HORTICULTURAL TRADE FINANCE: *Tying Western Counter Parties into the Deal*

BY

EDWIN MASIMBA MOYO[1]

UNCTAD, GENEVA
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[1] CEO Global Financial Services Inc.

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HORTICULTURAL TRADE FINANCE : TYING WESTERN COUNTER PARTIES INTO THE DEAL

1.0 EXECUTIVE SUMMARY

Horticulture Exporters in developing countries especially in Africa, usually wait for an average of between 45 – 60 days before they receive payment for their goods from their major buyers in OECD countries. During this waiting period, they have to borrow locally to pay their creditors as well as for working capital purposes so that they can remain in operation and produce for new export orders. In most cases, overdraft[2] facilities are used for such purposes. However, most times, their financing needs are not fully met by these facilities, and not always on time. As such, this makes it difficult for them to efficiently plan for orders and manage costs effectively. Thus, this situation drastically affects their abilities to meet orders and manage costs effectively. Moreover, banks sometimes, in managing concentration risks, are not willing to support this sector notwithstanding its growth potentials.

On the other hand, buyers in OECD countries are generally mindful of their own cash flows which could be affected by making up-front payments through letters of Credit[3] or pre-payment[4] which are conditional before goods are shipped. Usually, it takes between 30 – 90 days before they receive the imported goods. Some horticultural exporters in Zimbabwe used to enjoy pre-financing at the discretion of the buyers while others even obtained loans in advance from banks before shipping their produce. This system has since been discontinued because of Zimbabwe's low credit rating on the international market.

By paying up-front for goods (through cash collateralized L/Cs), which are deliverable only after 30 – 90 days, the buyers are subjecting themselves to increased working capital costs through borrowing up-front to finance the importation. They will also be paying in advance for goods whose benefit will only be realised when the goods are sold.

It is for this reason that foreign buyers in the Horticultural Sector (supermarket chains, auction floors and traders) are not willing to open letters of Credit to their sellers, in this case, African Exporters, but prefer to

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[2] Overdraft: Provision of instant credit by a lending institution, i.e. the amount by which withdrawals exceed deposits, or the extension of credit by a lending institution to allow for such a situation.

[3] Letter of credit (or Documentary Credit): It is an undertaking issued by a bank (Issuing bank) for the account of the buyer (the Applicant) or for its own account, to pay the Beneficiary (the Exporter) the value of the Draft and/or documents, provided that the terms and conditions of the Documentary Credit are complied with.

[4] Pre-payment: payment for goods or services prior to receipt.

operate on open account[5], which is a simple method of paying cash on delivery of goods.

This situation has left horticultural exporters in Africa with no choice than to source for funds to generate exports and thereafter expect payments by the buyers. Unfortunately, in the horticulture market, the *buyer calls the shots*. In effect, the exporters seek funding at "all costs" to meet their export orders. This paper, therefore, seeks to demonstrate how horticultural exporters in developing countries, especially Africa, can obtain cheaper sources of finance through **Forfaiting**, thereby bringing buyers into the funding arrangement, somehow.

2.0 FORFAIT FINANCE

2.1 What Is Forfaiting?

Forfaiting is the purchase of a trade debt or receivable, at a discount, without recourse to the exporter or previous holder if the negotiable instrument evidencing the debt is not paid at maturity by the obligor or guarantor. The term forfait originated from the French word forfait which means to give up. In this circumstance, it means to give up one's rights to receive payments under the underlying transaction, i.e. the seller giving up his rights to receive future payments to the forfaiter in consideration for a discounted value received immediately

