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The low-risk nature of Trade Finance for Albanian traders

Dorina Çumani[1]

Abstract— This paper will bring to the Albanians trader attention the most important instruments of Trade Finance. Also, this paper will focus on the usage of TF instruments, the reasons that Albanian traders must use them and why they have a low-risk nature. TF instruments are built to protect international traders from different shapes of risks in international trade. Where, the most important players are exporters, banks and importers. Firms or companies by shortening the time of production, delivery, approved credit, the risk situation can be improved and in the same way as liquidity and profitability. If Albanian traders control the risks they can expand exports into new markets and it can be very profitable.

Index Terms — Albanian traders, Trade Finance, Export, Import, Banks, Instruments, Risk.

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1 INTRODUCTION

Developing and transitional economies need to take a critical look at their trade policies. Facilitating their trade has become more indispensable in this era of globalization than ever. Developed economies have through trade facilitation succeeded in developing their firms and industries and equipping them with the ability to trade in almost all parts of the world to their advantage. This global competition challenges the competitive edge of domestic firms even in their home markets and Albania is no exception to this development. Trade finance refers to innovative, custom-engineered financial instruments and services that fulfill a country's import and export needs. Trade finance is not like regular commercial bank lending, insurance mortgage or lending. The words, "innovation and custom-engineered" are very vital to the development of any successful trade finance products. Albanian traders are looking for any competitive advantage such as increasing their sales or to extend to other markets. Trade finance has flexible payments terms that make a product more competitive. Given a similar product form different countries, product financing can make the difference as to whether a sale will be made or lost. In other way, interest rate and other fees has a strong effect on price and can make a product very noncompetitive in the international market. These factors are therefore to be adjusted because left to market force their movements could be in the reverse direction and render the country's products noncompetitive[11]. This paper discusses the issue of trade finance as a tool for effective trade facilitation. It will first attempt to provide a definition, the trade risk, the main layers in trade finance and an overview of the subject matter; it will then proceed to show how trade finance instruments works and how much riskily they are.

[1] Dorina Çumani ,
European University of Tirana, Albania
dorinacumani@gmail.com

2. WHAT CAN DO TRADE FINANCE FOR ALBANIAN TRADERS?

2.1 International trade risk

All, firms- SMEs or Companies contain elements of risk but when they trade internationally, the risk profile is different than trading home. By shortening the time of production, delivery, approved credit, the risk situation can be improved and in the same way as liquidity and profitability. **[3]** If Albanian traders control the risks they can expand exports into new markets and it can be very profitable. So, is important the exporters and the importers take the risk assessment. The risk could have different shapes and forms that could affect both sellers and buyers. Main trade risks in international trade are: product production and transport risk, commercial risks, political risks, adverse business risks, currency risks, financial risks.

2.1 Risks in international trade (souece Unescop)

Risk Category	Economic (commercial) risks related to the trading partner	Exchange rate risk	Transportation risk	Political risks		
				Foreign policy	Domestic policy	Economic policy
Examples	Importer is not willing or unable to pay Importer does not accept merchandise Exporter does not deliver on time or products agreed	Floating exchange rates: variations in exchange rates Fixed exchange rates: risk of devaluation	Damaged or loss of goods	War Embargo Restrictions	Revolt Civil War	Prohibition to transfer foreign exchange Currency declared non-convertible

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2.2 Main players on Trade Finance

The main players in international trade combine their respective skills to ensure successful transactions and the reduction or elimination of risks which are ever-present in trading. International trade transactions are financed at some point, principally by banks specializing in this activity. These activities protect against risks during all stages of transport up to the destination. For the exporter, main risks are non-payment or late payment which affects cash flow. For the importer, faces the risks of non-delivery, short delivery and delivery of goods. To protect themselves against default by buyers and against political risks, traders are able to take trade finance instruments. The most important players are exporters, banks, importers. The importance of the role played by banks in trade finance cannot be underestimated. They provide services to every operator in the trade chain and for every stage of any transaction. Banking instruments and techniques are made available with worldwide including Albanians traders. The rapid growth of world markets owes much to the ability of these financial institutions to adapt to change, to keep pace with development and to maintain a high level of skill in handling transactions. In addition to finance, banks provide a number of support services essential to exporters and importers wishing to enter new markets. Credit and status reports on foreign operators, advance details of overseas contracts and government tenders are regularly supplied to customers seeking trading opportunities. [4]

