting to note, however, that the countries in developing regions have begun trading more with each other, so much so that "South-South trade has accounted for over half of developing country exports since 2010."[6] Countries in East Asia and the Pacific region have reported a consistent increase in their exports.

PERCENTAGE OF EXPORT BY REGION[7]

Global trade volume is expected to increase at a rate of **5.1%** through the year 2016.



This is all well and good, but what it means for businesses located in Asia (or who conduct trade with businesses in Asia), is that while many countries in Asia may still be classified as developing markets, trade with those countries is already being developed and growing quickly. Businesses are realising that it is no longer an option not to be present in these markets if they are to succeed, and they must enter these markets and establish relationships with suppliers and clients in these markets—relationships which will ensure that those businesses will be well situated to take advantage of increasing trade.

Bangladesh has had the highest volume growth in imports and exports in the years 2012 to 2013.[9]

Cross-border and offshore corporate FX providers have increased dramatically, primarily driven by the increasing demand for payment settlement in foreign currencies in the form of FX transactions, primarily in emerging markets, as "emerging markets are . . . expected to be the key drivers of growth in global trade."[8] This is most visible in Asia, where countries which rely on exports of manufactured products (and services), such as China, Malaysia, the Philippines and Thailand, will see the greatest increase in trade in the near future and are being targeted by businesses for new opportunities. Similarly, Asian countries with low labour costs, such as Cambodia, Lao PDR, Myanmar and Vietnam, are also queuing up to be the next hot spot for trade growth. Historically, the top three product groups that have driven manufacturing and trade in the region have been apparel, electronics and automotive parts—the purview of large multinational corporations.

ASIA-PACIFIC REGION:

Imports paid for by Letters of Credit: **68%**

Exports paid for by Letters of Credit: **75%**[10]

Yet this is changing, as small and medium enterprises (SME) and mid-market enterprises (MME) begin expanding into new territories, thanks in part to the increasing ease of conducting business in these developing countries.[11] And it is not just in developing countries that MMEs are gaining traction: China alone, for example, has a staggering **40,160 MMEs**; even Singapore boasts over **1,500 MMEs**. Tapping into this pool of potential suppliers and clientele is paramount to the success of businesses today—and it is the new wave of international payment systems which is paving the way to these new opportunities.*

ADVANCE YOUR BUSINESS: TODAY

Lower Transaction Costs.

Firstly, currency transfer transaction costs will be reduced. Bank operated foreign currency transfer programs generally charge a fixed membership or admission fee, in addition to a per-transaction fee—and some go so far as to charge both a fee to send funds as well as to receive funds on top of the fixed fees. Many banks utilise a “flat fee” schedule, which penalises SMEs and MMEs who may be sending a smaller transfer amount, but wind up being burdened with the same high cost as if they were sending large transfer amounts (and some even have to pay additional fees to SWIFT).[13]

Modern foreign corporate payment providers often offer little or no set-up or maintenance fees, lower transfer fees, and generally more favourable foreign exchange rates (e.g., American Express FX International Payments has no set-up or maintenance fees at all). This translates into an immediate reduction in cost, as your business will not be burdened by fees that do not add any value to the services being offered. These savings directly impact your business’s bottom line, today.

COMPETITIVE ADVANTAGES TO YOUR BUSINESS

There is an added benefit to not being forced to pay these set-up and maintenance fees, as well as transfer fees: freedom and flexibility. The freedom and flexibility that now allows your business to send and receive payments whenever necessary, without the concern of incurring additional costs.

You now have the flexibility to manage your business's foreign currency payments and receipts in whichever way is best for your supply chain, or to optimise your cash flow management; instead of having to plan and ponder as to whether your foreign currency balances have accreted to a level that makes it worthwhile to accept the high cost of a currency transfer. Today, your business can make currency transfers when it wants, and when it incurs the highest benefit to your business.

> Perhaps the most important advantage to your business is the freedom to manage its global cash and capital as it sees fit, maximising the benefit of that capital in the right place and at the right time.

Perhaps the most important advantage to your business, a distillation of all the advantages discussed *infra*, is the freedom to manage its global cash and capital as it sees fit, maximising the benefit of that capital in the right place and at the right time, free from high fees.

