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國際貿易下之非信用狀交易實務與風險規避:
從台灣出口廠商之角度探討

International Trade Practice and Risk Aversion of Non-LC Trading
From the Perspective of Taiwanese Exporters

Student: Kevin Wang

Advisor: Professor Jack Wu

中華民國一百年六月

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研究生：王威凱 Student: Kevin Wang

指導教授：吳文傑 Advisor: Professor Jack Wu

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# Abstract

International Trade Practice and Risk Aversion of Non-LC Trading From the Perspective of Taiwanese Exporters

By

Kevin Wang

Taiwan, an island with outstanding economic miracle, has deeply depended on international trades to increase economic growth and national wealth. There are many successful companies, including listed enterprises and SME, manufacturing and marketing Made-in-Taiwan products all over the world through international trade and commerce. Therefore, undoubtedly the power international trade is one of our strength and plays a key role on stimulating economy as well as elevating the living standard of people. .

To compete with other international exporters, Taiwanese exporters must provide not only products with good quality and reasonable price, but also offer competitive payment terms to further strive for new clients and strengthen individual competitiveness. This is a recent trend of International Trade. From the risk-free payment term, such as- T/T Advance to O/A 90 days after shipment, Taiwanese exporters suffered both political risk and credit risk. Not to mention cash flow risk and exchange rate risk that normally appears during transaction.

Remembered financial crisis in 2007, market failed and malfunctioned at that time. As for corporate side, individual companies faced difficulties of continuously operation. Some even seriously went bankruptcy during that time. In this circumstance, Taiwanese exporters, even successfully won the orders, could not receive the payment on time from foreign buyers. Some of them may even suffered huge loss because of intentional disputes or buyer's

closedown. Therefore, it goes without saying that risk aversion is becoming an important issue for Taiwanese companies to survive.

There would be three major financial tools being introduced for risk aversion with three case studies. Each of them has its special features and functions by different needs. How and why does Taiwanese exporter choose and leverage for risk aversion will be explained and discussed. The purpose of this paper is to find out the solutions for Taiwanese exporters to reduce risk of international trade as well as increase competitiveness in the foreign trade and grow the economy as contribution in the long run.

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I dedicate this thesis to my parents with greatest gratitude and appreciation. They support me in all dimensions of my life, not only as I work to finish my degree, but also console while I was frustrated and directed me out of difficulties. Without their love and sacrifice, my life could not even approach to this milestone. Sincere thanks with my higher respects to Father and Mother for completing my life with endless support and love.

TABLE OF CONTENTS

List of Figures and Tables

1. Introduction

With more than 590,000 companies and 760,000 business houses[1] registered at Ministry of Economic Affairs on June 2011[2], Taiwan has been described as "The Island of International Trade" in the past few decades. The mainly reason is that Taiwan does not own extensive territory and abundant natural resources, such as iron, coal, or crude oil as other countries do. Besides, the location of Taiwan is right on the center of East Asia Island chain surrounded by the Pacific Ocean and the Taiwan Strait. Therefore, subject to scarce resources and small local market, companies in Taiwan have to seek opportunities oversea and try to expand market to the world. Based on global perspectives and adventure business culture, not only the famous multi-national Taiwanese companies, such as Acer, Delta, Mediatek, and HTC, who have been playing important roles on IT industries and marketing their products all over the world, but also many successful small and medium enterprises (SME) who have also been successfully dealing business with their global clients by different industries.

According to the statistics of Central Bank of the Republic of China (Taiwan), the foreign reserve of Taiwan until May 2011 has already attained to US$ 398.68 Billion.[3] Taiwan so far ranks the 5th of US foreign reserve in the world, only after China (US$ 2,622,000 Billion), Japan (US$ 1,135,549 Billion), Russia (US$ 502,460 Billion), and Saudi Arabia (US$ 456,200 Billion).[4] The amazing foreign reserve is accumulated by Taiwanese businessmen who grab every single and tiny opportunity to sell products and services with hard-working

[1] The major difference between a company and a business house is the regulated law. A company shall obey Company Law while a business house shall follow Business Registration Law. http://www.ntpc.gov.tw/web/FAQ?command=showDetail&postId=178108&groupId=12347

[2] According to the statistics of Commerce Industrial Service Portal, Ministry of Economic Affairs , R.O.C. http://gcis.nat.gov.tw/pub/simple/alive.jsp

[3] The statistics of foreign reserve until May 2011 is US$ 398.68 billion. http://www.cbc.gov.tw/lp.asp?CtNode=644&CtUnit=307&BaseDSD=32&mp=1

[4] The ranking list of global US foreign reserve is referred to the website of Stock Q.org. http://www.stockq.org/economy/reserve.php

attitude and economical personality. The footprints of Taiwanese businessmen have been remained and noticed all corners of the world, including Asia, Middle East, Europe, North America, Middle and South America, Africa, and Oceania. Until 2010 in these trading areas, there are total US$ 526 billion trading amount of Taiwan and Asia ranks No.1 with trading amount of US$ 328 billion, followed by US$ 73 billion of North, Middle, and South America. The third trading area is Europe with US$ 56 billion trading amount.[5] The huge trading figure is step-by-step accumulated by every single international transaction of Taiwanese exporters. Therefore, we could not deny that international trade plays a very important role of creating Taiwan economic miracle, not to mention that international trade has huge and positive influence on the change of Taiwanese industrial structures from original farming industry to profitable of IT and service industries.

It goes without saying that profits usually come with risk. Although Taiwan businessmen performed well in the past few decades, they still faced a lot of risk. Not to mention when the time goes bad, many companies go bankruptcy without an advance sign. Back to the financial crisis happened on December, 2007, the economy seriously damaged all over the world, including United States, Europe, Japan, and China. Almost every one of us influenced by the crisis more or less. Some people lost their job and were laid off by their employers. The other people even faced the closedown of the company they worked and lose their job. To settle down the social unrest and economic problem, every government tried hard by offering special policy to solve the liquidity problem, including QE 1, QE2, or even QE3 from U.S government, bailout policies from European Central Bank, and other rescue programs offered by IMF as well as regional cross-border organizations, such as EBRD, ADB, Export Credit Agencies, and governments in different countries. There is no doubt that the liquidity

[5] The trading figure of different areas is referred to the website of Bureau of Foreign Trade. http://cus93.trade.gov.tw/FSCI/

problem was a big issue at that time so that FED would pour money into the financial system and force market back to the track. As for government, there is no trust among banks and other financial institutions. Therefore, government had to regulate banks to keep supporting credits to their clients in this very special disastrous moment. However, banks were still become more and more prudent, or even strict, to any clients by tightening the credit line as well as forcing some clients to repay their loans right away. Some insurance companies even decided to get out of loan and credit market because of the huge loss from insurance claims. In this situation, not only exporters but also importers were deeply influenced by the strict credit policy of banks. In the view of macro-economy, market demand had already shrunk to a certain extent. Plus, companies could not get the financial support from banking industry. No wonder the total trading amount decreased in a fast speed since 2008. From the perspectives of companies, they needed the credit more than before. However, the reaction of financial institutions was cruel and brittle and put all enterprises in a huge dangerous situation of financial pressure as well as suffered cash flow risk during this time. Now has been already 3 years after the financial crisis, each economy seemed to be on the track of recovery with the help of bailouts or government policies. The international trading amount also increased by a certain degree. However, did the economy really become better? The answer is maybe or maybe not. Here is an interesting statistics about bankruptcy of U.S financial institutions for the past 10 years as the following table.

Table 1.1: U.S Banks Went into Liquidation for Past 10 Years

Year	Number	Year	Number
2000	2	2006	0
2001	4	2007	3
2002	11	2008	25
2003	3	2009	140
2004	4	2010	157
2005	0	2011 until June 17	47

The resource is from Federal Deposit Insurance Corporation

http://www.fdic.gov/bank/individual/failed/banklist.html

As referred to Table 1.1, we originally assumed that financial crisis would damage the banking system with the worst situation at 2008. However, the truth is U.S banks kept falling down by 140 banks closing down at 2009 to 157 banks failure at 2010. Generally speaking, banks would go to liquidation because of clients' defaults or bad loans. If the economy really becomes better, banks would have fewer and fewer bad loans with higher chance to make profits and to survive in the end. Nonetheless, facts could speak. The possible explanation of the recovery is the abstract sense of economy or maybe some part of economy has bounced back, instead a real and complete economic recovery. Therefore, this figure could conclude that there is still systematic risk as well as general trade-related risk existing in the market. If the economic situation still suffers, the business and operating situation of individual companies could be worse, especially for those companies dealing with the business of International Trade. They still need time to recover and carefully observe the market situation.

Following the above logic, risk exists all the time. Companies shall be more prudent in recent years, not only paying attention to international politics and economy but also patiently searching better partners and working on the fair contract to protect the right themselves. In the practical world, every competitor has similar ability to compete each other in terms of R&D and marketing strategy. Except the quality and price, trading mode and payment term have become another important issue and the trend of trading competitiveness. Apparently the trend of payment term goes to Non-LC transactions with the majority of O/A payment term. Therefore, once the convenience between seller and buyer becomes more and more important, the extent of risk exposure becomes bigger and bigger. Once companies suffer some unexpected event, such as defaults from major buyer or market failure, they would be seriously damaged and further destroyed in terms of finance structure and general operation.

In order not to get out of market in one-time and operate continuously, the best way for companies is taking action on risk aversion. Companies have to know the real-time situation of outside environment, including Macro-economy, trading country and market and match with their specialty and condition to completely understand what kind of risk they are facing now. By doing so, they would know how to make good use of financial tools, such as Export Insurance, Export Credit, International Factoring Services, and Stand-by LC, to cover trading risk, funding gap, and exchange rate risk.

Through the financial tools of international trade, companies undoubtedly can lower down the operating risk as well as strengthen financial structure and cash flow control.

Furthermore, applying well of these financial tools can upgrade the power of individual enterprises and finally increase the competitiveness of Taiwan in the field of International Trade, which match the final purpose of this paper.

The topic is related to the payment terms of international trade, especially focus on exports of Taiwan. This does not mean that imports of Taiwan is not important for research, but because Taiwan exports are more directly related to economic growth in the past and still occupy irreplaceable position of government policy and economic target. Therefore, I would like to strengthen for Taiwan exports and try to study deeper to see the improvement or solutions which may benefit Taiwanese exporters and local economy as well.

Historically speaking, Taiwanese exporters did very well in the field of International Trade. However, they have been facing a lot of risk while doing business with foreign buyers, such as trading risk, cash flow risk, and exchange rate risk. If exporters could not manage the risk well, they might suffer huge loss not just the delivered goods, but also the advanced investment-suck cost[6] for the preparation of materials and products. Therefore, how to deal with the trading-related risk has been an unavailable and important issue for Taiwanese exporters. In section 2, the recent trend of International Trade will be introduced and analyzed. Also, the most common and useful payment terms in the real world will be introduced and explained, with focus on the most popular payment terms: Document against Payment, Document against Acceptance, and Open Account. Finally, the three major risks will be addressed with detailed explanation.

The remainder of the paper is organized as follows: Section 3 discusses the literature review beginning with an overview of political and credit risk. In addition, relevant studies pertaining to different solutions in the risk aversion, such as Factoring and Export Insurance will be examined and discussed. Regarding the solution for risk aversion, which will be discussed in Section 5 will depend on the based knowledge of real practice. Last but not least, Section 6 presents the difficulty for Taiwanese Exporters when dealing with international trade with conclusion and recommendation of the study.

[6] Sunk costs are retrospective costs that have already been incurred and cannot be recovered. http://en.wikipedia.org/wiki/Sunk_costs

2. Recent Trend and Modes of Non-LC Payment Terms

2.1. Recent Trend of International Trade

Each company has its own capital funded by its shareholders. No matter how large a company could be, its capital is still limited to some amount. Therefore, a company shall leverage its limited resources, including funding and human resources, to the maxima utility. Regarding funding need for general operations, most companies would borrow money from banks or other financial institution so that they could handle business over the limited capital capacity. As for foreign trades, companies would have different policies depending on their credit policy or culture. Some companies keep their trading policy conservative, simply taking the order with payment term of T/T[7] 100% in advance before delivery. However, in addition to price competition, most companies take action on non-price competition, such as providing longer payment terms with loose limitation. There are four major types of payment terms ordered from the lowest risk (L/C) to the highest risk (O/A): Letter of Credit (L/C), Document against Payment (D/P), Document against Acceptance (D/A), and Open Account (O/A). Each payment term will be detailed discussed later.

Since most companies have their own credit control to secure their capital and assets, it is difficult for them to trust unknown buyers and do business through international trade. Except the first try out order paying by cash, most companies would step-by step follow the secure procedure to do business with foreign buyers. The securest and the most popular financial tools for Taiwanese exporters are to require foreign buyers to issue Letter of Credit (L/C) with the beneficiary of Taiwanese exporters. However, banks will charge foreign buyers for

[7] Telegraphic Transfer or Telex Transfer, often abbreviated to TT, is an electronic means of transferring funds overseas. A transfer charge is collected while sending money. http://en.wikipedia.org/wiki/Telegraphic_transfer

service fees by issuing L/C. Furthermore, depending on different buyers, banks may ask for fixed deposits or real estates as the collateral before issuing L/C to foreign buyers. It seems inconvenient and costly for foreign buyers to issue L/C from banks. Therefore, with market goes more and more competitive, Taiwanese exporters have to start leveraging Non-L/C payment terms, such as D/A, D/P, and O/A, to attract potential buyers and boost volume of sales as well as increase their competitiveness.