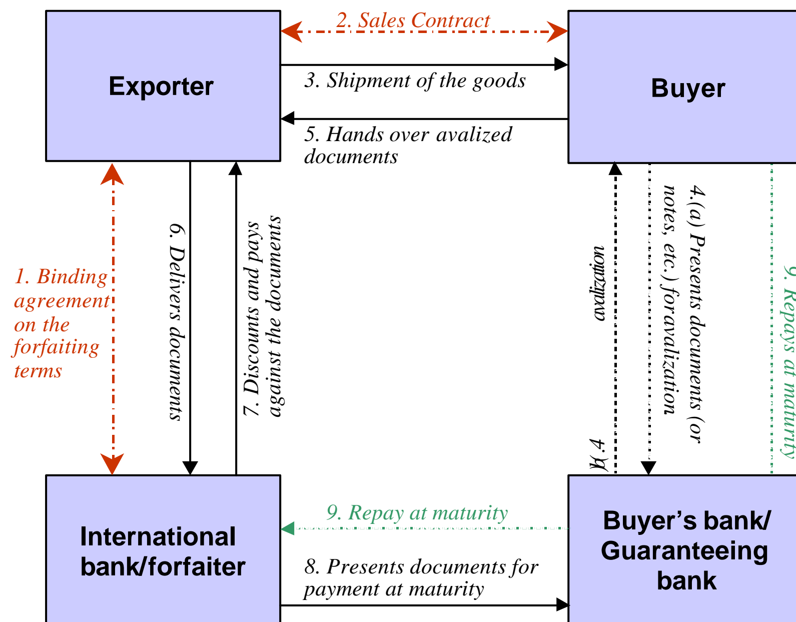
For anyone struggling to understand forfaiting, it is best to forget the name and the accompanying jargon and simply recognise forfaiting for what it is - nothing more than an easy payment arrangement with some discount. It is the sale, by an exporter and purchase by a forfaiter, of receivables (i.e. payments), falling due at some future date, arising from deliveries of goods or services, without recourse to any previous holder. In this arrangement, the face value of the Notes is discounted at an agreed rate from the date of purchase until a future maturity or due date.

More recently forfaiting has been used to finance commodity contracts on short-terms. Flexibility in its application has been the key to the increasing use of forfaiting and it has continued to be adopted and adapted by the market as client requirements have changed over time.

[5] Open Account: A trade arrangement in which goods are shipped to a foreign buyer before, and without written guarantee of, payment. Because this method sets an obvious risk to the supplier, it is essential that the buyer's integrity be incontestable.

The following is how forfaiting would normally apply in the horticulture finance:

1. The forfaiter gives commitment to purchase the horticulture export deal.
2. Both exporter and buyer of the horticultural produce sign a commercial contract.
3. The produce is delivered.
4. Bank gives guarantee to the buyer/importer.
5. Buyer hands over documents to the exporter.



6. Exporter delivers documents (or notes, etc.) to forfaiter.
7. Forfaiter discounts documents and pays exporter.
8. Forfaiter presents documents to the buyer's bank for payment at maturity.
9. Importer/buyer re-pays bank at maturity.

In its most traditional application, forfaiting paper is a safe form of investment since the paper effectively carries two names (buyer and his bank) where other instruments often carry only one (the buyer).

In other words, forfaiting paper is issued by an importing company, in this case the buyer and guaranteed by a prime bank in the country concerned (in this case the buyer in Europe). Both the importer and the guaranteeing bank will have to default to render the trade paper "non-performing". This means that there is, in general, a lower credit risk than for, say, securities issued by a company or bank.

2.2 Comparison between Forfaiting and Factoring

Both factoring and forfaiting involve the purchasing of receivables. They both aim at creating a source of finance by the purchase from a seller/exporter of receivables due from a buyer at a future date.

The Unidroit Convention on International Factoring (Ottawa, 28 May 1988) defines **factoring** as the assignment by a supplier of receivables arising from contracts of sale of goods made between the supplier and its customers (debtors) to a factor, in which the factor is to perform at least two of the following functions:

- finance for the supplier, including loans and advance payments;
- maintenance of accounts (ledgering) relating to the receivables;
- collection of receivables;
- protection against default in payment by debtors.

Factoring can therefore be an operation in which financing and credit collection functions are combined, or it can be the "outsourcing" of credit management and collection functions, without any finance provided to the supplier. In practice, however, the majority of factoring operations are done for financing purposes, and many factors stress this element in their publicity - to the extent that many define factoring as a primarily "cash for invoices" operation.

L ***Similarities***

For the seller both factoring and forfaiting maximize cash flow, reduce transaction risks, and may enhance competitiveness by offering flexible payments terms to the buyer.

In both cases, the risk of delivery of satisfactory goods or services and the fulfilment of the underlying contract remains with the seller, while the buyer of receivables (whether a forfaiter or a factor) assumes the commercial, political and economy risks of the buyer's country.

L **D*ifferences***

The differences, however, are that Factoring deals mainly with non-negotiable instruments like book receivables, whereas forfaiting deals mainly with negotiable instruments, like bills of exchange, promissory notes, and letter of credit.