Only **62%** of banks feel they can satisfy customer demand.[14]

BENEFITS FOR INBOUND PAYMENTS

With a foreign currency transfer solution, your business now has alternatives to transferring funds via traditional banks. This allows your business to accept payments quickly and easily, from clients around the world, in virtually every country imaginable (e.g., American Express FX International Payments' network operates in over **110 countries**, with over **80 currencies**). Your business is no longer limited by its bank network, and the slow speeds of their wires and transfers.

Corporate FX providers also generally have a very low minimum nominal transfer threshold, permitting your business to transfer as little—or as much—currency as it needs. The average amount of a letter of credit is **US$653,000**; but for currency transfer services, the average amount is generally in the **US$30,000** range.[15] This flexibility opens a new world of opportunity to your business: clients who before may have been too small for it to be worthwhile accepting small payments from them are now accessible to your business. Clients which perhaps did not have international banking relationships yet established, they too, are now within your purview.

Clients in emerging markets, who are eager to purchase your goods and services, now have the means to send payment to your business easily and affordably. Your business has the ability to be a first mover in a new market, establishing relationships there before your competitors do, developing enduring relationships with local clients in these emerging markets, which can develop into long lasting relationships as those markets open further and increase their purchasing power.

US $653,000: Average amount of a Letter of Credit

US $30,000: Average amount of currency transfer service[6]

Your business is also able to manage its accounts receivables more efficiently, remitting currency back to your home country whenever it is necessary, without waiting for the foreign currency to accumulate in foreign accounts, needlessly binding up your business's cash. Fast and reliable currency transfers let your business streamline its payment structure, so that your clients can easily and quickly submit payments. This in turn equals increased confidence in contract execution, allowing your business to be certain that payment has been successfully executed before delivering goods or services to clients.

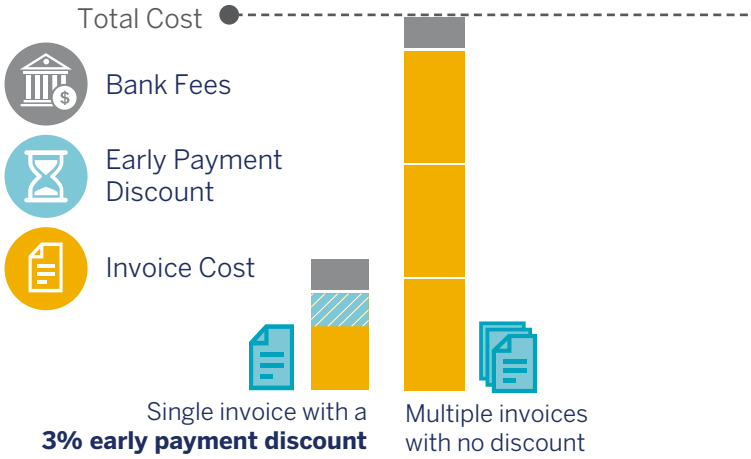
This increased confidence in receiving payments from clients also means that your business no longer has to rely so heavily on letters of credit (see sidebar for more information on letters of credit). For your relationships with established clients, with a history of trust and reliable payments, your business can forego establishing a letter of credit (a burdensome and costly tool compared to modern electronic payment methods) and instead simply receive payment directly from the client. No more onerous letters of credit and dealing with a merchant bank to ensure all the documentary processes have been met. Your business knows it is safe to ship the product to the client because your business has the payment safely settled in its account. And, for situations where a buyer is seeking to place a one-time order, a currency transfer service offers a simple and inexpensive way to send payment, without having to establish an ongoing relationship.

Your clients' ability to make transfers easily also means faster payments to your business, as they can take advantage of favourable invoice terms. This translates into improved cash flow for your business and better utilisation of your capital (see case study).[17]

CASE STUDY:

USING CURRENCY TRANSFERS

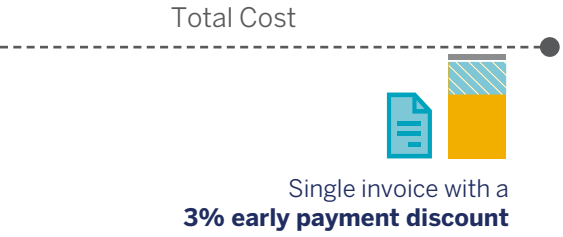
Sam's business offers favourable payment terms which offer a **3% discount** for payments made within ten days, or the full amount of the invoice if paid more than ten days after invoicing. Sam offers the discount so that payment can be received faster, and the money utilised sooner, to help keep the business running. Sam's clients would like to submit payment within the terms of the invoice in order to receive the **3% discount** as well.