Based on the yearly exports announcement of the Central Bank of Republic of China, the recent trend of International Trade by the payment term category- Sight L/C[8], Usance L/C[9], D/A + D/P, and Remittance(O/A) [10] are all listed as the following Table 2.1 and Table 2.2. From 1999 to 2010, it is clear that the total trading amount grew by 102.3% (From US$ 22,380.4 to US$ 279,604.8 million). This huge growth in exports double confirms Taiwanese economic miracles depending on every single industry with widespread product lines marketing all over the world.

8 Sight L/C: A letter of credit made payable to a beneficiary upon presentation to the opener of conforming documents. http://financial-dictionary.thefreedictionary.com/Sight+Letter+of+Credit

9 Usance L/C: A letter of credit payable at a determined future date after presentation of conforming documents. http://financial-dictionary.thefreedictionary.com/Usance+Letter+of+Credit

10 Remittance (O/A) refers to the Advance Payment before delivery and Open Account after delivery. In practice, except few irreplaceable hot-selling products using the Advance Payment terms, most trades rely on Open Account payment terms.

Table 2.1: Recent 12 Years of Taiwan Exports in US$ Million

Year	1999	2000	2001	2002	2003	2004
Sight L/C	22,380.40	23,649.50	18,267.00	17,109.60	17,876.20	19,863.20
Usance L/C	6,729.10	6,897.30	6,261.90	6,190.10	6,870.20	8,177.40
Total L/C	**29,109.50**	**30,546.80**	**24,528.90**	**23,299.70**	**24,746.40**	**28,040.60**
D/A + D/P	5,345.00	5,237.30	4,252.70	3,986.00	4,330.70	4,489.30
Remittance(O/A)	103,757.70	125,345.20	108,450.20	115,202.40	134,076.30	171,525.80
Total Non-LC	109,102.70	130,582.50	112,702.90	119,188.40	138,407.00	176,015.10
Total	**138,212.20**	**161,129.30**	**137,231.80**	**142,488.10**	**163,153.40**	**204,055.70**

Year	2005	2006	2007	2008	2009	2010
Sight L/C	20,832.60	21,097.60	22,321.00	21,766.10	15,639.10	21,075.00
Usance L/C	9,006.00	11,203.70	12,631.10	13,778.60	10,608.50	11,581.70
Total L/C	**29,838.60**	**32,301.30**	**34,952.10**	**35,544.70**	**26,247.60**	**32,656.70**
D/A + D/P	4,452.90	4,352.90	4,488.40	4,795.00	3,581.10	4,205.70
Remittance(O/A)	177,607.50	186,269.40	213,589.60	236,763.50	184,544.70	242,742.40
Total Non-LC	182,060.40	190,622.30	218,078.00	241,558.50	188,125.80	246,948.10
Total	**211,899.00**	**222,923.60**	**253,030.10**	**277,103.20**	**214,373.40**	**279,604.80**

Referred from Table 2.2- Recent 20 years of Taiwan Exports analyzed by percentage, we can know that Taiwanese exports mainly rely on using L/C, including Sight L/C and Usance L/C. With time goes by, we can clearly find that the L/C using percentage is decreasing from 57.2 % in 1991 to 11.7% in 2010. While the same decreasing situation happened to D/A and D/P payment terms, D/A and D/P added up to occupy 6.4 % in 1991 and decrease to only 1.5% in 2010. However, the only trend that increases is the payment terms of Open Accounts. As referred to the chart, Non-LC Trading increased from 42.8% in 1991, to 88.3% of total exports in 2010. Therefore, we can conclude that the payment term of Non-LC, mostly Open Account deals, has become the major stream of International Trade not simply in the recent years, but also in the future. The reason that O/A term become the most popular trading term is mainly due to the advantages of convenience and cost-efficiency. Nevertheless, using more convenient and economical way of payment terms, such as using D/A term or O/A term would facilitate the trading activities at the same time face higher risk of insolvency. It goes without saying that companies shall be more prudent with higher attention for those Non-L/C trading deals. Therefore, the paper will focus on Non-LC payment terms to match the developing trend of International Trades.

Table 2.2: Recent 20 Years of Taiwan Exports (%)

Year	1991	1992	1993	1994	1995	1996	1997
Sight L/C	50.2%	46.1%	41.1%	35.7%	32.2%	28.6%	24.2%
Usance L/C	7.0%	7.1%	6.4%	6.0%	5.9%	6.3%	6.4%
Total L/C	**57.2%**	**53.2%**	**47.5%**	**41.7%**	**38.1%**	**34.9%**	**30.6%**
D/A + D/P	6.4%	6.4%	6.1%	6.0%	6.0%	5.1%	4.6%
Remittance(O/A)	**36.4%**	**40.4%**	**46.4%**	**52.3%**	**55.8%**	**60.0%**	**64.8%**
Total Non-LC	**42.8%**	**46.8%**	**52.5%**	**58.3%**	**61.8%**	**65.1%**	**69.4%**
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Year	1998	1999	2000	2001	2002	2003	2004
Sight L/C	18.9%	16.2%	14.7%	13.3%	12.0%	11.0%	9.7%
Usance L/C	5.7%	4.9%	4.3%	4.6%	4.3%	4.2%	4.0%
Total L/C	**24.6%**	**21.1%**	**19.0%**	**17.9%**	**16.4%**	**15.2%**	**13.7%**
D/A + D/P	4.4%	3.9%	3.3%	3.1%	2.8%	2.7%	2.2%
Remittance(O/A)	**71.0%**	**75.1%**	**77.8%**	**79.0%**	**80.9%**	**82.2%**	**84.1%**
Total Non-LC	**75.4%**	**79.0%**	**81.1%**	**82.1%**	**83.7%**	**84.9%**	**86.3%**
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Year	2005	2006	2007	2008	2009	2010
Sight L/C	9.8%	9.5%	8.8%	7.90%	7.30%	7.50%
Usance L/C	4.3%	5.0%	5.0%	5.00%	4.90%	4.10%
Total L/C	**14.1%**	**14.5%**	**13.8%**	**12.80%**	**12.20%**	**11.70%**
D/A + D/P	2.1%	2.0%	1.8%	1.70%	1.70%	1.50%
Remittance(O/A)	**83.8%**	**83.6%**	**84.4%**	**85.40%**	**86.10%**	**86.80%**
Total Non-LC	**85.9%**	**85.6%**	**86.2%**	**87.10%**	**87.80%**	**88.30%**
Total	100.0%	100.0%	100.0%	100.00%	100.00%	100.00%

Below figure clearly shows the recent trend of international trading classified by LC and Non-LC payment terms for past 20 years. The development trend is clear that LC deals decrease quickly from year 1991 to year 2004 and steadily on 15% from year 2004 to year 2010. However, Non LC deals increase sharply from year1991 to year 2004 and keep the level over 85% of the whole exports from 2004 until now. The turning point is around year1992 to year 1993, which Non-LC trading terms first surpass LC term. In other words, since year1992, exporters are more willing to apply more risky payment terms to increase their competitiveness compared to other suppliers. Applying Non-LC payment terms has become non-price bargain power so that every other suppliers or competitors would take the same action to secure their market. Finally, Non-LC payment terms turned out to be the major stream of transactions in international business.

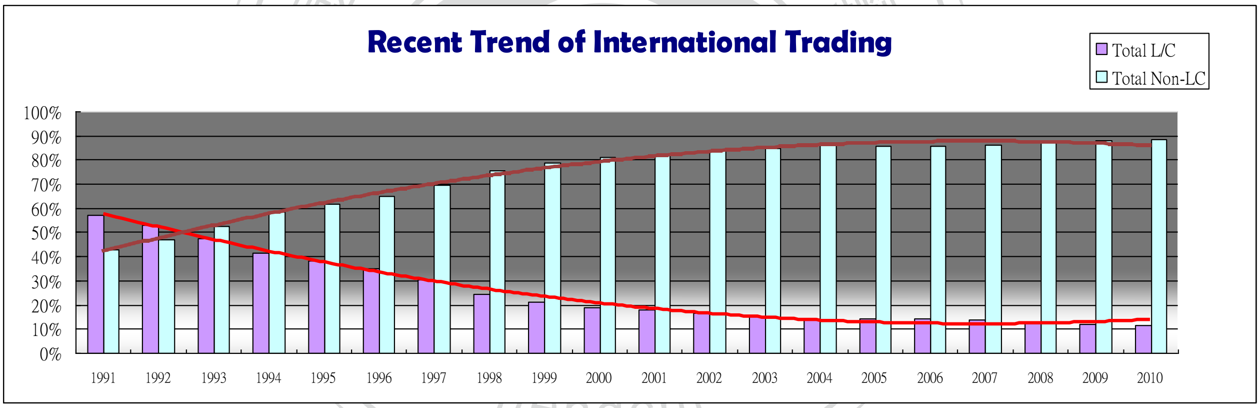

Figure 2.1: Recent Trend of International Trading for Past 20 Years

2.2. Modes of Non-LC Payment Terms-D/P

Among the major types of trading terms, L/C is undoubted the lowest risk of payment term with the pay-back guarantee and credibility of issuing bank. However, issuing L/C would unavoidably increase financial costs for foreign buyers as well as make the trading procedures more complicated and time wasting due to banks regulations. As the 2010 figures showed above, only 11.7% of trades leveraged L/C to facilitate the payment procedure. The trend is clear that Taiwanese exporters need a tool with simplified operating procedure and financial cost reduction. Thus, the risk concern shall be transferred from issuing banks to foreign buyers and undoubtedly the operation of Non-LC deals have become more and more important at the past few years.

The second payment term with comparatively lower risk is Document against Payment (D/P). Generally speaking, D/P is an arrangement under which an exporter instructs the presenting bank to hand over shipping and title documents to the importer only if the importer fully pays the accompanying bill of exchange or draft. D/P is also called cash against documents.

There are at least 5 parties involved in the D/P transaction, such as Taiwanese Exporter, Foreign Importer, Shipping Company, Collection Bank, and Associate Bank of Collection. Each party is very important and has its irreplaceable role to facilitate the trading deal at different stages of D/P procedure. Before going through the trading procedure, I would explain function of each party as the based knowledge as the following:

(1) Local Exporter & Foreign Importer

The function of trading is to bridge the difference and communicate different products or prices all over the world. As long as the difference exists, the trading tractions between exporters and importers will continue to suit each other's need. Therefore, Local Exporters and Foreign Importers are the very first and important parties to start and bridge the transaction.

(2) Collection Bank

D/P is the second lower risk for trading payment term because of Collection Bank. In real practice, exporters shall prepare many documents, including commercial invoice, packing list, banker's bill, etc., before delivery. Collection Bank will be the one responsible for the document accuracy as well as preparing the collection notice to Associate Bank of Collection with all shipping documents by mail.

(3) Associate Bank of Collection

Based on foreign country, the role of Associate Bank of Collection is to review the collection notice from Collection Bank. If the notice meet the shipping documents, Associate Bank of Collection will notify a foreign importer to pay. After making the payment, foreign importers will receive Bill of document for them to take the cargo.

With more understandings of the role and function for trading parties of D/P, it will be clearer to introduce D/P procedure as figure 2.1 shows:

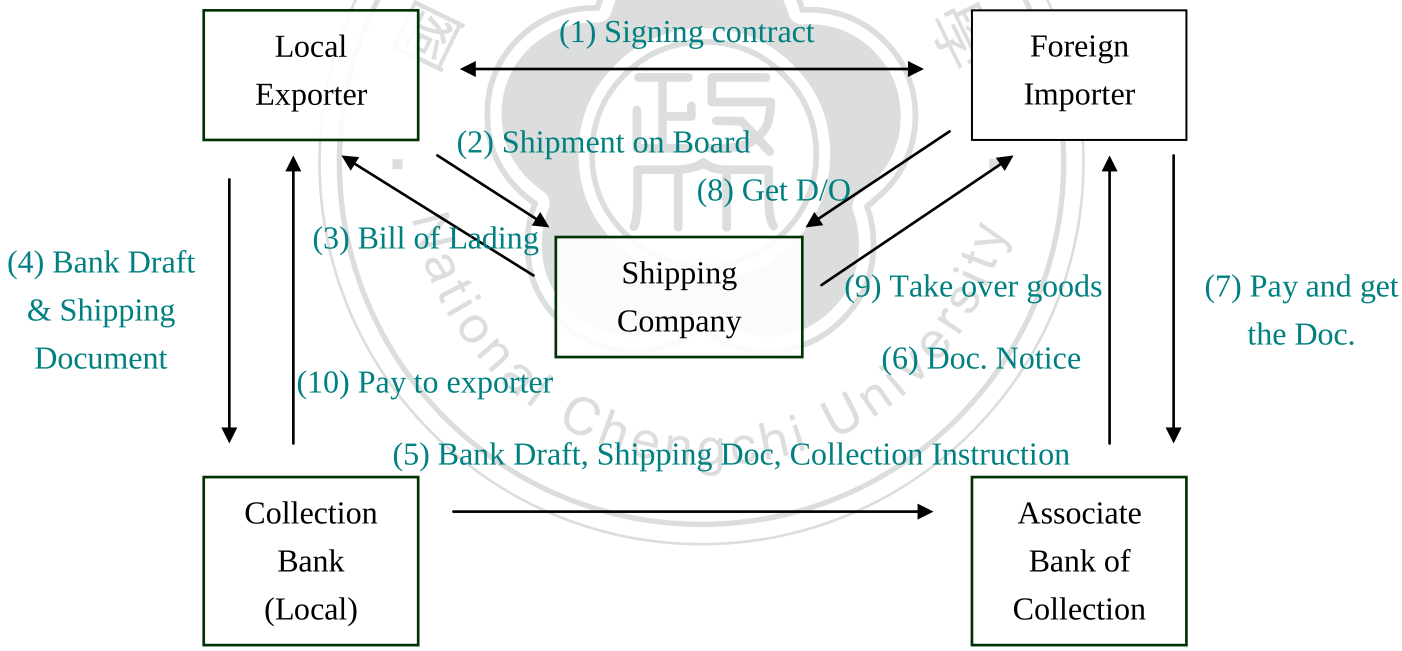

Figure 2.2: Operating Practice of D/P Procedure

The detailed explanation of D/P procedure is as follows:

Step 1: Signing business contract

With negotiation between sellers and buyers, each party would have intention to work together and finally have agreement for the transaction.