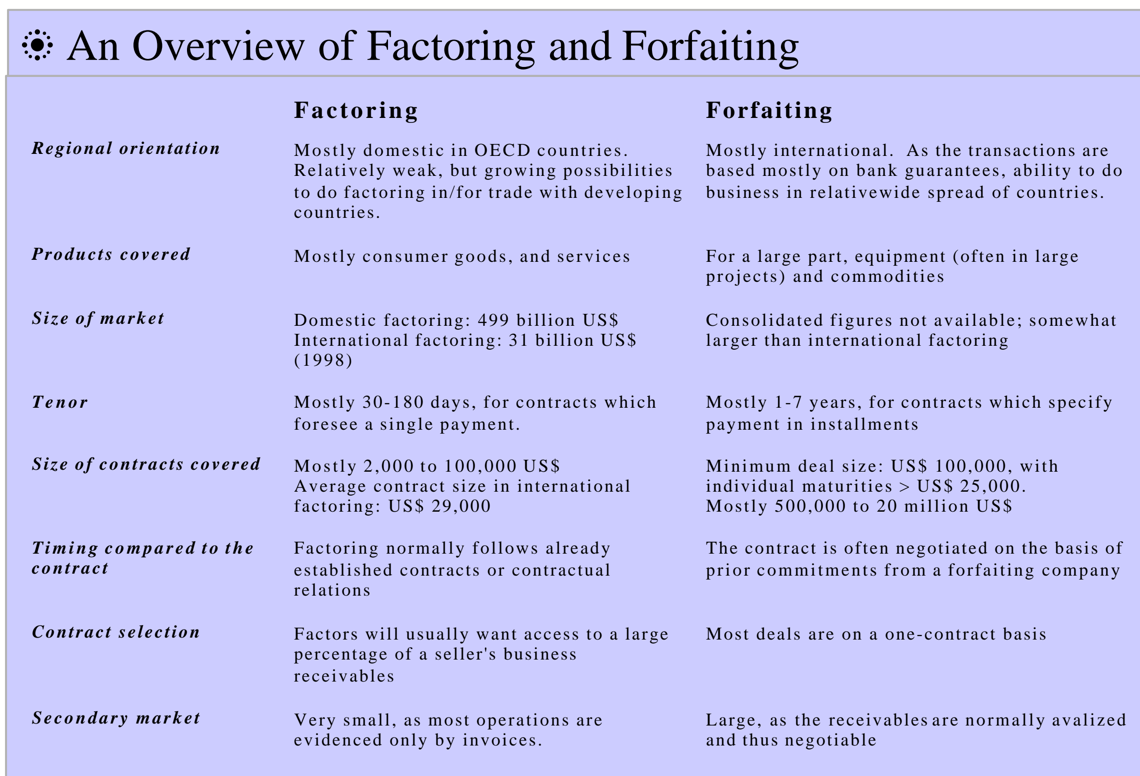
Forfaiting deals with one single existing and known transaction whereas factoring deals with a group of present and future receivables on the books of the seller. In factoring, the seller assigns all or part of the receivables to the factor, including those in

the future. In factoring, the service of collecting receivables always represents part of the contract, whereas forfaiting offers this service indirectly for the individual transaction handled in any agreement. In factoring, it is quite common not to finance 100% of the value of the receivables but to retain a certain amount. In forfaiting 100% of the present value (future value minus the interest discount) is always disbursed.

Factoring often covers domestic short- to medium-term business whereas forfaiting is mostly used for medium- and long-term deals involving cross-border transactions. However, nowadays forfaiters are discounting short-term deals mainly in commodity transactions.

Forfaiting usually uses a main document called the promissory note that has the following characteristics:

- An unconditional (an irrevocable) promise in writing,
- Made by one person to another,
- Engaging to pay:
  - → at a fixed future dated
  - → a certain sum in money
  - → to or to the order of a specified person or to the bearer/order.