But there is a sticky wicket: Sam's clients don't want to pay the transfer fees levied by traditional banks—fees that are so onerous that they cut into the **3% discount** being offered by Sam, negating the discount enough to make it not worth their while to send the payment sooner. Instead, Sam's clients wait to submit payment, on the off chance that perhaps another few invoices may accumulate, and then they can make a lump-sum payment to try to reduce their transaction fees. In this (common) scenario, no one wins. Sam is waiting longer for invoices to be paid, and Sam's clients are not able to take advantage of the favourable invoice terms.

Enter a better alternative: a corporate payments provider, such as American Express FX International Payments and American Express AccessLine™.

With this, Sam's clients do not hesitate to send their payments early, as the fees to do so are minimal, and combined with the favourable invoice terms, tip the balance in favour of an early payment. Now, it is a win-win scenario: Sam has cash on hand earlier to run the business, and Sam's clients enjoy lower costs all around.



Lastly, the ability to transfer funds fast and easily translates into the ability to anticipate and respond to foreign exchange currency fluctuations. Instead of your company watching its foreign currency positions dwindle in value, a currency transfer service gives it the agility to react quickly to changing market conditions and adjust currency positions before losing value.

BENEFITS FOR OUTBOUND PAYMENTS

The benefits of using a currency transfer service do not end with inbound payments. International payment providers give your business the ability to make fast and easy payments to your suppliers, allowing your business to manage its supply chain more efficiently. This gives your business the opportunity to streamline its business processes. Businesses involved in manufacturing, for example, can increase their efficiency, and utilise just in time manufacturing, by ensuring that timely payments can be made to suppliers for time sensitive orders. Instead of having to make payments weeks or months in advance, and potentially increase costs by accepting and storing unnecessary raw materials (as well as suffering higher operation costs, for larger warehouse facilities), your company can receive raw materials precisely when it needs them—and pay your suppliers precisely when necessary.

The ease and speed of currency transfers translate into the ability for your company to make timely payments to suppliers. Being able to deliver payments in a timely fashion means that your business can meet your suppliers' favourable payment terms, saving your company money through discounts. File uploads for payment and currency transfer processing enable your business to transfer foreign currencies to several payees at one time, by uploading a list of payees and the amounts (and currencies) to transfer. Utilising a file upload feature helps your business save time, and it also helps ensure that regularly scheduled payments are not missed or overlooked. You can see and organise all your daily, weekly, or monthly currency transfers at a glance, before uploading the file to execute the transfers; instead of having to manually enter each currency transfer one by one.

Time sensitive payments, such as urgent payments to suppliers for unexpected orders or emergencies, are also handily managed with the use of a corporate payments provider. Payments are easy to set up, without lengthy or cumbersome forms, so that your company can quickly send a currency transfer and keep running smoothly; and, the beneficiary can also easily receive the currency transfer, ensuring that your business relationship with them remains stable. Also, for payments to trusted suppliers or partners, your business is no longer limited to utilising expensive and burdensome letters of credit.

Lastly, emerging markets that previously were out of your company's grasp because of the complexity of establishing a local bank relationship, or hesitation to tie up a substantial amount of your company's cash in a volatile foreign currency in a country with strict capital controls, 19 can now be successfully targeted.

Lastly, emerging markets that previously were out of your company's grasp because of the complexity of establishing a local bank relationship, or hesitation to tie up a substantial amount of your company's cash in a volatile foreign currency in a country with strict capital controls,[19] can now be successfully targeted. Your company can avoid having to keep deposits of foreign currency in several countries on reserve to pay suppliers, thus reducing the risk of not being able to repatriate reserves when necessary.

CONCLUSION

How your business can benefit.