Step 2: Shipping on board

Following the contract, exporters have to prepare the shipment on board.

Step 3: Taking B/L

After shipment on board, the shipping boat will issue “Mate’s Receipt”, which exporters can use to exchange for Bill of Lading (B/L) from the shipping company.

Step 4: Preparing shipping documents to Collection Bank

With all the documents, including banker’s bill, B/L, Invoice, Packing list, and other shipping document, at hand, exporter shall prepare the complete shipping documents to Collection Bank.

Step 5: Preparing collection order and mail all the shipping documents to Associate Bank of Collection

After receiving shipping documents from exporters, the collection bank will follow the instruction of exporter to type the collection order and mail all the documents to foreign Associate Bank of Collection.

Step 6: Notifying importers that the arrival of shipping documents

Verifying the accuracy of collection order with shipment documents and notifying importers.

Step 7: Making the payment and taking the documents

If importers accept the notice from Associate Bank of Collection, then importers will pay for the shipment and take the documents away for cargo.

Step 8 & 9: Using bill of document to exchange D/O[11]

After paying for the documents, importers can use bill of documents to exchange D/O for taking over goods.

Step 10: Transferring payment to Exporters

[11] D/O is the abbreviation of Delivery Order, which is the certificate for importers to take over shipments. http://article.bridgat.com/big5/guide/process/200804/205.html

Once received the payment from importers, Associate Bank of Collection will give credit advice to Collection Bank. Then, Collection Bank will transfer the payment to local exporters.

2.3. Modes of Non-LC Payment Terms-D/A

Document against Acceptance (D/A) is another payment term through banks. However, the major difference between D/A and D/P is that importers do not need to pay cash immediately for shipping documents, instead simply accept the banker's draft and commit to pay in 30, 45, 60, or 90 days later depending on different payment conditions. In the case, importers would have more room for selling the products they imported with less funding pressure. Furthermore, if Taiwanese exporters want to be more competitive than other foreign exporters in the same condition, except price and quality, Taiwanese exporters should go for D/A terms to be more elastic of payment terms so that foreign importers would prefer to do business with Taiwanese exporters.

Figure 2.2 is the practice of D/A procedure.

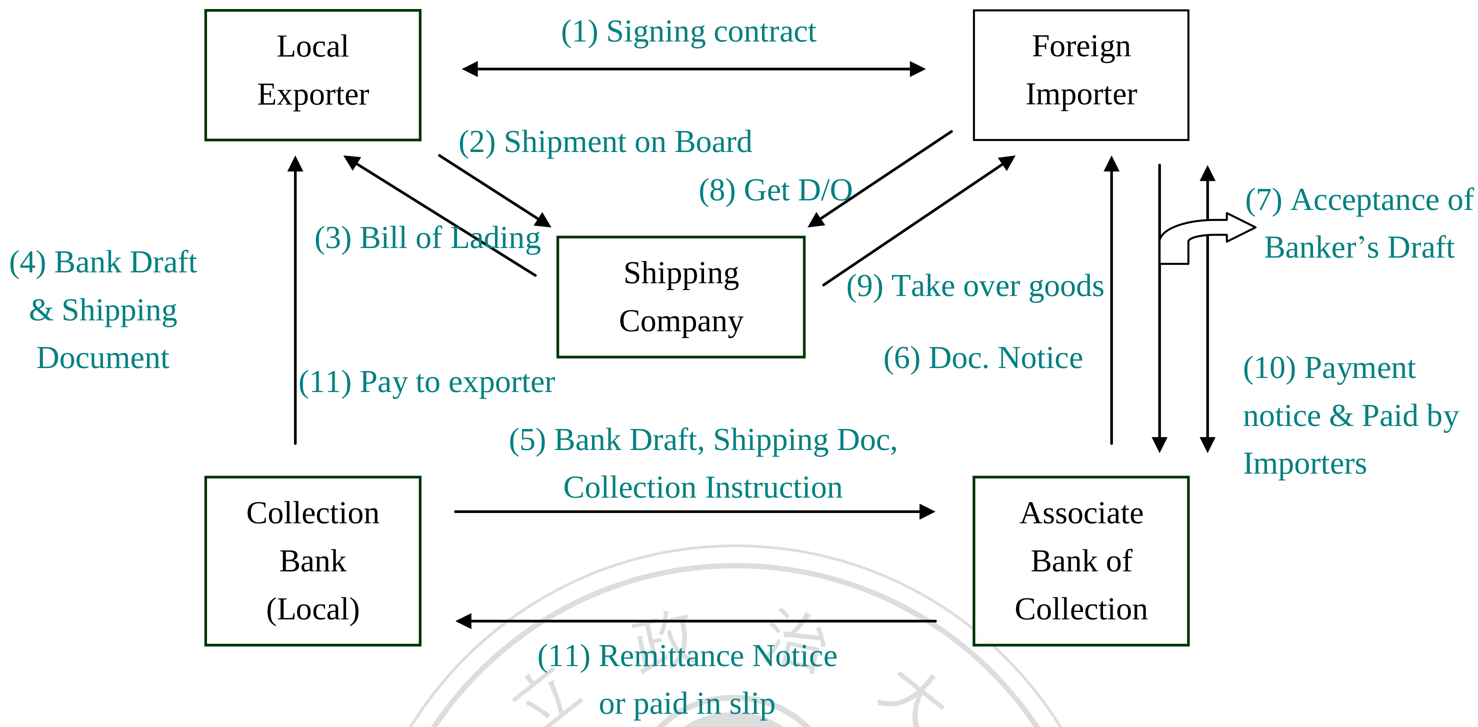

Figure 2.3: Operating Practice of D/A Procedure

The detailed explanation of D/P procedure is as follows:

Step 1: Signing business contract

With negotiation between sellers and buyers, each party would have intention to work together and finally have agreement for the transaction.

Step 2: Shipping on board

Following the contract, exporters have to prepare the shipment on board.

Step 3: Taking B/L

After shipment on board, the shipping boat will issue "Mate's Receipt", which exporters can use to exchange for Bill of Lading (B/L) from the shipping company.

Step 4: Preparing shipping documents to Collection Bank

With all the documents, including banker's bill, B/L, Invoice, Packing list, and other shipping document, at hand, exporter shall prepare the complete shipping documents to Collection Bank.

Step 5: Preparing collection order and mail all the shipping documents to Associate Bank of Collection

After receiving shipping documents from exporters, the collection bank will follow the instruction of exporter to type the collection order and mail all the documents to foreign Associate Bank of Collection.

Step 6: Notifying importers that the arrival of shipping documents

Verifying the accuracy of collection order with shipment documents and notifying importers.

Step 7: Acceptance of banker's draft

This step is different from D/P term, because what importers need to do is to accept the banker's draft and guarantee to pay in the future. Taking D/A 30 as an example, which is 30 days after acceptance (D/A 30 days), importers can take the shipping document first and pay for the imported products 30 days later. Therefore, importers have more room in terms of time and funding to deal with the products.

Step 8 & 9: Using bill of document to exchange D/O

After paying for the documents, importers can use bill of documents to exchange D/O for taking over goods.

Step 10: Payment notice & Paid by Importers

When the appointed payment date is due, Associate Bank of Collection will notify importers again and ask importers to perform the acceptance and make the payment.

Step 11: The payment transfer to exporters

Once received the payment from importers, Associate Bank of Collection will give credit advice to Collection Bank. Then, Collection Bank will transfer the payment to local exporters.

2.4. Modes of Non-LC Payment Terms-O/A

As referred to Table 2.2, the percentage of O/A terms has reached to 86.8% of the whole trading amount and become the most popular payment term of credit sale.

Before addressing the operation of O/A term, here are some must-know features of this payment term as the following three points:

(1) Saving time

The reason that exporters and importers are willing to take this term is strong trust and belief within each other. Exporters will directly send out all the shipping documents to foreign importers after delivery without any condition. In the case, banks involve little, only except the remittance transfer through the banking system. Therefore, both exporters and importers will save time of the operation for the review of shipping documents as well as the delivery of documents.

(2) Lowering costs

If banks can be skipped for the O/A trading process, there is no doubt that charges from banks will be saved. The saving cost might not be that huge. In the case of fee charging for Taiwanese banks, banks will normally charge 0.05 % of the trading amount for service fees. Not to mention another charge from Associate bank of collection. In Chinese old sayings: “A penny saved is a penny earned”, both exporters and importers will try their best to save money especially in this challenging market with little profits.

(3) Higher risk

Although the way of doing transaction without the involvement of banks can save time and lower cost of both exporters and importers, the elastic and open room sometimes will put both parties into the danger of insolvency or commercial disputes. Except the agreement of business contract signed by exporters and importers, there are no other effective rules to regulate the behavior of trading parities. In other words, some bad trading parties would leverage the elasticity of O/A trading term to cheat and default on purpose for the interests of themselves. Therefore, when taking O/A as the payment term, exporters or importers shall be more prudent and pay attention to every detail so that they would not lose the whole cargo or products simple due to a little bit saving of costs.

After knowing the features of Open Account, we can articulate the easier figure for the transaction as Figure 2.3.

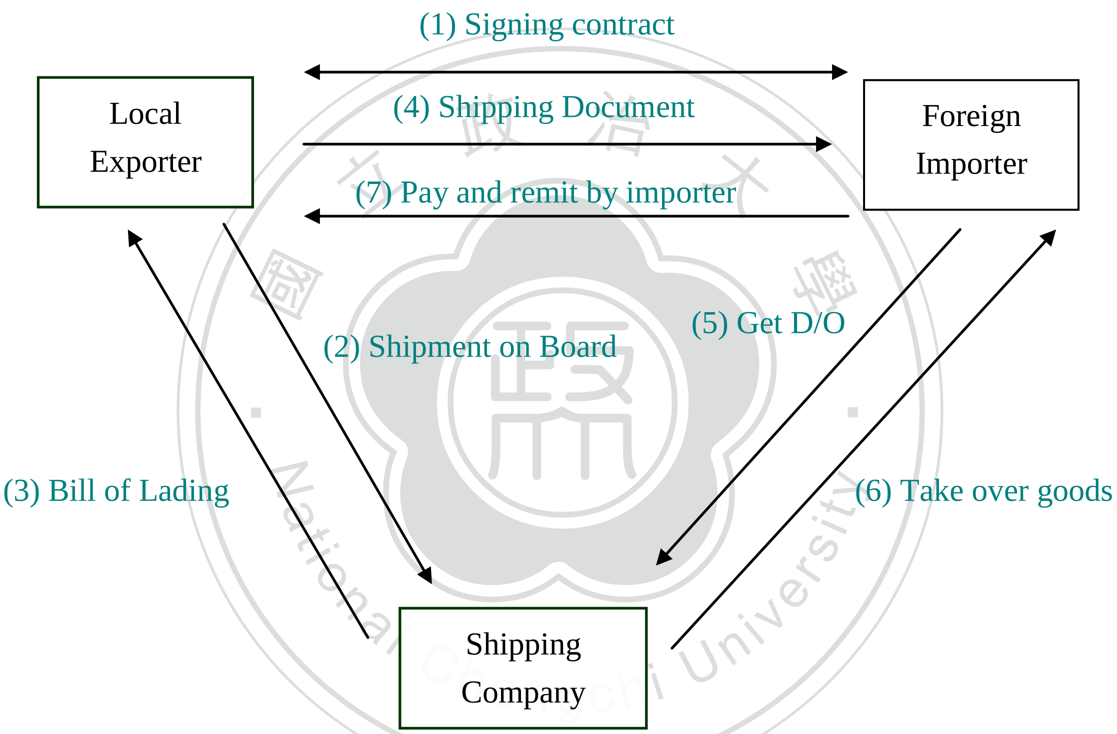

Figure 2.4: Operating Practice of O/A Procedure

The detailed explanation of O/A operation is as follows:

Step 1: Signing business contract

During O/A transaction, the business contract is extremely important, because this is almost the only guideline and principle for both parties to follow and obey. Therefore, the very important first step is to sign a fair contract without disputes or vague articles so that each party can perform contract clearly and legitimately.