An Overview of Factoring and Forfaiting

	Factoring	**Forfaiting**
Regional orientation	Mostly domestic in OECD countries. Relatively weak, but growing possibilities to do factoring in/for trade with developing countries.	Mostly international. As the transactions are based mostly on bank guarantees, ability to do business in relativewide spread of countries.
Products covered	Mostly consumer goods, and services	For a large part, equipment (often in large projects) and commodities
Size of market	Domestic factoring: 499 billion US$ International factoring: 31 billion US$ (1998)	Consolidated figures not available; somewhat larger than international factoring
Tenor	Mostly 30-180 days, for contracts which foresee a single payment.	Mostly 1-7 years, for contracts which specify payment in installments
Size of contracts covered	Mostly 2,000 to 100,000 US$ Average contract size in international factoring: US$ 29,000	Minimum deal size: US$ 100,000, with individual maturities > US$ 25,000. Mostly 500,000 to 20 million US$
Timing compared to the contract	Factoring normally follows already established contracts or contractual relations	The contract is often negotiated on the basis of prior commitments from a forfaiting company
Contract selection	Factors will usually want access to a large percentage of a seller's business receivables	Most deals are on a one-contract basis
Secondary market	Very small, as most operations are evidenced only by invoices.	Large, as the receivables are normally avalized and thus negotiable

3.0 THE SUPPORT BUYERS CAN GIVE

Buyers (auction floors, supermarket chains and traders in the case of horticulture trade) are essential for the development of new financial instruments such as the discount of export receivables (or forfaiting) because, as sources of payment in the trade transaction, their co-operation can add some measure of comfort to financiers.

Currently very few traders and agents give short- to medium-term loans to exporters in order to finance cash flows. These loans are deducted from export proceeds, but are limited, as they largely depend on the relationship between the exporter and the buyer. Moreover, when small producers receive cash advances from big trading firms this would lead, in most cases, to a reduction in the selling price they receive.

One of the reasons why most agents and traders are sceptical in advancing loans is due to lack of loyalty on the part of exporters, who are mostly shopping around for better prices in the market. There is a strong fear from both traders and agents that these exporters may side-market their produce to those offering higher prices. In such circumstances, any advances provided to them may not be recovered.

On the other hand, supermarket chains and auction floors do not provide facilities such as loans. Their view is simply that they are not banks or financial institutions. They are also not keen to issue letters of credit to exporters because, as discussed earlier, these create extra costs, thus necessitating the need to deal only on open account basis.

Besides, in most cases the produce is exported to the agent or trader who later sells to either the supermarket chain or the auction floor. The exporter's relationship is therefore with either the agent or trader, making it difficult for the auction floors and supermarket chains to finance the exporters directly. Although this situation is changing with more exporters dealing directly with supermarket chains both auction floors and supermarket chains still prefer to operate on open account.

In present situation, both supermarket chains and auction floors are less willing, in comparison with traders and agents, to seek further guarantees or avals for their debt instruments to the exporters. Traders and agents are more willing to operate with exporters under this arrangement, as they know the exporters better. It is expected that as this financing arrangement becomes deepened, auctions and supermarket chains will begin to appreciate the need for their supporting the scheme.

Thus, the willingness of buyers to play such a supportive role appears mixed at the moment, due to the fact that the products are new on the markets. As the saying goes, ”Old habits die hard.” Supermarket Chains

such as Tesco's and Marks and Spencers, see no fault in the current system where they pay on open account. They see the methods of assigning receivables as cumbersome and as such do not want to be bothered. Interestingly, though, most banks have no fears about the credit risk of these supermarket chains and have occasionally been quick to add their avals to their promissory notes, on request by the exporters or their agents.

Traders, on the other hand, are more willing to have their foreign receipts assigned as they clearly understand the advantages to them for being involved in these financing schemes. They are looking to maximise their earnings, whereas supermarket chains are more interested in making money through their normal business of trading as opposed to the money market.

4.0 FORFAITING - CASE STUDY 1

4.1 The Transaction: Tesco/Fox Fresh Export Zimbabwe

Under this forfaiting transaction, the local company (Fox Fresh exports Zimbabwe) airfreights its flowers or fresh vegetables to a foreign buyer, in this case, Tesco Supermarkets in the United Kingdom. Tesco issues a tenored promissory note to the exporter. These notes are then avalized by Tesco's bank. Once the aval is added, the exporter, instead of waiting for 30 to 180 days for payment and/or borrowing money on the local market to finance his working capital needs, can approach a bank for immediate payment in foreign currency less a discount rate. The exporter would then use the confirmed receivables backed by the aval of the bank as security and would thus receive payment 2 – 4 days after exporting. In this way, he is able to effectively borrow off-shore without any exchange rate risks, and benefiting also from all interest rates advantages.