2.3 Financing trade

Commonly two main types of financing for firms are distinguished: long-term and short-term financing. Long-term financing is usually needed for the production of goods or other investments while short-term financing bridges the time gap between the shipment of a good by the exporter and the reception of a good by the importer. The short-term credits for companies through trade finance normally have a maturity of up to 180 days but can be extended to 360 days (Auboin and Meier-Ewert, 2003).
Short-term credit trade financing is crucial for international trade since it makes sure that the movement of goods is backed up with sufficient fluidity and security for the participating trade partners. The availability of financing during the goods transportation period allows trading companies did not have to use their own cash flows for the transportation financing as instead they can finance for instance their production. It is hard to imagine world trade without any kind of trade finance since 80% to 90% of all world trade is relying on some kind of trade financing, including insurance and guarantees (Auboin, 2009).
The role of the bank as an intermediary is crucial as it provides not only a guarantee of payment but also makes sure that each party involved receives its service right after they complete their part of the contract. The bank hence assumes the risk of the transaction and provides working capital loans.
Alternatively, banks can also provide other forms of credits to only the exporter or only the importer so that the firms have enough working capital available to cover the time gap of the goods transportation. In case an advance payment is given to an exporter, this is referred to as pre and post-shipping financing. If an importer is given a loan to finance its acquisition of goods, this is called a buyer's credit. There are of course also other types of trade financing but they work according to the same principles (Auboin and Meier-Ewert) (2003) .

2.4 According to the theory, trade finance is defined:

Trade and Supply Chain Finance facilitates[1] timely and secure payment across borders, provides financing, enables the effective management of risk, and supports information flow between partners in a transaction. The emphasis on each of these elements will vary with each relationship and/or transaction.

Trade finance is a specialized and potentially complex type of financing. Effective communication and well-managed relationships with trade bankers and other trade financiers can prove invaluable to businesses of all sizes and levels of expertise, in navigating the uncertainties of international markets.[1]

Trade and supply chain finance are more than enablers of international business and trade; more than merely transactional solutions limited to the flow of money across borders. Trade and supply chain finance are highly strategic elements of the successful pursuit of business opportunities in international markets, at every stage of a given trade deal, and throughout the lifecycle of a trading relationship.[1]

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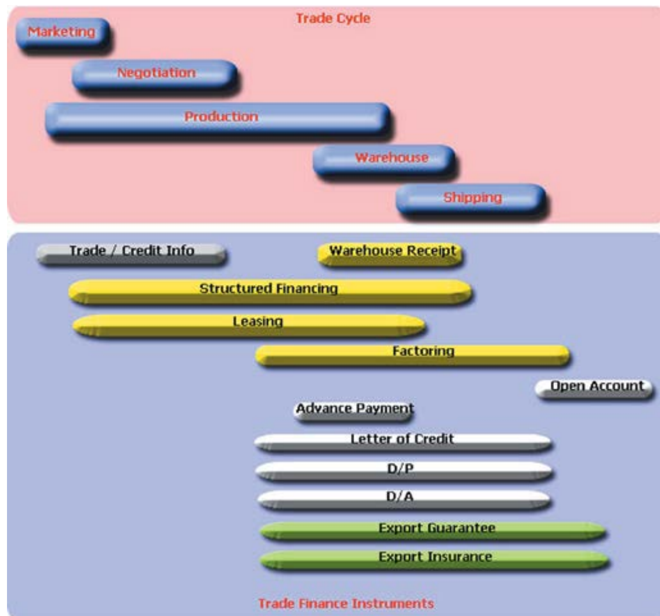
3. Trade cycle and trade finance methods and instruments



- Methods and instruments to raise capital (in yellow in figure 3.1)
- Methods and instruments to mitigate risks (in green in figure 3.1)
- Methods and instrument to effect payment (in light grey in figure 3.1) (Source Unescop)