Step 2: Shipping on board

As the D/P and D/A transaction, exporters will prepare the shipment on board.

Step 3: Taking B/L

After shipment on board, the shipping boat will issue "Mate's Receipt", which exporters can use to exchange for Bill of Lading (B/L) from the shipping company.

Step 4: Directly transfer shipping documents to foreign importers

Since documents do not need to go through at least two banks (Bank of Collection & Associate Bank of Collection), what exporters need to do is to transfer the shipping documents to foreign importers.

Step 5 & 6: Using bill of document to exchange D/O

After paying for the documents, importers can use bill of documents to exchange D/O for taking over goods.

Step 7 Importers pays and directly remit to exporters

When the appointed payment date is due, importers have to make the payment directly to exporters.

2.5. Major Risks Involved in International Trade

Before discussing the risk trading parties may face, one thing needs to be emphasized is that no matter how high or low the risk it is, exporters and importers have to be selective to the counter party. If they find the right companies to cooperate with, there shall be less and less problems or defaults generated during international trades. However, from the real practices of D/P, D/A, and O/A payment terms, there will be unavoidably three major risk being generated and may cause trading barriers of International Trade.

From the perspectives of Taiwanese exporters, they will face risks explained as the following three categories:

2.5.1. Trading Risk

In the transactions of Non-LC deals, all the transactions mainly rely on the credit of foreign buyers. Taiwanese exporters should be selective for the trading party and pay attention to the its ability of making money in terms of revenues and profits as well as its financial structures, including current ratio, quick ratio, debt to equity ratio, and so on. Besides, the prospects of industry are also very important. If foreign buyers were in sun-setting industry, Taiwanese exporters would better do the business with more concern of safety, such as asking for guarantee or collateral as the protection. Therefore, foreign buyers could default the payment by their inability of making the payment as the below reasons:

(1) Bankruptcy or insolvency[12]

(2) Restructuring[13]

(3) Takeover[14]

(4) Financial problems of an individual importer

Another possible reason for foreign buyers default is the lack of willingness to pay. In the case, foreign buyers still have ability to make the payment. However, they may not have profits in the transaction due to market change and falling price. Sometimes, buyers will try to find some reasons to refuse the payment and finally cause commercial disputes.

Last but not least for trading risk is the political risk and economic risk in importing country. The most possible reasons for the political risk are as follows:

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[12] Bankruptcy or insolvency is a legal status of a person or an organization that cannot repay the debts it owes to its creditors. http://en.wikipedia.org/wiki/Bankruptcy

[13] Restructuring is the corporate management term for the act of reorganizing the legal, ownership, operational, or other structures of a company for the purpose of making it more profitable, or better organized for its present needs. http://en.wikipedia.org/wiki/Restructuring

[14] In business, a takeover is the purchase of one company (the target) by another (the acquirer, or bidder). In the UK, the term refers to the acquisition of a public company whose shares are listed on a stock exchange, in contrast to the acquisition of a private company. http://en.wikipedia.org/wiki/Takeover

(1) War

(2) Internal Disorder

(3) Foreign Aggression

(4) Revolution

(5) Foreign Exchange Control

This risk of the above-mentioned events could be treated as local systematic risk. Nobody can foresee the timing or serious situation before it really happened. Therefore, for Taiwanese exporters, it is better to trade with developed or developing countries with comparatively stable political system or democracy to reduce the political risk.

2.5.2. Cash Flow Risk

To attract more orders from foreign buyers, most Taiwanese exporters tend to offer D/A or O/A terms, which could be treated as a way of deferred payment as a favor to foreign buyers. However, in general, exporters would prepare materials and manufacture from materials to products for sale. Therefore, exporters have to invest partial amounts for material preparation and manufacturing costs to their suppliers.

If the payment date being deferred for a long time, such as D/A 180 days which applied a lot in the fertilizing industry, exporters shall better ask the similar term as opposed to their suppliers to balance the cash flow. When the situation goes bad, or exporters have less bargain power against foreign importers than suppliers, sometimes exporters may suffer a situation of illiquidity or bankruptcy with profits in income statement. To prevent the situation, exporters shall keep the concept in mind “Cash is King” for some risky deals. To be more precise, Taiwanese exporters can follow the below equation and keep their eyes on the number as the following formula:

Financing Gap = Net Cash Flow

= Cash Flow Out – Cash Flow In

If Financing Gap > 0, companies need cash for general purpose.

If Financing Gap < 0, companies need to make good use of their money as investment.

Therefore, no matter how healthy the financial structures exporters or importers are, they have to keep the financing gap negative so that the money generated from sales could actually turn into cash for general purpose of the operation.

2.5.3. Exchange Rate Risk

Exchange rate risk, as per discussion, is another unavoidable risk when doing trades. As long as the time difference exists, there will be Exchange rate risk involved in the transaction. However, the longer the time lasts, the bigger the risk exporters will expose. For example, if an exporter signed a contract of US$ 100,000 (= NT$ 3,000,000) with a foreign importer at the exchange rate 1US equals to NT 30. Both parties agreed the payment term of O/A 120 days after shipment. The exporter shall wait 120 days after shipment for the payment from the importer. However, when the payment date is due, the Exchange rate has changed to 1US equals to NT 28. Then, the exporter still received the payment of US$ 100,000, but when the exporter exchange the payment from USD to TWD, the company would only get NT$ 2,800,000, which cause the exporter to loss NT$ 200,000 because of the appreciation of TWD. The 6.67% loss may not be a huge amount of money compared to the whole shipment. However, in the real world, it is difficult for exporters to sacrifice 6.67% profits in the extremely challenging market simple because of the Exchange rate risk. In the latter section, there will be some financial tools helping for avoiding the above-mentioned risk.

3. Financial Tools for Risk Aversion

About the three major risks mentioned in the early section, none of them could be 100% natural hedged by special arrangements of transactions. Although Trading Risk, Cash Flow Risk, and Exchange Rate Risk are all important for exporters, the most concern for exporters will still be the Trading Risk. The most difficult part to have a successful deal is to know that who is the right partner to cooperate with and who will keep promise, instead of playing games while trading. Therefore, this section will focus on dealing with the Trading Risk by introducing three solutions, such as Export Insurance, International Factoring Service, and Stand-by Letter of Credit.

3.1. Export Insurance

In order to have comprehensive understanding of export insurance, a trading specialized bank, The Export-Import Bank of the Republic of China (Exim bank), shall be introduced as the base knowledge of the financial service- Export Insurance.

Exim bank was established on January 11, 1979, under the Export-Import Bank of the Republic of China Act. It is a state-owned bank supervised by the Ministry of Finance. Its mission is to promote export trade and develop the economy, while its vision is to strengthen trade finance and assist external trade. Exim bank’s main objective is to support government economic and trade policies by providing financing, guarantees and export credit insurance to help enterprises expand external trade and overseas investments. It also increases international cooperation to ensure the steady and continuous development of Taiwan's economy.

The export credit insurance offered by Exim bank includes Comprehensive Export Credit Insurance for document against payment (D/P) and document against acceptance (D/A) transactions, Comprehensive Export Credit Insurance for open account (O/A) transactions, Export Credit Insurance for Small and Medium Enterprises, Export Credit Insurance for letter of credit (L/C) transactions, Medium- and Long-term Deferred Payment Insurance, Overseas Investment Insurance, and Global-Sure Credit Insurance. According to the internal information, Export credit insurance coverage of 2010 totaled NT$63,957 million, with a year-on-year increase of 10.17%.

Although the range of export insurance offered by Exim bank could almost cover all the trading types, including L/C, D/A, D/P, O/A, Medium & Long term deferred deals, Overseas Investment transaction, and package insurance products, such as Global-Sure Credit Insurance, which is similar to the operation of commercial credit insurance. Since the paper emphasize on Non-LC (D/P, D/A, and O/A) transactions, the first step for Taiwanese exporters is to know how to apply for Export Insurance to cover buyers' trading risk. The following figure shows the procedure of applying export insurance in terms of Non-LC transactions.

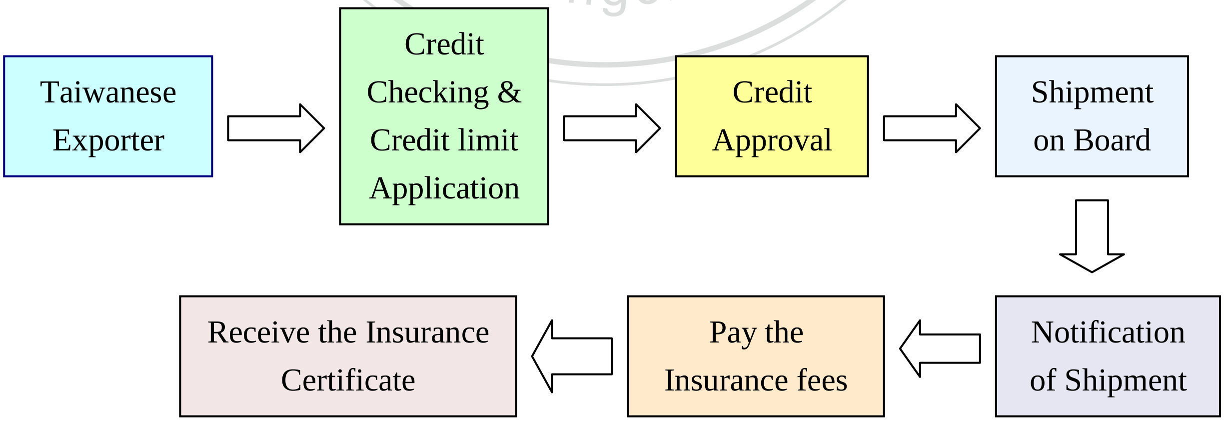

Figure 3.1: Procedure of Export Insurance

Owning to the reason that Exim bank is a 100% stated-owned bank with specialized focus and mission of government policy, Exim bank is not allowed to support foreign enterprises or OBU registered companies. Therefore, Taiwanese exporters are the only focus and target for Exim bank to serve. As the figure shows, Taiwanese exporters have to provide credit reports to Exim bank so that the credit limit could be underwritten by Exim bank. If exporters have no clue or channel to provide credit report, they could rely on the credit service through Exim bank by its group deal with cheaper price of credit reports. Table 3.1[15] is the Credit Reports Fees by Exim bank's offer. No matter what countries the applicant like to inquire, the price range is generally from NT$ 1,200 to NT$ 4,800. However, if an applicant wants to inquire credit reports by itself without going through Exim bank, the price will be 2 to 3 times higher than the price offered by the below Table.

Table 3.1: Credit Rate Sheet by Country

	COUNTRY	NT$		COUNTRY	NT$		COUNTRY	NT$
1	ALBANIA	3,050	25	GREECE	2,050	49	NORWAY	2,600
2	ARGENTINA	2,400	26	GUAM	3,450	50	PANAMA	3,000
3	AUSTRALIA	4,800	27	GUATEMALA	2,700	51	PARAGUAY	2,700
4	AUSTRIA	2,200	28	HAITI	3,050	52	PERU	2,700
5	BELGIUM	2,250	29	HONDURAS	3,000	53	POLAND	2,750
6	BOLIVIA	3,000	30	HONG KONG	2,600	54	PORTUGAL	2,250
7	BRAZIL	2,700	31	HUNGARY	3,400	55	PUERTO RICO	2,600
8	BULGARIA	3,050	32	ICELAND	2,600	56	ROMANIA	3,050
9	CANADA	2,150	33	INDIA	1,200	57	RUSSIA	3,050
10	CHILE	3,000	34	IRELAND	2,150	58	S.AFRICA	2,600
11	CHINA	3,000	35	INDONESIA	3,000	59	S.KOREA	3,050
12	COLOMBIA	3,000	36	B.V.I	3,050	60	SAINT VINCENT	3,050
13	COSTA RICA	3,000	37	ISRAEL	4,050	61	SAUDI ARABIA	3,350
14	CYPRUS	2,250	38	ITALY	2,250	62	SINGAPORE	4,500
15	CZECH	2,800	39	JAMAICA	3,050	63	SLOVAK	3,050
16	DENMARK	2,600	40	JAPAN	4,500	64	SPAIN	2,200
17	DOMINICA C.	3,050	41	JORDAN	3,350	65	THAILAND	3,600

[15] The credit checking fees is referred from the website of The Export-Import Bank of R.O.C. www.eximbank.com.tw

18	DOMINICAN	3,000	42	KUWAIT	3,350	66	TRINIDAD & TOBAGO	3,050
19	ECUADOR	3,000	43	LUXEMBOURG	3,000	67	TURKEY	1,800
20	EGYPT	3,350	44	MALAYSIA	3,150	68	U.S.A.	2,850
21	FIJI	3,200	45	MEXICO	3,050	69	UNITED ARAB EMIRATES	3,350
22	FINLAND	3,100	46	MOROCCO	2,800	70	UNITED KINGDOM	2,500
23	FRANCE	2,150	47	NETHERLANDS	2,250	71	URUGUAY	2,700
24	GERMANY	1,700	48	NEW ZEALAND	4,800	72	VENEZUELA	3,000

After applying the report, foreign credit agency will be mandated for making the latest report for Exim bank to decide whether the buyer is qualified enough to offer the risk credit. Once got the notification from Exim bank, exporters could insure the shipment after the on board date. Finally, Exim bank will issue Insurance Certificate and insurance receipt once exporters pay the premium. To sum up, Exim bank try to make the procedure as simple as it could be so that each Taiwanese enterprises, no matter listed companies or SME, could enjoy the government policy to benefit themselves from avoiding trading risk in the international business.