Exporter	**:** *Fox Fresh Exports Zimbabwe*
Client	**:** *Tesco Supermarket, U.K.*
Export Value	**:** *USD 1,000,000*
Discounting Bank	**:** *Rabobank*
Discount Rate	**:** *5% flat*
Days to Payment (Maturity)	**:** *90 days*
Value to Exporter	**:** *USD 950,000*

Procedure

a *Fox Fresh Exports Zimbabwe receives confirmation of value of their exports and settlement dates from Tesco.*

b *Fox Fresh Exports Zimbabwe instructs Tesco to issue promissory notes to be paid through its bank to Rabobank.*

c *Tesco issues avalized promissory notes to the exporter (this is the traditional way, nowadays it is done more on a bank to bank basis where the buyer's bank issue notes to the exporter bank directly).*

d *Rabobank pays Fox Fresh Exports Zimbabwe less the discount (5%).*

e *In 90 days Tesco's bankers make final settlement with Rabobank.*

4.2 Advantages in the Tesco/Fox Fresh Export Zimbabwe Transaction

1. ***To the buyer (Tesco)***:

- The buyer (Tesco) will enjoy a bit of credit terms and as such will not be under too much pressure to pay immediately.
- The buyer can now get the product, sell, receive money and invest it before final settlement in 90 – 180 days.

2. ***To the exporter (Fox Fresh Exports Zimbabwe)***:

- Fox Fresh Exports Zimbabwe is paid within 7 days of exporting.
- As with most facilities currently on offer, this facility does not require any rigorous credit rating for Fox Fresh Exports Zimbabwe and all the inconveniencing procedures an exporter usually has to go through to obtain an off-shore facility. In this case, all that is required is a promissory note or equivalent guarantee on the part of the foreign buyer unequivocally indicating through his bank that he will pay within the agreed period.
- Fox Fresh Exports Zimbabwe's competitiveness is enhanced as he can afford to give good credit terms to his foreign clients without worrying about cashflow.
- Fox Fresh Exports Zimbabwe will not have to borrow locally or from off-shore for working capital purposes because he will get payment for his exports almost on a cash basis (within seven days) – hence, borrowing costs are reduced dramatically.
- Now that Fox Fresh Exports Zimbabwe will be getting their payment earlier than before, they can:
  (a) Invest any idle portion of their foreign currency (after repatriating what is immediately needed for working

capital) for a period of 60 days, in the case of Zimbabwe, before liquidation into Zimbabwe dollars as per the RBZ (Reserve Bank of Zimbabwe) requirements. This in effect means that Fox Fresh Exports Zimbabwe can recover some of the costs or charges made in the attempt to obtain prompt payment

(b) Fox Fresh Exports Zimbabwe can repay some of their loans (local loans), thus avoiding further crippling interest accruals particularly if the loans are denominated in Zimbabwe dollar terms.

(c) Fox Fresh Exports Zimbabwe can now increase their export turnover and plant efficiency because payment for sales is now on a cash basis.

3. *To the bank (Rabobank)*:

- Rabobank (the forfaiter) does not need to worry about country risk (Zimbabwe risk).
- The facility is based on a transaction basis and the risk that Rabobank is taking is with the foreign buyer Tesco, and not with Fox Fresh Exports Zimbabwe.

4. *To the country (Zimbabwe)*:

- The country, in this case, Zimbabwe, is now collecting its foreign currency receipts faster than before, thereby improving on its balance of payments or foreign currency reserves.

Below, is another example of a forfaiting proposal. This financial proposal is arranged by Innofin Africa for Zimbabwe horticultural farmers. The financial proposal is based on export receivables.