Your business can begin benefitting from corporate payment services, like American Express's FX International Payments, today. With no set-up or account maintenance fees, low transfer costs, and live customer support to assist in opening an account, there is no reason not to open an account today in order to be prepared for your next currency transfer. The reporting features that American Express FX International Payments offers clients also gives you the ability to manage and track your business's inbound and outbound currency transfers, to analyse and forecast its cash flow better, and to predict when and where foreign currency will be needed to meet your business's demands.

With the ability to transfer currencies (inbound and outbound) easily and quickly, your business will reduce its transaction and capital costs, develop new and stronger relationships with clients and suppliers, and strengthen its footprint in foreign markets.

LOOKING FORWARD

There is no question that businesses are moving away from traditional methods of transferring currency, and towards modern alternatives. A clear and marked decrease in the use of letters of credit, and an increase in corporate FX providers, is evident, for good reasons: ease of use, speed and lower cost. Businesses around the globe still have the same goals and concerns that our merchant in Florence had: the best way to grow, and the most secure and efficient way to do so. The world is smaller today, but those concerns are a constant refrain: today, our merchant has modern tools to meet those goals. **The benefits of foreign corporate FX providers outlined in this whitepaper all point towards a bright future for global trade—and a bright future for your business.**

FOOTNOTES

[1] John Padgett, Paul D. McLean, Economic Credit in Renaissance Florence (Southern Illinois University Carbondale, Working Paper No. 9, 2009), available at http://opensiuc.lib.siu.edu/pn_wp/9.

[2] Thierry Senechal, Rethinking Trade & Finance, An ICC Private Sector Development Perspective, International Chamber of Commerce, 34 (2014).

[3] Id.

[4] Ralph H. Folsom, Michael Wallace Gordon, John A. Spanogle, Jr., Peter L. Fitzgerald & Michael P. Van Alstine, International Business Transactions, A Problem-Oriented Coursebook, 224 (11th ed. 2012).

[5] Thierry Senechal, Rethinking Trade & Finance, An ICC Private Sector Development Perspective, International Chamber of Commerce, 20 (2014).

[6] Id.

[7] Based on SWIFT MT700 messages. Id. at 47.

[8] Thierry Senechal, Rethinking Trade & Finance, An ICC Private Sector Development Perspective, International Chamber of Commerce, 110 (2014).

[9] Thierry Senechal, Rethinking Trade & Finance, An ICC Private Sector Development Perspective, International Chamber of Commerce, 47 (2014).

[10] Id. at 49.

[11] SMEs are defined as companies with turnover of £25m or less, a headcount of 250 employees or less, and gross assets of less than £12.5m. MMEs are defined as companies with turnover of £25m to £500m. Collection, Mid-sized businesses, U.K. Department for Business Innovation & Skills (30 June, 2012), https://www.gov.uk/government/collections/mid-sized-businesses.

* For a more detailed analysis of the opportunities for business in Asia, please see the associated American Express Foreign Exchange International Payments whitepaper “Global Trade and Outsourcing Trends.”

FOOTNOTES

[12] Thierry Senechal, Rethinking Trade & Finance, An ICC Private Sector Development Perspective, International Chamber of Commerce, 98 (2014).

[13] Morten L. Bech, Christine Preisig & Kimmo Soramäki, Global Trends in Large-Value Payments, 14 Federal Reserve Bank of New York Economic Policy Review (September 2008).

[14] Thierry Senechal, Rethinking Trade & Finance, An ICC Private Sector Development Perspective, International Chamber of Commerce, 37 (2014).

[15] Id. at 48.

[16] Id.

[17] Setting Payment Terms, Australian Government Business (accessed 19 September, 2015), http://www.business.gov.au/business-topics/selling-products-and-services/payments-and-invoicing/Pages/setting-payment-terms.aspx.

[18] Invoicing and payment terms, Northern Ireland Business Info (accessed 19 September, 2015), https://www.nibusinessinfo.co.uk/content/payment-terms-commonly-used-invoice-payment-terms-and-their-meanings.

[19] Hal S. Scott & Anna Gelpern, International Finance, Transactions, Policy, and Regulation, 656 (19th ed. 2012).

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