Last but not least, Export Insurance provides IDEAL services as the following:

(1) Inquire

Exporters can make good use of credit checking services to have deeper understandings of foreign buyers by cheaper price offered by Exim bank. Besides, if the insured amount of foreign buyer exceed to certain amount, now is NT$ three million, Exim bank will pay for the credit checking fees as a feedback of premium.

(2) Diagnose

Buyers' credit will be verified by the Exim bank underwriters with no charge. Sometimes this is a good way to test whether the foreign buyer is a good one to cooperate with or a cheater or a fake company. The underwriting process is the best way for exporters to diagnose their buyers' credits without actually knowing each other.

(3) Exposure

Exporters will acquire the credit of buyers from Exim bank. The approved credit could be taken as a standard for internal control. If exporters sell goods below the credit limit, all of their shipment will be protected mostly (80% -90%) by the export insurance.

(4) Administrate

It is easy for a company to manage 10 or 20 buyers at the same time. However, it will become extremely difficult to manage over 50 buyers with different countries and culture backgrounds. The best way for companies to manage the buyers' risk is to take Export Insurance as one of the must in Standard Operating Procedure. In that case, companies do not need to pay too much attention to the selection of buyer. Instead, companies will have more energy to develop their business.

(5) Loss Indemnity

The most important of Export Insurance is the loss indemnity once buyers default. Exim bank is not a profit-oriented company, instead more willing to help Taiwanese companies. Once suffered the situation of default, the problematic case will be discussed in Export Insurance Committee, which is a fair and open committee, to decide the result of the claim. In other words, loss indemnity for clients is the most concern of Exim bank rather than profits concern of commercial insurance company.

3.1.1. Export Credit

As for Cash Flow Risk and Exchange Rate Risk, Exim bank undoubtedly provides financial services, Export Credit, to reduce both Cash Flow Risk and Exchange Rate Risk. To keep it simple and easy, Taiwanese exporters do not need to provide any fixed deposits or collateral as payment protection, instead only provide Exim bank with Insurance Certificate and receipt, which are also issued by Exim bank. Then, exporters can drawdown the credit for funding right after shipment to avoid Cash Flow Risk and Exchange Rate Risk as well. Figure 3.2

shows the operating procedure of Export Credit for Taiwanese Exporters.

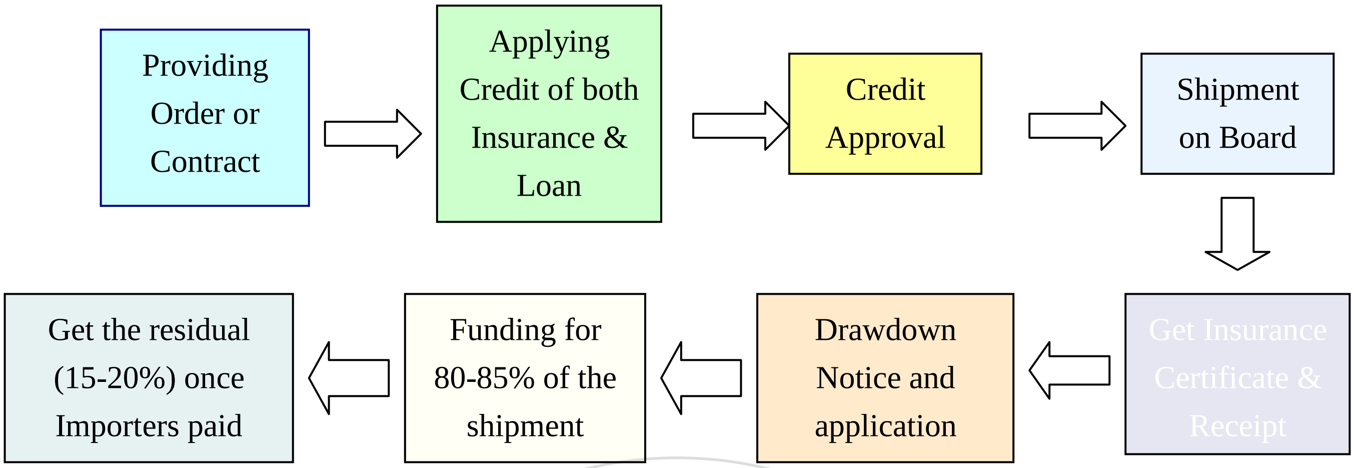

Figure 3.2: Operating Procedure of Export Credit

Based on the cover from Export Insurance, Taiwanese Exporters can apply Export Credit without providing any other collateral. Furthermore, they are allowed to use their original banking account. This is a very different way compared to other commercial banks. In general, banks is very much like to receive deposits as their low interest funding resources and lend the deposits out as banking loans to make profits. Therefore, it is very convenient to apply Export Credit without going through troublesome account-opening procedures.

After signing contracts or getting the order from foreign buyers, exporters can apply both Insurance credit and loan credit. This doings can save time for standard banking procedure. Once got approval from both, exporters can deliver goods to foreign buyers and drawdown loan credit after shipment on board. Thereafter, Exim bank would provide 80 to 85% of total shipment, which are all covered by the credit line of Export Insurance. At the stage, exporters have already got the most part of future payments and naturally avoided Cash Flow Risk and Exchange Rate Risk at this moment.

For example, if the payment term is D/A 90 days after shipment, exporters will get the payment after 90 days from importers. Even with Export Insurance covered the political risk and credit risk of foreign buyers, Taiwanese exporters will still suffer Cash Flow Risk and Exchange Rate Risk in the coming 3 months. Therefore, if exporters could get the most part of payment (80-85 %) from Export Credit after shipment, it is convenient for them to avoid both risks simply by one action. After 90 days, importers will make the payment through the channel of Exim bank and corresponding bank. Finally, Exim bank will calculate the interests and procedure fees and remit the residual payment to exporters.

3.2. International Factoring Service

Like the function of export insurance, international factoring provides the protection for exporters. In general, factoring is defined as the purchase of account receivable on a non-recourse notification basis. The factor assumes to the client's risk on credit-approved sales and client's customers are notified to pay the factor directly. The other definition is that the purchase of credit-approved account receivable from a seller without recourse and with notification to the buyer.

Following the definitions, factoring rely mostly on credit sale basis to sell products or services. There are at least three participants for the service of factoring, such as Factors, exporter, and importer. Factors include import factor and export factor, mainly dealing with risk-taking and purchase business of account receivables. According to the location of factors, they could be classified export factor or import factor. An export factor is responsible for finding business and offer funding for local exporters; an import factor is responsible for receiving the payment and burden the financial risk of importers.

So far, there are three major organizations of international factoring. They are Factors Chain International (FCI), International Factors Group (IF Group), and Heller Group. FCI, held on

1968, is currently the biggest organization with the exposure of more than 53 countries. General Rules for International Factoring[16], the regulations of FCI, has already become the must-know guidelines in the field of international factoring.

3.2.1. The Function of International Factoring

There are four major function of factoring explained as follows:

(1) Taking over the Credit Risk of Foreign Buyers

Exporters could leverage factoring services to transfer 100% of buyer's risk from exporters to factors. Except business disputes happened in the transaction, factors shall be responsible for the future payment once foreign importers fail to make the repayment. Therefore, covering risk of importers is the first function for factoring services.

(2) Funding Purpose

Assignment of credit is the way to do factoring. Most factors provide exporters with funding services. Besides, some exporters apply credit line of commercial banks by using their AR[17] with factoring. Since all the AR is more or less guaranteed and strengthen the payment ability by factors, banks are more willing to offer their credits without a doubt. Therefore, using factoring is a good way to get the funding not only from factors, but also from commercial banks.

(3) Account Management and Collection Services

If a company involves in the field of international business for a certain period, it is natural for a company to steadily build up its clients' pool. However, with the growing number of clients, it will turn out to be very difficult to manage all the clients by shipment. The client management and shipping information will all be taken care by factoring services. Moreover, factoring services also include troublesome AR collection work. In

[16] FCI General Rules For International Factoring retrieved from http://bbs.sinotf.com/thread-2344-1-1.html

[17] AR is the abbreviation of Account Receivables.

every single deal, every factor will prepare Monthly Management Account Report for exporters so that exporters will understand the updated payment situation of each client and have ability to evaluate the credit adjustment of each client.

(4) Providing Consulting Services of the Global Market

Most factors are affiliates or associated companies of commercial banks. Besides, they all join one of the three factoring organizations with global connection. Therefore, exporters could make good use of international factors to not just take care of risk, but also get the business information of the importing countries. Therefore, consulting services and information sharing is another unique service of international factoring services.

3.2.2. The Operation of International Factoring for O/A Term

For the international factoring service, there will be 2 payment terms, such as D/A term and O/A term, suitable for the service. The operation of international factoring and steps of practices are explained as the following figure:

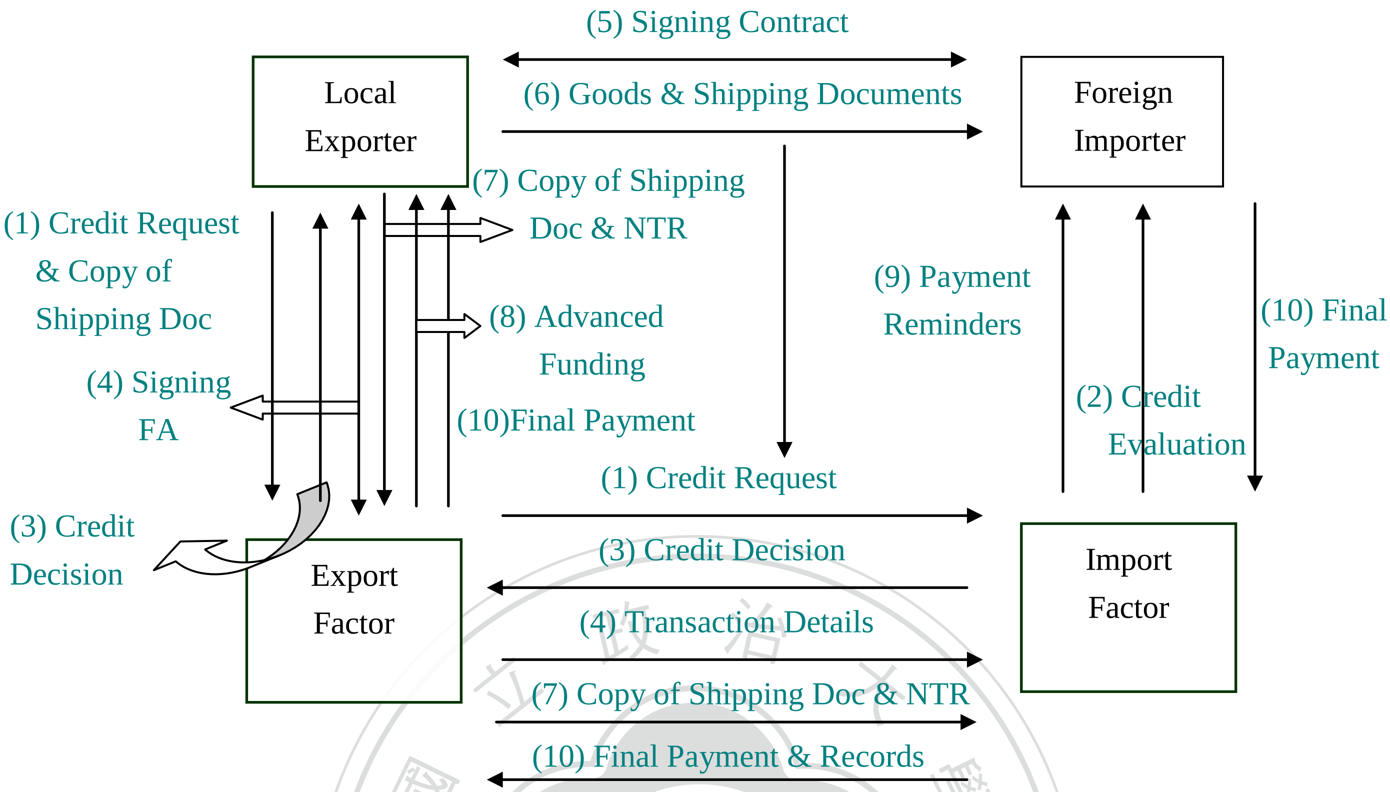

Figure 3.3: Figure of International Factoring for O/A Term

The explanation of international factoring for O/A term

Step 1: Credit Request

The first move of applying international factoring service is to fill out the application and prepare copy of shipping documents to export factor. Then, export factor will pass the credit request to import factor for further review.

Step 2: Credit Evaluation

After receiving the request from export factor, import factor will leverage it resources to check the credit of importers to see if import factor could give any credit for the application.

Step 3: Credit Decision

Once import factor take the risk of foreign importers, import factor will approve a credit line and notify export factor.

Step 4: Signing FA[18]

A factoring Agreement (FA) is an important contract signed by exporters and export factor, which regulate rights and obligation of both sides.