The most useful TF instruments

3.1. Cash-in-Advance

With cash-in-advance [5] [6] [7] payment terms, an exporter can mitigate credit risk because payment is received before the goods are transferred. Wire transfers and credit cards are the most commonly used cash in advance options available for Albanians exporters. For small export transactions are cash-in-advance by the internet.
There are two problems: requiring payment in advance for the buyer it creates unfavorable cash flow and in another way the goods may not be Assent if payment is made in advance. These way exporters may lose to competitors who offer more attractive payment terms. Wire transfer in Cash-in-advance is the most secure and least risky method of international trading for exporters and the least secure and an unattractive method for importers. Payment before sending the goods eliminates the risk of non-payment.
Cash-in-Advance is recommended for use in high-risk trade relationships or export market. Cash-in-Advance is appropriate for small export transactions. Use it when the importer is a new customer and/or has a less-established operating history. The importer's creditworthiness is doubtful, unsatisfactory, or unverifiable. The political and commercial risks of the importer's country are very high. The exporter's product is unique. The exporter operates an Internet-based business where the payments with credit card are a must to remain competitive.

3.2. Letters of Credit

Letters of credit (LCs) [5] [6] [7] are one of the most secure instruments available to international traders. An LC is an instrument that the bank on behalf of the importer provides that payment will be made to the Albanian exporter provided that the terms and conditions stated in the LC have been met, as specified the documents. The buyer establishes credit and pays his or her bank for this service. An LC is useful when credit information about a foreign buyer is difficult to obtain. Also, protects the buyer until the goods have been shipped as promised.
The importer pays his bank a fee for this service. In a case when the buyer may negate payment to the exporter, documents should be prepared by trained professionals or outsourced for these kinds of instruments.
An LC also is a contractual agreement whereby the issuing importer's bank, acting on behalf of its importer or buyer, promises to make payment to the exporter against the receipt the documents. The LC is a separate contract from the sales contract where the banks are not responsible for the quality of the goods or whether each party fulfills the terms of the sales contract. In LC transactions, banks deal in documents, not goods. Unless the conditions of the LC state the document may not be changed or canceled unless the importer, banks, and exporter agree.
Recommended for use in higher-risk situations. New trade relationships or less established relationships. The risk is spread between exporter and importer, provided that all terms and conditions as specified in the LC are fulfilled too. Payment made after the goods were sending.

3.3. Documentary Collections

A documentary collection (D/C) [5] [6] [7] is a transaction where the exporter entrusts the collection of the payment for a sale to its bank, which sends the documents that its buyer needs to the importer's bank. They are the instructions to release the documents to the buyer for payment. Funds are received from the importer and remitted to the exporter through the banks involved. D/Cs involves using a draft that requires the importer to pay on a specified date (document against acceptance). The collection letter gives instructions that specify the documents required for the transfer of title to the goods. Although banks are facilitators for their clients, D/Cs offers no verification process and limited recourse in the event of non-payment. D/Cs is less expensive than LCs and less complicated. The import-

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er is not obligated to pay for goods before sending the goods. The exporter's bank and the importer's bank play a crucial role in these instruments and banks do the transactions less riskily for both.

3.4. Open Account

An open account[5] [6] [7]transaction is a sale where the goods are shipped and delivered before payment is due, which in international sales is typically in 30, 60 or 90 days. This is one of the most advantageous options in terms of cash flow and cost for the importer, but it is consequently one of the highest risk options for the exporter because exporters may lose a sale to their competitors. Albanian exporters can use one or more of the appropriate trade finance techniques to mitigate risk. They can seek extra protection using export credit insurance during is offering open account terms. Open account terms may help win customers in competitive markets also, may be used with the appropriate trade finance techniques that mitigate the risk of non-payment.
Open account is recommended for use in low-risk trading relationships or markets; in competitive markets. Boost competitiveness in the global market. Help establish and maintain a successful trade relationship.

3.5. Consignment

Consignment [5] [6] [7]in international trade is a variation of open account in which payment is sent to the exporter only after the goods have been sold by the foreign distributor to the end customer. An international consignment transaction is based on a contractual arrangement in which the foreign distributor receives, manages, and sells the goods for the exporter who retains title to the goods until they are sold. For the exporter shipping with consignment is very risky because is not guaranteed any payment and its goods are in a foreign country, in the hands of an independent distributor. Consignment helps exporters become more competitive boost the availability of faster delivery of goods. Selling on consignment help Albanian exporters reduce the direct costs of managing inventory and storing. The key to success in exporting on consignment is to partner with a reputable and trustworthy foreign distributor or a third-party logistics provider and an appropriate insurance should be in place to cover consigned goods.

