Mohamed Khaider University, Biskra

Faculty of Economics, Commerce and Management Sciences

Commerce Department

Module: English
Branch: Finance and International Trade
Level: First year Master

Lecture 01: Introduction to International Trade Finance

Learning Objectives

After teaching this Lecture the Students should be able to:

- *Define the Trade Finance*

- *Identify the Risks posed in International Trade*

- *Illuminate the risks of international Trade*

A common challenge in buying and selling goods and services, particularly in international trade, arises from the seller wanting payment before shipping the goods, while the buyer prefers to receive the goods before making payment. This issue, often referred to as the trade dilemma, highlights the risks inherent in trade and the need for external financing to bridge cash flow gaps. To address this, the financial sector offers trade finance products and services, helping to reduce uncertainty for both buyers and sellers while also providing necessary funding.

1- Defining the Trade Finance

Trade finance comprises various methods designed to reduce and transfer trade-related risks to the financial sector, as well as to facilitate domestic and international trade by leveraging bank financing. Its primary objective is to support the movement of goods across borders, using the goods themselves, receivables, and the cash flow generated from the trade as key forms of security.

Trade finance is centered on facilitating the movement of goods across borders, relying mainly on the goods, receivables, and cash flow generated from the trade as the primary forms of security.

2-Characteristics of Trade Finance

Trade finance transactions generally involve a minimum of three key parties: the exporter (seller), the importer (buyer), and the financier. Unlike other credit products, these transactions are distinguished by the following characteristics:

- A fundamental supply of goods or services
- An agreement for buying and selling

- Logistics and transportation arrangements
- Necessary supporting documents (e.g., certificates of origin)
- Coverage for potential risks through insurance
- Payment conditions and financial instruments, such as letters of credit, upfront payments, and delayed payments

Trade finance facilitates the funding of the trade cycle at different stages of a transaction, enabling participants to manage the necessary capital while minimizing risks in global trade.

Both international and domestic financial institutions provide various financial solutions to support cross-border trade, helping businesses handle international payments, mitigate associated risks, and secure working capital.

The Providers of Trade Finance

- Banks
- Funds
- Alternative Financiers such as forfaiting houses
- Insurance Underwriters
- Trading Companies

Users of Trade Finance

- Importers
- Exporters
- Trading Companies

3-Risks of Trade Finance

Global trade possesses distinct features that lead to various types of risks. As a result, trade finance professionals primarily focus on identifying and minimizing these risks. Below is an overview of some major risks associated with international trade finance.

- **Country Risk**
  A set of risks linked to conducting business with foreign counterparts, including exchange rate fluctuations, political instability, and sovereign risk. Key considerations include the country's political environment, economic stability, legal framework, and access to foreign currency liquidity.

- **Corporate Risk**
  Risks related to the financial stability of importing or exporting companies, primarily assessing their creditworthiness and any past instances of non-payment, non-delivery, or defective delivery.
- **Commercial Risk**
  The potential for financial loss due to issues within the trade itself, such as the quality or adequacy of goods, contract robustness, pricing concerns, and other trade-related deficiencies.
- **Fraud Risk**
  The threat of dealing with fraudulent parties, counterfeit documents, or insurance scams, which can result in financial and reputational damage.
- **Documentary Risk**
  Given the importance of documentation in international trade, missing, incorrect, or incomplete paperwork can lead to shipment delays and payment disruptions for both buyers and sellers.
- **Foreign Exchange/Currency Risk**
  The risk associated with exchange rate fluctuations impacting payments and receipts in foreign

currencies. Without hedging, these changes can significantly erode profits or even lead to financial losses.

- **Transport Risk**
  Since the majority of global goods transportation occurs by sea, various risks arise, including storms, accidents, cargo theft, spoilage, piracy, fire, and other logistical challenges.

4- Trade Finance Products Categorizations ;

Trade finance products are typically categorized under two areas: Unfunded Trade Finance and Funded Trade Finance.

- **Unfunded Trade Finance Products**
  These products focus on credit support rather than providing liquidity. The financial institution does not supply funds to the trade participants but instead guarantees their performance in various roles, ensuring the transaction proceeds smoothly.
- **Funded Trade Finance Products**
  These involve direct financing, where a financial institution provides liquidity to the parties engaged in the trade transaction, facilitating smoother cash flow.

Both buyers and sellers aim to maximize control over the ownership transfer of goods and the related payment process.

Trade finance solutions help balance the differing interests of exporters and importers. Exporters seek to reduce the risk of non-payment by accelerating payment, while importers aim to minimize supply and performance risks by ensuring goods are received before making payment. Trade finance products act as risk-absorbing mechanisms, addressing payment and supply uncertainties while offering exporters faster receivables and importers extended credit options.