Step 5: Signing contract

After confirming the applied credit of foreign importers, local exporters have less risk exposure because of the protection from export factor and import factor. Therefore, exporters have no doubt of the transactions with unfamiliar buyers and will dare to take new orders.

Step 6: Goods & Shipping Documents

Following the business contract, exporters have to deliver their goods on board to importers with related shipping documents.

Step 7: Copy of Shipping Documents & NTR[19]

After goods on board, exporters must prepare Notification & Transfer of Receivables (NTR) and copies of shipping documents for the information of export factor.

Step 8: Advanced Funding

The most important for companies to leverage the services of international factoring is to get the funding, normally 80% to 90% of the shipment, from export factor as well as to avoid the risk of exchange rate and cash flow risk. Although exporters can only ask for the payment protection, mostly they will also apply the credit from export factor based on the assignment of AR.

Step 9: Payment Reminders

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[18] A factoring agreement is entered into by a factoring firm and a business that wants to sell their accounts receivable at a discount for an immediate cash advance. The customer is also part of the agreement but is not involved in the process because their terms do not change except that they now owe the money to another company. The rate of these agreements will depend not on your business' credit record like loans but on the credit records of your customers.
http://www.interstatecapital.com/factoring-agreement

[19] NTR is the abbreviation of "Notification & Transfer of Receivables".

Just like other credit terms, import factor will take the responsibility of notifying importers to make the payment on time. This is also important both for export factor and local exporters. The reason is that if factor does not receive the payment, factor would suffer loss in the factoring services. As for exporters, they may not get back the remaining amount of money, or even may face the situation of giving back the advance funding once involved in the commercial disputes.

Step 10: Final Payment & Records

The final payment is treated as the payment for very last remaining part of goods, normally 15% to 20% of the whole shipment. Of course, both export factor and import factor would make a record of this transaction for reference of future business.

3.3. Stand-by Letter of Credit

Referred from Farlex Financial Dictionary, Stand-by LC is a statement issued by a bank to the buyer of a good, stating that the seller will receive payment on time and in the correct amount. For example, if the buyer fails to make payment, the bank will do so on his/her behalf. To elaborate further, the issuing bank is at "Stand-by" position – the role to support applicants. Therefore, the essence of Stand-by LC is still similar transaction of O/A term with guarantees by issuing bank. Undoubtedly, Stand-by LC is another trading way of Non-LC payment terms.

3.3.1. Four Major Features of Stand-by LC

According to ISP 98[20], Stand-by LC, once issued, is an independent, irrevocable and binding commitment followed by documents. Therefore, there are 4 characteristics of Stand-by LC as the following points:

[20] The 89 Rules in International Standby Practices (ISP98) offer a precise and detailed framework for practitioners dealing with standby letters of credit. Developed by the Institute of International

(1) Irrevocable Feature

In general, Stand-by LC is not allowed to cancel or modify.

(2) Independence

Following the underlying contract, an applicant will sign the Reimbursement Agreement to commit his/her responsibility to issuing banks. The effectiveness of Stand-by LC is independent from the original business contract and Reimbursement Agreement.

(3) Connection to Documents

Issuing banks shall follow the notification and instructions of shipping documents and verify those documents on their face to see whether Stand-by LC and shipping documents suit for each other.

(4) Binding Commitment

Once Stand-by LC being issued, it has binding power to issuing bank. No matter the issuing fees has been paid or not, issuing banks shall perform and execute the Stand-by LC by the request of beneficiary.

Because Stand-by LC could be used for risk protection, the very important feature of Stand-by LC is independence. Below figure will show the relationship and stands out independence of Stand-by LC. Each party, including applicant, beneficiary, and issuer, is independent from each other and being regulated by different agreements.

Banking Law and Practice, endorsed and published by the International Chamber of Commerce (ICC), ISP98 is the standardized text for the use of standbys worldwide.

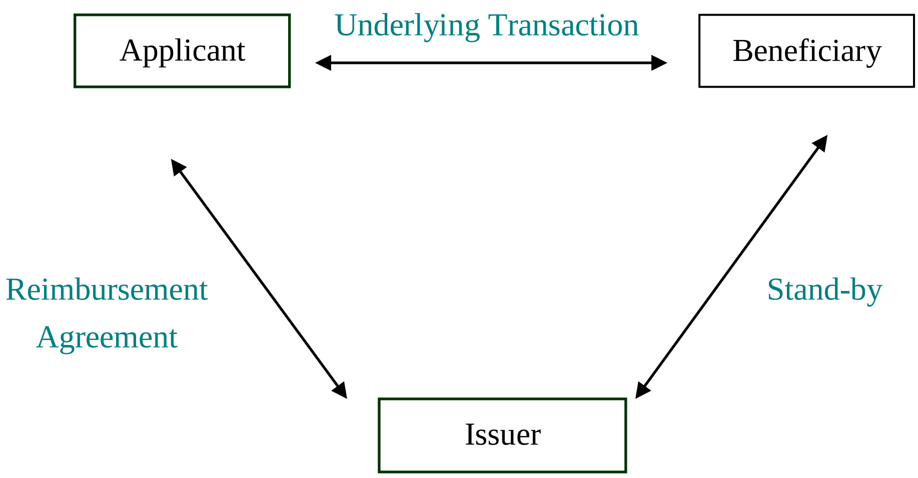

Figure 3.4: Relationship among Applicant, Beneficiary, and Issuer

3.3.2. The Major Types of Stand-by LC

There are at least eight kinds of Stand-by LC as follows:

(1) Performance Stand-by LC

(2) Advance Payment Stand-by LC

(3) Bid Bond Stand-by LC

(4) Counter Stand-by LC

(5) Financial Stand-by LC

(6) Direct Pay Stand-by LC

(7) Insurance Stand-by LC

(8) Commercial Stand-by LC

From the perspectives of Taiwanese exporters, the most common and popular are (5) Financial Stand-by LC and (1) Performance Stand-by LC. Taking the following figure as the example to explain the relationship and the usage of Financial Stand-by LC and Performance Stand-by LC, the first move is the signed contract between export and importer. In case of importer’s bad credibility, exporter would ask foreign importer to apply Financial Stand-by LC and guarantee the payment in the future. Once approved by bank, bank will issue

Financial Stand-by LC as the protection for exporter. However, at the same time, importer is also worried about the failed shipment or cheating from exporter. Importer will ask exporter to issue a Performance Stand-by LC to guarantee the shipment on board. Local bank will also verify the credibility of exporter to see if exporter is qualified to apply and issue Performance Stand-by LC. Because issuing Stand-by LC is similar to the act of providing credit to the applicant, banks will be very careful for verifying the qualification of companies applying Stand-by LC.

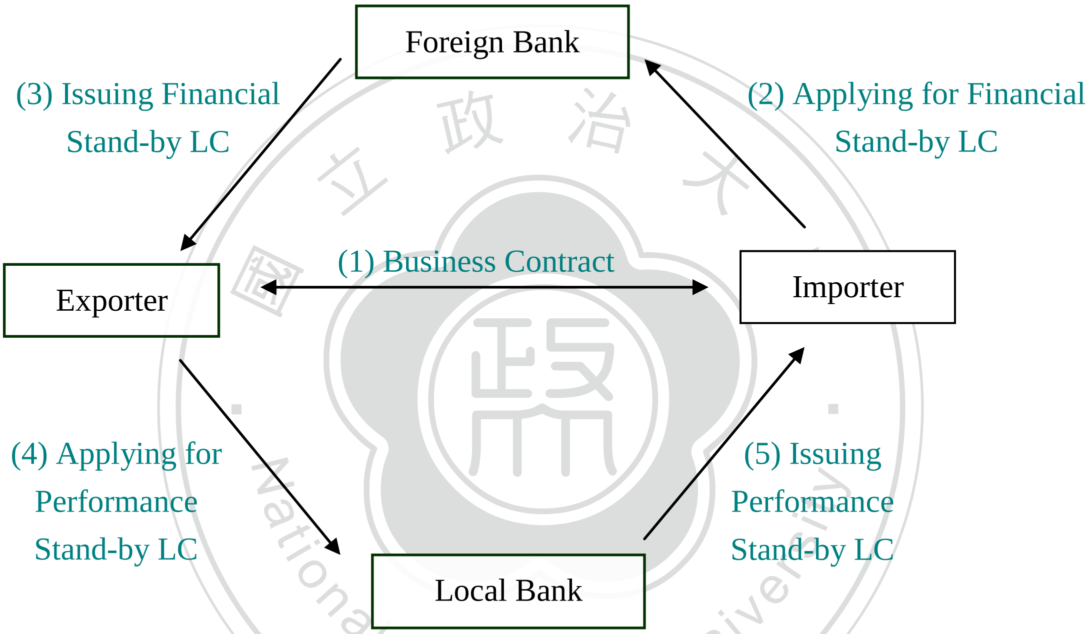

Figure 3.5: Relationship of Stand-by LC

3.3.3. The Attitude of Issuing Banks for Stand-by LC

The function of Stand-by LC is to guarantee the future payment. From the perspective of banks, they are providing credits to applicants. The risk exposure for banks is similar to give a loan. Therefore, the attitude of banks for the Stand-by LC application is definitely prudent with complete credit check and understandings of applicants. Here are the major concerns of banks explained the following 5 P:

(1) People (Borrower)

The most important factor for banks to consider is People. Banks will judge a company by the character of chairperson. Also, the efficiency of management team and financial manager are all careful evaluated by banks in the process of reviewing credits.

(2) Purpose

In general, borrowing purpose is also considered, because borrowers may borrow money for other usage and finally turn out to be a bad loan. However, in the case, the purpose of Stand-by LC deal is no doubt to facilitate the transaction with the function of reducing the worry and uncertainty between exporter and importer.

(3) Payment

Banks will consider the whole asset of a company and its ability of making profits in business. If a company is not good at making money, it will become very difficult for banks to give the credit of issuing Stand-by LC.

(4) Protection

Banks prefer to ask fixed deposits or collateral as the protection of credits, unless the applying company is a big company with perfect financial structure or this company is the subsidiary of famous group, such as AU, Asus, or Foxconn conglomerates.

(5) Prospective

The prospective in terms of industry or products is also the major factor for consideration. For example, solar-cell companies used to be popular in the recent years due to green issue. However, the volatile subsidized policy and the over-supply manufacturing situation has turned the market from the blue sea to the red one, seriously damaging the profitability of solar-tech related companies.

3.4. The Comparison among Financial Tools

After the introduction of three financial tools for risk aversion, Taiwanese exporters shall have clear picture of the operation way and understand each of different financial tools to certain extent. However, there are still some difference among these financial tools as the below table shows.

Table 3.2: Comparison of Financial Tools

	Items	Commercial Credit Insurance	Export Insurance (R.O.C)	International Factoring	Stand-by LC
1	Property	Private	Government	Private	Private
2	Risk Coverage	Credit Risk (80-90%)	Political Risk & Credit Risk (80-100%)	Credit Risk (80-100%)	Credit Risk (100 %)
3	Product Lines	Except L/C insurance	All Products (L/C,D/A,D/P,O/A)	All Products (L/C,D/A,D/P,O/A)	Guarantee Related Products
4	Way of Operation	Package Sale	Case by Case & Package Sale	Case by Case & Package Sale	Case by Case Basis
6	Application	Providing F/S for Credit Checking	Providing F/S for Credit Checking	Through FCI members	Providing F/S for Credit Checking
6	Risk Sense	Fast Pace	Slow Pace	Middle Pace	Middle Pace
7	Target Clients	Big clients	All clients	All clients	Big clients
8	Funding	None	Export Credit	Advance funding	None
9	Collection	Sellers themselves	EXIM Bank of R.O.C	Import Factor	None
10	Limitation	None	Only Taiwanese Clients	None	Local applicants

In addition to Export Insurance, International Factoring, and Standby LC, the table includes Commercial Credit Insurance as the standard for comparison by categories of the following 10 different aspects, such as Property, Risk Coverage, Product Lines, Way of Operation, Application, Risk Sense, Target Clients, Funding Offer, Collection, and some limitation briefly explained as the following:

(1) Property

Except Exim bank is a government-owned institution, else three are typically private-based entity. The only difference between public and private organization is the operating target. Mostly private firms tend to maximize shareholder's benefits and will be more care about price and profit as well. As for public unit, especially Exim bank, the mission is to assist Taiwanese exporters to successfully sell oversea. Therefore, in the case, sometimes exporters may have some room for the negotiation of risk and price.

(2) Risk Coverage

There are two kinds of risk involved in the scope of Trading Risk. One is Political Risk, the other is Credit Risk. Political Risk is uneasy to foresee and unusual to happen. Moreover, once involved in Political Risk, it takes time to fix out and may need to suffer a huge loss until political issues being solved. Therefore, private companies are not willing to take political risk and simply offer the cover for Credit Risk. As for the cover ratio, the ratio (80-100%) is mainly decided on the case by case basis with consideration of different situations. In general, insurers or factors would like to keep every player in the skin of the game so that they could somewhat avoid Moral Hazard[21] of any party who likes to cheat during the transaction.

(3) Product Lines

Commercial Insurance Company is the only one who do not involve in the business of Letter of Credit, because they think the risk and amount of L/C is quite low without much room for making profits. Therefore, they do not offer any product to cover the risk of L/C. Else three would leverage different products and ways to cover all the risk. As for Exim bank and Factors, they separately provide different products to cover L/C risk, such as L/C Export Insurance and Forfeiting service[22].