3.6. Export Credit Insurance

Export credit insurance (ECI) [5] [6] [7] protects an exporter of products and services against the risk of non-payment by importers, or reduces the payment risks associated with doing business internationally. This way exporter can increase export sales, establish market share in emerging and developing coun¬tries, and compete more vigorously in the global market.
ECI generally covers commercial risks: such as protracted defaults/slow payment, or insolvency of the buyer, bankruptcy. Political risks: such as terrorism, war, revolution, and riots that could result in non-payment. ECI also covers currency inconvertibility, expropriation, and changes in import or export regulations. ECI is offered either on a single-buyer basis or on a portfolio multi-buyer, for short-term and medium-term repayment periods. ECI while minimizing the risks for the users allows exporters to offer competitive open account terms to foreign buyers. ECI is recommended for using in conjunction with open account terms and pre-export working capital financing.

3. 7. Export Factoring

Export factoring [5] [6] [7] is a complete financial package that combines export working capital financing, credit protection; foreign accounts receivable bookkeeping, and collection services. A factoring house is a bank or a specialized financial firm. These perform financing through the accounts receivable and purchase of invoices. Export factoring is an agreement between the factor and exporter. In this agreement the exporter's short-term foreign accounts receivable for cash at a discount from the face value, normally without recourse. The factor also assumes the risk of the ability of the foreign buyer to pay and handles collections on the receivables. Thus, by virtually eliminating the risk of non-payment by foreign buyers, factoring allows the exporter to offer open account terms, boosts competitiveness in the global market and improves liquidity position. Factoring foreign accounts can be an alternative to export credit insurance, expensive short-term bridge loans; other types of borrowing that create debt on the balance sheet and long-term bank financing.

8. Forfeiting

Forfeiting [5] [6] [7] is a method of trade finance that allows exporters to obtain cash by selling their medium and long-term foreign accounts receivable at a discount on a "without recourse" basis. A forfeiter is a specialized finance firm or a department in a bank that performs non-recourse export financing through the purchase of medium and long-term trade receivables. "Without recourse" or "non-recourse" means that the forfeited assumes and accepts the risk of non-payment. The current minimum transaction size for forfeiting is $100,000. Small and medium-size companies become more aggressive in seeking financing solutions for exports to countries considered high risk because they are slowly embracing forfeiting.

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Forfeiting eliminates virtually all risk to the exporter. Forfeiting financed 100 percent of contract value. Forfeiting generally works with a letter of credit, bills of exchange, or promissory notes. Forfeiting is recommended for exports of capital goods, commodities, and large projects on medium and long-term credit, 180 days to seven years or more.

Choosing between payment contracts is central for firms to adapt to diferent constellations of financial conditions in diferent country pairs and over time. Limiting this choice can reduce traded quantities signifcantly, increase prices, and reduce the ability of exporters to react to short term uctuations in fnancial conditions. [10]

4. What the data says?

4.1 Analysis

The 2015 Trade Register clearly demonstrates the low-risk nature of trade finance:
Export letters of credit, provided by issuing banks to guarantee payment, saw the lowest transaction default rate at just 0.01 percent;

Import letters of credit, provided by the receiving bank, saw a 0.08 percent default rate.
Import and export loans saw a 0.22 percent default rate.

Customer default rates landed at 0.04 percent for export letters of credit,

0.29 percent for import letters of credit and 0.72 percent for import and export loan products.

Businesses, often SMEs that need these products to manage working capital, saw a lower transaction default rate than financial institutions (0.68 percent versus 1.43 percent).

Product	Transaction default rate	Exposure weighted default rate	Obligor default rate	Moody's rating for comparable default rate
Export L/C	0.01%	0.02%	0.04%	Aaa - Aa
Import L/C	0.08%	0.07%	0.29%	Baa
Performance Guarantees	0.17%	0.11%	0.43%	Baa - Ba
Loans for Import / Export	0.22%	0.17%	0.72%	Ba

4.1 Analysis of short-term trade finance data in the Trade Register

The data says that trade finance have a low risk nature and use its instruments brings to the traders centarnty that their trasctions would be performed.