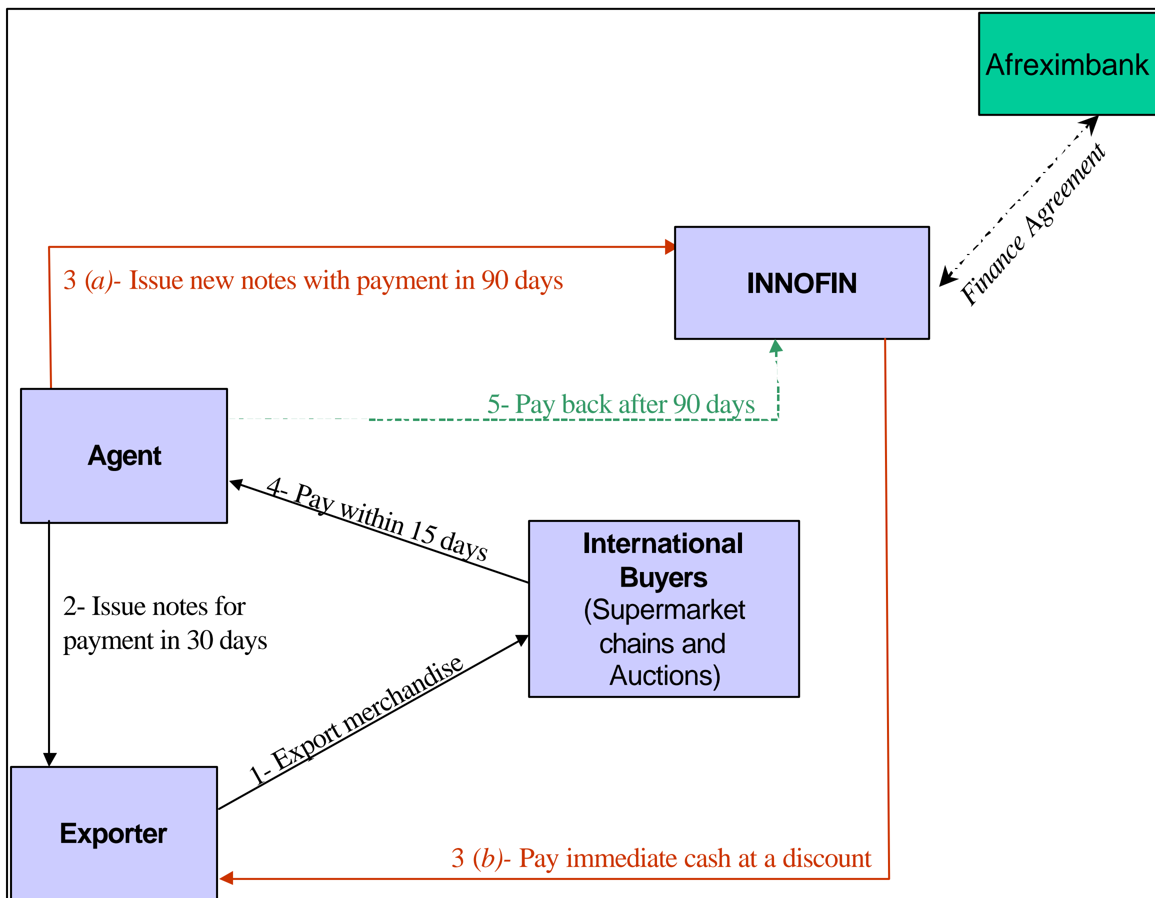
5.0 INNOFIN AFRICA: FINANCING PROPOSAL TO THE AFRICAN EXPORT AND IMPORT BANK - CASE STUDY 2

5.1 General Information

Innofin Africa is a fully incorporated company in Zimbabwe and registered in London with a mission to facilitate African trade by assisting African Horticultural Exporters to improve international trade cashflows through discounting of export receivables. It was incorporated in 1999 and subsequently formed a Bankruptcy-remote Special Purpose Vehicle (SPV) based in Jersey for the purpose of purchasing debt-instruments arising from exports made by African Horticultural Exporters to buyers in the OECD countries.

How it works
Innofin will purchase debt instruments from African Horticultural Exporters to the Organisation of Economic Co-operation and Development (OECD) countries. These instruments will be of internationally accepted standard in terms of quality and expected performance.

Buyers or their agents will issue promissory notes, which the note buyer in this case (Afreximbank) will purchase. Afreximbank will pay Innofin and Innofin will pay the exporters less their discount.



Facility Request
The facility required by Innofin is a new one and is for the purposes of purchasing export receivables arising from exports already made by African exporters to the OECD countries.

The amount required is at least US$50 million, which is expected to run as a facility for a year and will be renewable each year.

It is the view of Innofin that the facility will be subject to documentation to be negotiated between the bank and itself. The security or collateral for this facility will be any of the following.

- Promissory notes[6]
- Bills of Exchange/Drafts[7]
- Letter of credit (LC)s done by assignments
  Here the advising bank adds it own confirmation to a letter of credit, so the beneficiary has the security that the local bank will pay the beneficiary upon presentation of the correct documents.

Innofin proposes that the final maturity of the facility be 360 days commencing from the date of the signing of the Facility Agreement.