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[21] Moral hazard occurs when a party insulated from risk behaves differently than it would behave if it were fully exposed to the risk. http://en.wikipedia.org/wiki/Moral_hazard

[22] Forfeiting Service is a method of export trade financing, especially when dealing in capital goods or with high risk countries. In forfeiting, a bank advances cash to an exporter against invoices or

(4) Way of Operation

In the concern of commerce, private insurer tends to win for package sales, which can sharply increase its business achievements. Also, it is much more cost-efficient to do the package deal under the limitation of human resources and administration fees. This principle suits for any institution, including all insurance companies, Factors, and banks. However, one important mission of Exim bank is to assist SME[23]marketing oversea. Therefore, Exim bank has to provide case by case products for the convenience of Taiwanese exporters; Stand-by LC is normally reviewed at the case by case basis.

(5) Application

To start the application, most institutions, including Commercial insurance company and Exim bank, require exporters to provide the financial statements and payment records of importers so that they could verify buyers' credit and risk. As for International factoring, applicants only need to provide simple information of buyers and Factor will leverage its international network through members to see if any foreign import factor will take the risk. In the case, it is not necessary to provide financial statements to Export factor. Lastly, Stand-by LC issuing banks may not ask financial reports of foreign buyers, instead they will ask financial reports of local applicants. The reason is that the risk of Stand-by LC issuing bank are mainly depending on the local applicants- the final firewall of credit/guarantee protection.

(6) Risk Sense

It is common that commercial institutions would be very sensitive and move fast while the situation is going worse. As for government unit, it is normally slower to react not

promissory notes guaranteed by the importer's bank. The amount advanced is always 'without recourse' to the exporter, and is less than the invoice or note amount as it is discounted by the bank. The discount rate depends on the terms of the invoice/note and the level of the associated risk. http://www.investorwords.com/7315/forfeiting.html

[23] In general, the definition of SME is its capital restraint (Under NT$ 80 million) or the current employees (Under 200 people). http://www.tri.org.tw/ceo/

only for the complicated bureaucracy, but also for the poor network and international exposure compared to other organizations.

(7) Target Clients

For commercial companies, business always comes after big clients. Therefore, subject to limited resources, they will only focus on big clients for the profit concern. As for Exim bank, though big clients can bring in a lot of premiums revenues, Exim bank still has to take care of Taiwanese SME. It is more like a policy concern than profit concern.

(8) Funding Offer

Only Exim bank and Factoring companies offer provide funding for those applicants, such as Export Credit and Advance funding. Else institutions will focus on the risk aversion as well as risk protection.

(9) Collection

About collection, none of the institutions will collect once involving in commercial disputes. If not, the applicant shall get prepared of all the shipping document and claim. At the stage of collection and claim, Exim bank and Factors will help for collection through their network, however commercial insurance companies have lower possibility to do the afterwards procedure of collection. The other concern is that sometimes the collection fees and related costs are already more than the shipment loss. In that case, it is not necessary to go through procedure thereafter.

(10) Limitation

Most institutions, except Exim bank, have no special limitation for the qualification of applicants. As long as the buyers or the applicants are good, commercial insurance companies, factors, and issuing banks are all willing to take the risk. As for Exim bank, the foreign entity is not allowed to apply for Export Insurance and Export Loan. Because government resource is scarce, Exim bank has to focus on Taiwanese enterprises, which are already very difficult to take good care of each company. In recent years, Exim bank promoted a special product named “Global- sure”, which could cover Taiwanese OBU companies in some limitation. With the increasing speed of globalization, the nationality of applicants may not still an issue in the international business.

4. Case Study: How Does These Financial Tools Benefit Taiwanese Exporters?

Taiwanese enterprises are well known for the ability of market adaptation, the reaction speed in urgency, well resources application, and management efficiency in this changing environment. There are many ways for companies to leverage, such as Opening a BVI[24] company to get more free room for business as well as reduce financial costs. The paper focuses on the risk related to different payment terms and discusses financial tools as solution. To emphasize the benefits of taking financial tools, this section talks about cases in the real world and wish Taiwanese exporters have deeper understandings and will apply financial tools to avoid risk as well as strengthen their competitiveness. Concern for the trade secret and confidential information, cases will all be introduced by a fake name with some digits adjustment.

4.1. Case Study 1: TronicPower Technology Corporation

TronicPower Technology Corporation (TronicPower) was established t on May, 2007 with registered office at Neihu Dist. Taipei City, Taiwan. TronicPower designs, manufactures and markets a feature-rich line of affordable high-quality Uninterruptible Power Supply (UPS) systems and it is a true manufacturer with several manufacturing facilities. TronicPower employs a fully-staffed R&D department and has a solid ISO 9001 certified supply chain. Based on its proven ability to provide high-quality, reliable products TronicPower offers an industry-leading 3-year warranty on UPS products, rather than the industry standard 2-year warranty.

[24] The Virgin Islands, often called the British Virgin Islands (BVI), is a British overseas territory, located in the Caribbean to the east of Puerto Rico. http://en.wikipedia.org/wiki/British_Virgin_Islands

Regarding the products, TronicPower designs and manufactures a complete line of uninterruptible power supply (UPS) systems to meet the full spectrum of power protection needs from enterprise applications to home office and entertainment systems as the below figures.

The other major product of TronicPower is PV inverter.[25] As the green issue becomes more and more popular in recent years, there is a lot of demand of solar-related products generating with bigger market and higher margin. TronicPower undoubtedly would not give up the good chance, especially TronicPower has already in the power field for many years and the technology of PV inverter is quite similar to the specified technology and know-how of UPS technology.

[25] A solar inverter or PV inverter is a critical component in a solar energy system. It performs the conversion of the variable DC output of the Photovoltaic (PV) modules into a clean sinusoidal 50 Hz or 60 Hz AC current that is then applied directly to the commercial electrical grid or to a local, off-grid electrical network. Because all photovoltaic panels produce electricity in DC, an inverter is required for all solar power systems to make the electricity usable. Solar inverters use special procedures to deal with the PV array, including maximum power point tracking and anti-islanding protection. http://en.wikipedia.org/wiki/Solar_inverter

4.1.1. The Application of Payment Term & Export Insurance

The founder of TronicPower, Mr. Hsieh, has been in the field of UPS for decades with large client base and management experience backed up with abundant knowledge and technology. Most important of all, he is equipped with risk consciousness and knows how to leverage financial tools for risk aversion. To compete with other suppliers, TronicPower need to offer at least O/A 30 days as payment term. Therefore, he depends on Export Insurance to do the risk control and manage a large and growing number of clients, including new or unfamiliar buyers. His logic is clear that if Exim bank could offer the credit of foreign buyers, he will take the order no matter the client is new or small. Here comes the internal procedure of TronicPower.

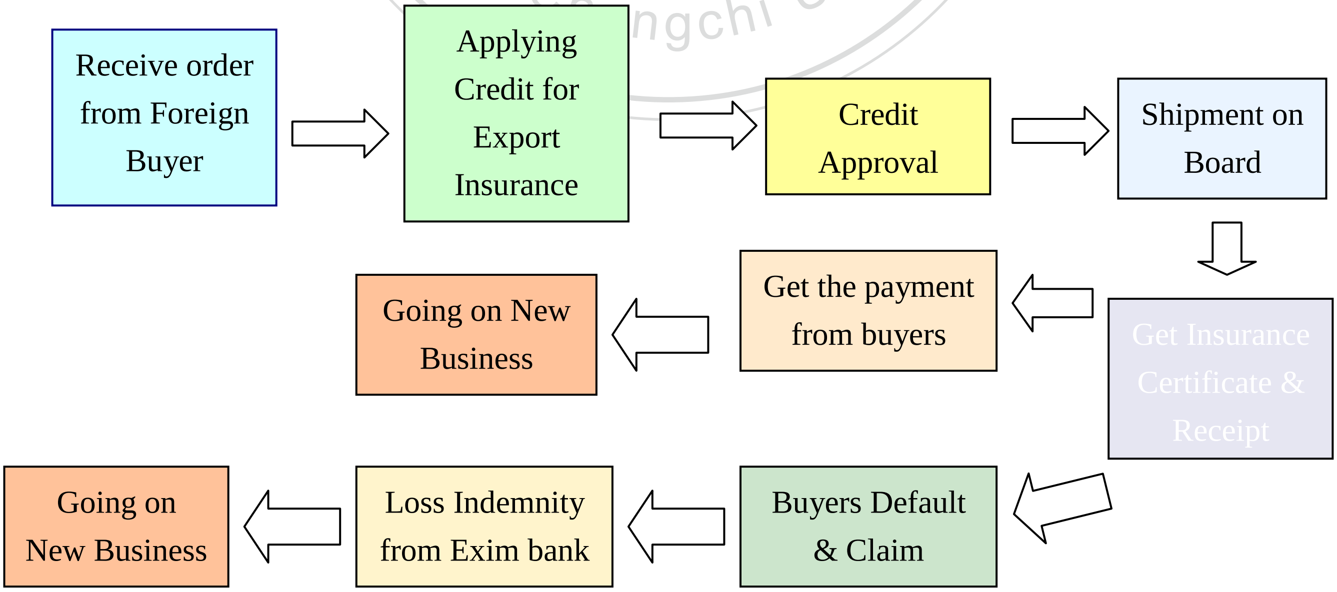

Figure 4.1: Operating Procedure of TronicPower

Based on the risk covered by Export Insurance, TronicPower will be comfortable of any new order from different countries, which will be good for business development.

4.1.2. What does Export Insurance Benefits TronicPower?

When the market goes bad, it is difficult to expect what will happen for the on-going business. Although some may challenge the protection system of Export Insurance is an extra burden of company expense, Export Insurance did help as the following incident. In the real case of TronicPower, there is a German buyer, named Mustek Computer GMBH (Mustek), made UPS 6 orders to TronicPower on June to August, 2009. The amount of 6 orders totaled US$ 479,402.10 with the payment term of O/A 90 days. However, due to the over-debts with weak financial structure, Mustek went bankruptcy on Nov. 2009. Three of the total 6 orders could not be paid because of bankruptcy. The unpaid amount is US$ 203, 096.48 and 80% of them were covered by Export Insurance. After the procedure of application, TronicPower received the amount of US$162,469.58 for loss indemnity as the following formula shows:

$$\boxed{\text{Loss Indemnity} = \text{Net Loss} * \text{Cover Ratio}}$$

To further study, we can go deeper by the following calculation

Table 4.1: Calculation of Risk Coverage and Protection

Item	Formula	Results
Loss Indemnity	US$ 203, 096.48 * 80%	US$ 162,477.18
Premium Being Paid	US$203,096.38 *80% * 0.5 %	US$ 8,123.86
Risk Coverage	= Loss Indemnity	US$ 162,477.18
Protection	US$ 162,477.18 / US$ 8,123.86	20 times

As for risk aversion and benefits are all arranged and explained as the following table.

Table 4.2: Risk Exposure and Benefits of TronicPower

Risk Types	Trading Risk	Cash Flow Risk	Exchange Rate Risk
Risk Exposure	YES	NO	YES
Reaction	Export Insurance Cover 80% of Risk	Export Credit if Necessary	Natural Hedge
Benefits	Loss Indemnity	Advance Funding if Necessary	None

In the case, Export Insurance did cover most of the trading risk- 80% for TronicPower and undoubtedly the loss indemnity is great protection as well as benefits once unpaid event occurred.

TronicPower do not need any funding because of its Zero Debts Policy. In other words, TronicPower is good at controlling and bargaining with its suppliers and clients. Therefore, it can avoid Exchange Rate Risk by hedging naturally.

As for Cash Flow Risk, there is no need for any funding because of Zero Debts Policy. Therefore, TronicPower might not need any cover for Cash Flow Risk. However, TronicPower could still apply for credit limit and get the advance funding if any emergency happened.

4.2. Case Study 2: Taiwan Calcom Graphic Co. Ltd.

Taiwan Calcom Graphic Co. Ltd (TCGC) was founded on July 1992, 19 years until now. The product lines of TCGC focus on plotter, ink, machine and accessories, and related software as exhibited below:

(1) Plotters

(2) Machines and Accessories


Heating Cutter


Mini Welding Machine


Hot Hemming and Welding Machine


Automatic Eye Fastening Machine


Laminator


Heating Trimmer

(3) Ink

TCGC started as an authorized ENCAD inkjet plotter agent in Taiwan and had successfully phased out the traditional plotters by latest inkjet technology. Thus, TCGC brought forth the new age of color output. Thereafter, TCGC was developing professional color imaging system integration and the expansion of product lines continuously. With advanced computer and digital output technology, the printing process and time had been substantially shortened. Besides, the inkjet consumables became more popular that widened the large format output market, speeding up printing and advertisement applications and circulation.

In respect of the blooming vision of image market, TCGC had devoted to the integration from resources. The completely integrated system from inkjet consumable manufacturer to chain store sales system has constructed TCGC a complete and diversified enterprise. With a great success of media innovation and formula, TCGC are able to supply very own media qualified to meet global demand. Currently TCGC markets its products and services all over the world, including Mainland China, Japan, South Korea, Singapore, Malaysia, Thailand, Philippines, New Zealand, Australia, U.S.A, Canada, U.A.E, and so on.