We analyse customer, transaction and exposure weighted default rates but with a breakdown by region. A granular breakdown of how specific countries have been classified into regions. The highest default rates can be observed in the Middle East due to the sanctions introduced in Iran. Additionally there are significantly higher default rates in the ex-CIS region driven by the defaults in Ukraine and Kazakhstan. In this context it is important to note that these significant variations in default rates are largely due to idiosyncratic shocks. However, it is fair to say that idiosyncratic shocks such as sanctions and political conflicts mostly arise in certain regions of the world, hence rendinsome regions naturally more risky than others. [8]

Customer default rate by region of risk, 2007–2014

Region	Total obligors	Total obligors in default	Obligor default rate
Africa	1,481	6	0.41%
APAC	2,506	11	0.44%
Central and South America	1,657	14	0.84%
Europe (non-CIS)	2,776	15	0.54%
ex-CIS	3,947	50	1.27%
Middle East	1,161	33	2.84%
North America	1,222	0	0.00%
Total	**14,705**	**129**	**0.88%**

Transaction default rates by region of risk, 2007–2014

Region	Total transactions	Transactions for obligor in default	Transaction default rate
Africa	3,831	15	0.39%
APAC	7,482	22	0.29%
Central and South America	4,226	21	0.50%
Europe (non-CIS)	6,041	22	0.36%
ex-CIS	6,159	79	1.28%
Middle East	3,379	82	2.43%
North America	2,692	0	0.00%
Total	**33,810**	**241**	**0.71%**

Exposure weighted default rates by region of risk, 2007–2014

Region	Total Exposure ($MM)	Total defaulted exposure ($MM)	Exposure default rate
Africa	56,491	126	0.22%
APAC	126,333	196	0.15%
Central and South America	75,219	117	0.16%
Europe (non-CIS)	110,319	252	0.23%
ex-CIS	61,198	674	1,10%
Middle East	55,989	666	1,19%
North America	58,770	0	0.00%
Total	**544,319**	**2,030**	**0.37%**

Tab.4.2, 4.3, 4.4 (Trade Register analysis)

Variation in the use of trade finance across countries also suggests that the efect of financial shocks on trade is not uniform but depends on country characteristics.[9] Depends on macroeconomic factors, countrie risk, financial development ext.
For example:

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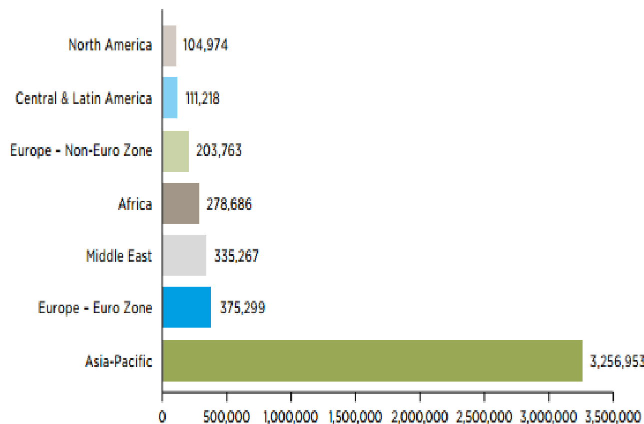

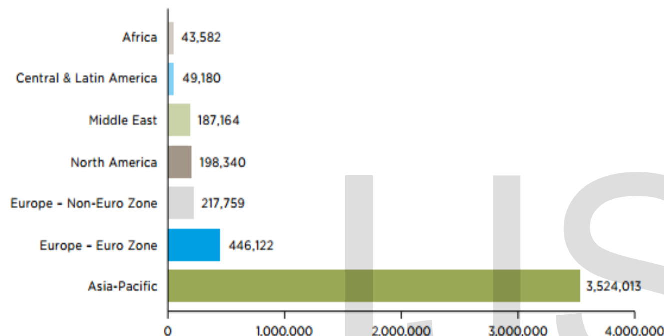

4 CONCLUSION

All authors and financial institucions are agreed that Trade Finance instruments have a low-risk nature.
They mitigate international trade risk.
They have a large colletion where Albanians traders can choose the right instrument for their needs: instruments to raise capital ,instruments to mitigate risks or instrument to effect payment.
Using TF instruments, Albanian traders boost competitiveness in the global market, establish and maintain a successful trade relationship.

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