Rationale for Seeking Afreximbank Support

Afreximbank is the premier African Trade Financing Bank on the African continent. Naturally, Afreximbank has got an intimate understanding of the financing problems that the African exporters generally face in their quest to boost international trade opportunities while employing the most efficient funding methods.

Macro-Economic and Sectoral Issues

The facility applied for is for African Horticultural Exporters. As such, each export sector will have conditions, which are unique to its operating environment, however, the financing needs remain the biggest common denominator through all African Horticultural Exporting entities.

Generally, more and more African Horticultural Exporters and importers alike are receiving increased market information support from trade organisations formed by their governments. The brief of these organisations is to offer information and operational support that will assist exporters to penetrate new markets while consolidating on existing ones.

[6] Forfaiting usually uses a main document called the *promissory note* that has the following characteristics:
An unconditional (an irrevocable) promise in writing,
Made by one person to another,
Engaging to pay:
at a fixed future dated
a certain sum in money
to or to the order of a specified person or to the bearer/order.

[7] Bill of exchange: The most commonly used financial instrument in international trade. An unconditional payment demand for a specific sum of money, payable either at sight or at a specified future date. This is drawn up by the seller and presented to the buyer. This is sometimes called “the draft.”

<u>Marketing of the Products or Commodities to be Financed</u>

Most exports from Africa are commodities. However, there are also some products which have exhibited tremendous potential in the past few years particularly in the targeted market of the Organisation of Economic Co-operation and Development Countries. The following are some of the products and commodities that Innofin Africa has identified as having great potential and need for reasonably priced finance.

- Horticultural produce
- Tobacco
- Tea
- Coffee
- Cocoa
- Meat and Meat Products
- Minerals (Precious and Base)
- Clothing and Textiles

All these commodities and products are in great demand in the OECD countries. Innofin does not directly export these products but rather, facilitates the financing of their exporting. As such, Innofin Africa will only deal with exporters with established markets in the OECD countries. The exporters that Innofin has identified already have established markets but are having difficulties with foreign currency cashflows to effectively and consistently supply their markets.

The OECD countries' tariff system continues to be standardised with a view to giving Developing Nations in which category a lot of African Horticultural Exporters countries belong, greater opportunities to accessing their markets. As such tariff barriers continue to be lowered in favour of the developing countries without compromising on the quality of the commodities traded.

<u>Clients</u>

The company has the following established clients;

NAME	***PRODUCT***	***BUYER***	***VALUE PER YEAR IN USD***

Mitchell and Mitchell Fresh Exports	*Fresh Vegetables*	*Tesco, Asdas, J. Sainsbury, Safeways and Marks and Spencers*	*5 million*
Agriflora	*Fresh vegetables and fresh cut flowers*	*Tescos, Marks and Spencers, Dutch Auction Floor*	*3 million*
Export-a-bloom	*Fresh cut flowers*	*Dutch Auction Floor*	*1.5 million*
Pico Farms	*Fresh vegetables*	*Frumar Limited, London*	*3 million*
J. Gardenier B.V.	*Fresh cut flowers*	*Dutch Auction Floor Supermarket chains*	*8 million*
			Total Value *USD 20.5 MILLION*

The UK Supermarket chains who in this case include; Tesco Asdas, J. Sainsburys, Safeways and Marks & Spencers will issue their Promissory Notes against export receivables through National Westminster Bank and Barclays Bank, UK. It must also be noted that the supermarket chains are considered good risk within the UK financial sector and as such some banks will take Promissory Notes directly from them.

The Dutch Auction floors will issue Promissory Notes against export receivables through ABN Amro Bank and RaboBank. While Kezi, Frumar and Pellimport will issue their Promissory Notes through National Westminster Bank, HSBC Bank and RaboBank.

It must be noted that Kezi, Frumar and Pellimport are marketing agents and as such there may be necessity for Guarantees from their Banks against export receivables depending on how one perceives their risk.

However, their banks, which are in this case, National Westminster, HSBC and Rabobank, have agreed to avalize Promissory Notes against export receivables which have been given value. All Promissory Notes are unconditional.

5.2 Risks Associated with this Type of Finance

1. Inadequate or unauthorized documentation

This is the key potential risk associated with any paper evidencing or validating an underlying trade or financial obligation. Without recourse negotiable instruments certainly have no immunity to this type of risk.