4.2.1. The Application of Payment Term & International Factoring Services

Taiwan Calcom Graphic Co. Ltd is a family-owned business managed by a couple- Mr. and Mrs. Chen. The company is well-organized and divided the work by different specified fields. For example, Mr. Chen takes care of Product Technology and Marketing. As for Mrs. Chen, she is responsible for finance, accounting, and auditing. Since TCGC is middle-sized company already, however the chairwoman is still very prudent in the business with knowledge of risk aversion and international business.

Since Ink-related business has already been a mature market, TCGC have to offer O/A payment terms from 60 days to 120 days, depending on the bargain power of its counter parties. Besides, the 120 days elapse of time will cause pressure to company finance. Sometimes it is not easy to negotiate with the suppliers of TCGC over 45 days of payment term. Therefore, there will supposed to be 75 days of funding gap, which need the help of International Factoring Services as the below figure shows.

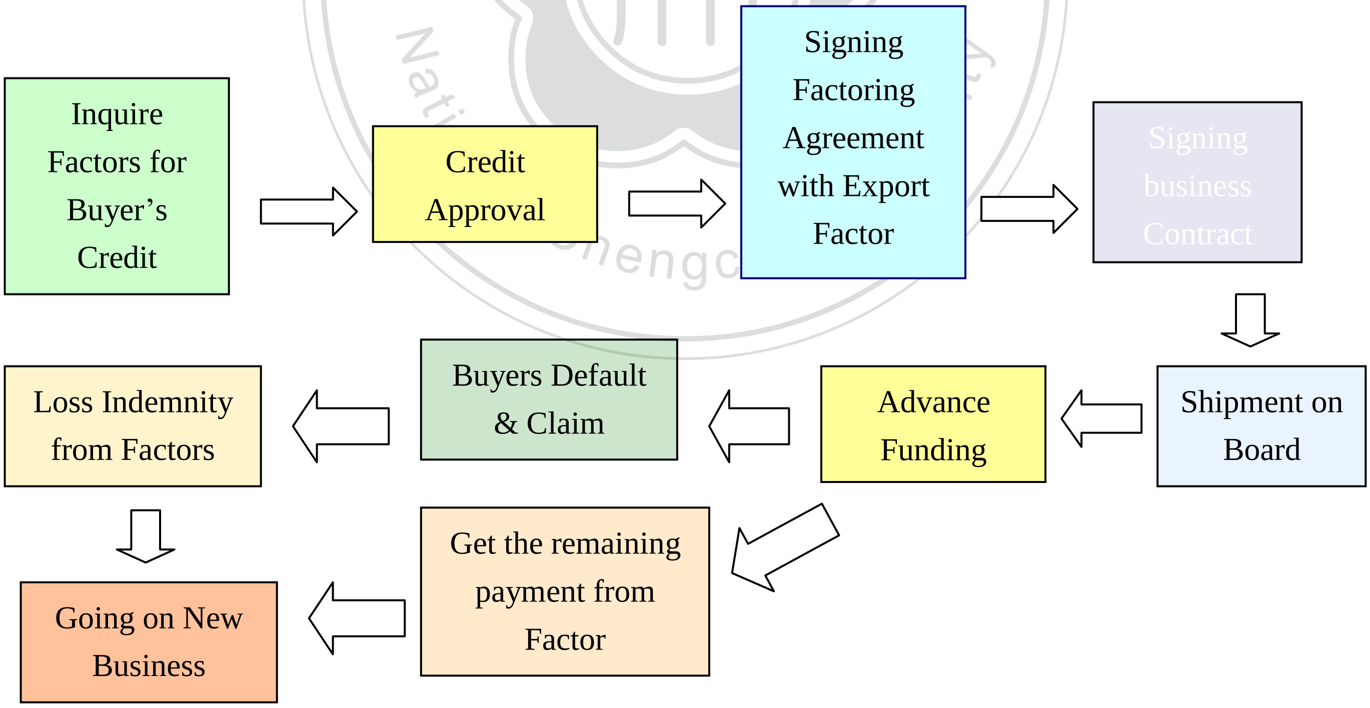

Figure 4.2: Operating Procedure of Taiwan Calcom Graphic Company

4.2.2. What does International Factoring Services Benefits TCGC?

Although the procedure to work with International Factors is more complicated than with Exim bank with many documents needed to be signed before cooperation, International Factors, of course, have other strengths compared to Exim bank. For example, the speed of credit response is a lot faster than Exim bank. In general, they only need less than two week for credit approval, which is quite important for exporters. They will know if they can take the order or give up in a short period of time. Besides, International Factoring sometimes could offer 100% risk coverage of account receivables, which can write off the Account Receivables and beautify the Balance Sheet. As for risk aversion and benefits are all arranged and explained as the following table.

Table 4.3: Risk Exposure and Benefits of TCGC

Risk Types	Trading Risk	Cash Flow Risk	Exchange Rate Risk
Risk Exposure	YES	YES	YES
Reaction	International Factoring Services Cover 100 % of Risk	Cover by Factoring (Finance)	Cover by Factoring (Finance)
Benefits	Loss Indemnity	100% Risk Aversion	100% Risk Aversion

In the case, TCGC needs both credit risk coverage and financial support. Therefore, it is good for TCGC to leverage International Factoring Services with providing credit line of trading risk and loan credit at the same time. Besides, Taiwanese export factor was willing to take 100% AR of TCGC and provide the same amount of credit for TCGC without other limitations. Therefore, leveraging factoring services with the above conditions is the best way for TCGC to cover all risks, including Trading Risk, Cash Flow Risk, and Exchange Rate Risk. Although factors may charge administration fees, which is more expensive than premium of Export Insurance, it is still worthy of applying International Factoring Services on certain circumstances.

4.3. Case Study 3: Miracle Medicare Corporation

Established in 1997, Miracle Medicare Corporation is one of the most well known, highly regarded home medical equipment providers in Asia, delivering complete product lines for Support Surfaces, Respiratory Therapy products, Welfare Equipment and Electronic Medical devices. MMC has established a strong presence in the international market and enjoys an expanding awareness for its brand image in burgeoning markets. The successful products and services springs from the compassion, understanding and careful attention to the human condition. The products- Pneumatic Cushion, Respiratory Therapy Device, Electrical Medical Devices, and Durable Medical Equipment, are all exhibited as the following:

Intensive Care-ACS LAL TURN

CPAP-XT-I

Pulse Oximeters-Fingertip OLED Pulse Oximeter

Mobility-DC-0415 / DC-0416 / DC-0408

4.3.1. The Application of Payment Term & Stand-by LC

Although MMC is very successful in Asia market, the company keeps searching demand all over the world and already selling products overseas, such as Germany, France, Russia, Brazil, South Africa, Turkey, Pakistan, and Bulgaria. In the process of searching buyers, MMC found the strong medical demand with potential market in Iraq.

Iraq is well-known for the 3rd oil reserve in the world with abundant farming and mining resources. An April 2009 estimate of the total Iraqi population is 31,234,000 with territory bigger than Taiwan by 12 times. However, since 1990, Iraq has been through Persian Gulf War twice with many events happened during this period, including the war between USA and Iraq, internal disorder, embargo from UN, and disconnection from foreign trade. In the situation, Iraq has to import goods through Jordan and Iran, which is inconvenient and less margins for Iraq importers. Therefore, with stable political and economic situation goes in Iraq, Iraq merchants started to actively do business without the intermediary so that they can make more profits with less limitations. This ongoing situation gave the great opportunity for MMC to step in the new potential market. Although Iraq market was still full of uncertainty, MMC got in the market since 2004 and set up a function-well funding and logistics system to facilitate its products and successfully built up its local connections in this Iraq market.

Due to the fame and word of mouth, MMC got the attention of Iraq government, which would like to leverage MMC to acquire goods and materials for reconstructions. In 2007, Iraq received the financial support from United Nation and soon sought MMC to import medical goods. However the description of payment term written in the business contract by Iraq is stated as the following:

(1) Advance Payment: Ten (10) percent of the Contract price shall be paid within thirty (30) days of signing of the Contract, and upon submission of claim and a bank guarantee for equivalent amount valid until the Goods are delivered and in the form provided in the bidding documents or another form acceptable to the Purchaser.

(2) On shipment: Eighty (80) percent of the Contract Price of the Goods shipped shall be paid within thirty (30) days of receipt of the documents specified in this contract clause. The payment will be through a direct payment from the World Bank to the supplier Bank account upon instruction from the purchaser.

(3) On Acceptance: Ten (10) percent of the Contract Price of Goods received shall be paid within thirty (30) days of receipt of the Goods upon submission of claim supported by the acceptance certificate issued by the Purchaser.

Briefly conclude the above contract clauses, MMC can only receive 10% down payment before shipment, and the rest 80% will be received 30 days after cargo arrival. The remaining 10% will be paid after the acceptance of imports testing.

This kind of clause is not a good term for MMC. Iraq, compared to other countries, still faced a lot of uncertainty in terms of politics and social issues. What if things go wrong after shipment, such as Internal Disorder or War, MMC may not be able to get the 90% payment.

4.3.2. What does Stand-by LC Benefits MMC?

It is always difficult to negotiate with government by its own purchase deal. In the case, although MMC won a big order from Iraq government, MMC still had to overcome lots of trading barrier, especially the coverage of Political Risk for Iraq government. Why MMC wants to apply Stand-by LC, instead of other financial tools, for this transaction? To further explain and know the reason, please refer to below table by possible solution of negative list.

Table 4.4: Possible Solutions for MMC

	Solution	**Cover Risk**	**Limitation**	**Solution?**
1	Commercial L/C	Credit Risk of Issuing Bank	* Not enough credit limit. * No willingness to take any risk once related to political issue.	NO
2	Commercial Insurance	Credit Risk for Buyer	* Do not cover political risk	NO
3	Export Insurance	Both Political and Credit Risk for buyer	* Difficult to offer enough credit limit in terms of political and credit risk in the case.	NO
4	International Factoring	Credit Risk for Buyer	* Do not cover political risk	NO
5	**Stand-by LC**	**Both Political and Credit Risk for buyer**	*** Political and Credit Risk will all covered by an issuing bank.**	**YES**

5. Conclusion

Taiwan has been well-known for IT industry and economic miracles for the past few decades. This was a great chance and advantage for Taiwan to develop and become the finance and technology center of Asia Pacific at that time. However, due to the political issue, Taiwan government shut the door for 8 years, from 2000 to 2008. Besides, mass media only reports news inside the island without too much exposure of international news. At the special circumstance, it is difficult for Taiwanese and Taiwanese companies to absorb oversea information as well as international trend of politics and economy, not to mention to understand foreign market and clients. Therefore, the very first suggestion to Taiwanese exporters is to fully understand international politics and market trend so that they could get prepared when the situation goes wrong and adjust their strategy to fit in with the market and react at the first moment.

The second suggestion for Taiwanese exporters is to be familiar with all kinds of trading formats, payment terms, and financial tools. For example, Taiwanese exporters can apply different payment terms, such as Usance L/C 90days after acceptance, D/A 60 days, or O/A 45 days, pricing by the level of risk exposure. In the case, foreign buyers can depend on their need and take the payment term they want by this diversified pricing offer.

In Chinese world, relationship is very important for successful business. With the mutual trust built up on relationship, Taiwanese companies will sometimes simply have oral agreement without any legal contracts. However, contract not only is the rules to regulate the right and obligation of both seller and buyer, but also the major legal certificate while involving in commercial disputes. Therefore, the third suggestion for Taiwanese exporters is to emphasize the contents of business contract so that they have clear rules to follow when facing disputes.

Last but not least, Taiwanese exporters better leverage financial tools to increase competitiveness in the world market without a doubt. However, it is difficult for some inexperienced companies to choose the appropriate tool if they have never got involved in the procedure or truly understood the professional knowledge and practice in the trade field. Therefore, the arrangement of recommendations as the below table gives the information to Taiwanese exporters when considering the usage of financial tools.

Table 5.1: Recommendations under Different Conditions

	Conditions	Recommendation
1	SME for Emerging Markets	Commercial LC / Export Insurance
2	SME for Mature Markets	Export Insurance / Factoring
3	Multi-national or Big Companies	Commercial Insurance / Factoring
4	Political Issues with Small Amount	Export Insurance
5	Political Issues with Huge Amount	Stand-by LC
6	Companies with Funding Demand	Export Credit / Factoring
7	New Clients or New Order	Commercial LC / Export Insurance
8	Urgent Need for Credit	Commercial Insurance/ Factoring
9	Financial Crisis or Market Failure	Export Insurance
10	Cost Concern	Commercial Insurance / Factoring

The above criteria are general recommendations under certain conditions. Each company has its own concern with different considerations. Taiwanese Exporters shall leverage as many as possible as possible depending on different buyers, markets, products, and timing. Most important of all, Taiwanese companies are recommended to cooperate with Export-Import Bank of R.O.C. Because Exim bank is a state-owned bank with stable policy and support, companies will still get the steady assistance in terms of credit and financial support when suffering systematic risk or financial crisis.

The final recommendation for Taiwanese exporters is to build up relationship with Exim bank, factors, banks, and other insurance companies at the same time so that they could apply the product or services they need as well as spread different types of risks to different institutions.

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