However fraudulent transactions in the forfait market have become more prevalent in the past three years, according to West LB Bank. The banking community has often received notification from either the British Bankers Association or Foreign correspondents, advising that fraudulent documents are circulating, purporting to give financial commitments on behalf of the issuer of such instruments. In the forfait market these documents are Letters of credit, promissory notes, bills of exchange and guarantees of book receivables. Therefore, it is advisable for forfaiters to verify the authenticity of avals or guarantees from the purported issuers before purchasing them.

In addition, because the trades are usually across political, economic and legal frontiers, these concerns can often be accentuated by local requirements as regards import licences, the validity of bank guarantees and the remittance of foreign currency. The local regulations are subject to change but it is rare for established documentation that is correct at the time of the transaction to be retrospectively altered by a statutory change in the importing country. The onus therefore, lies on the forfaiter in the primary market to make sure the documentation is correct, authorised and validated at the time of the exchange of documentation against cash.

2. Counter Party Risk

There is also a counter party risk which is certainly worth mentioning. This is a risk which is associated with any trade or financial transaction between two parties. Can Party A trust Party B to undertake and deliver its side of the transaction? For instance, if the buyer fails to pay for goods delivered, the forfaiter will have to pursue payment from the avalazing bank.

3. *Price Risk*

There is another real risk, which is that of Price. The discount rate is a combination of the estimated cost of funds for the period of the note plus a margin for the credit risk. In order to work out an accurate discount rate, a view has to be taken on interest rates. If the interest rates increase this could result in a loss. To hedge against this, one may need to take a position in the derivative market.

The issues of quality risks do not exist as the discounts are being made on export receivables that have already been given value.

4. Transaction Risk

A major feature of this type of non-recourse trade financing is that the underlying negotiable credit instrument is separated from the basis of the transaction risk. It is crucial that the credit finance mechanism is totally separated from the payment obligation. So, although the transaction risk is not prima facie a direct risk to the financier it can weigh heavily. It is certainly not unknown for financiers to turn down deals where selling counter parties were not considered good enough for this risk.

In order to identify and protect themselves from this risk, financiers may include in their forfaiting agreement with the exporters clauses which protect themselves against such risks.

5.3 Potentials for Expanding this Mechanism

♦ As finance markets increasingly look to securitize assets, forfaiting has a growing importance for trading both short- and medium-term receivables since unlike other trade instruments, there is no contingent liability on the sellers' books of account.

♦ Free market economies, removal of trade restrictions and reduction in Government Export Credit Schemes will enhance the use of these instruments.

♦ An increasing awareness of the existence of forfaiting and its applicability in certain circumstances combined with the fashion for emerging market risks on a variety of secondary market instruments, some far more exotic than non recourse trade related negotiable instruments.

♦ Its flexibility, which may create definition problems but enhances its amoeba – like growth in both the trade and finance markets.

♦ The maturity of the secondary market after forty years and banks and finance houses trading a forfaited paper in part gives the primary market certain vitality.

♦ Its potential to evidence financial obligations in addition to trade finance receivables.

♦ Its ability to be attached to existing negotiable trade and financial instruments within existing sovereign legislation.

♦ At this point national export credit agencies appear to be contracting state support to their exporters and relying increasingly

on the free market. At the same time it appears to the be the case that the credit-worthy world is expanding.

5.4 Potential Limiting Factors

♦ Restrictions on cross border trade and an increasing isolationism by some sovereign economies.

♦ There is also the reluctance of buyers to issue promissory notes or even seek further avals/guarantees from their bankers. This is due to their concern that once they issue promissory notes they become committed to firm fixed payment dates, default of which will incur penalties. Moreover, seeking additional bank guarantees involves extra costs to them.

♦ A secondary market which has no depth or liquidity. The secondary market is very important in the development of this mechanism since it enables note-holders to off-load when their balance-sheet desire such load shedding.

♦ Sovereign statute that restricts the transfer of negotiable instruments.

♦ A major fraud or dislocation in the market could cause panic among participants and erode the flavor of the market.

♦ The high regulatory environment under which most African exporters are operating. In Zimbabwe for instance, an exporter has to seek reserve bank approval to authorise a foreign bank to discount its export receivables. As he cannot acquit his CD1 Forms. A *CD1 Form*[8] is an instrument used by the Reserve Bank of Zimbabwe to monitor the inflow of export proceeds to the country. The portion of export receipts being discounted therefore need approval from the central bank. If the Central Bank is not agreeable with the discount rate this could prevent a financing transaction by a foreign bank from being concluded.

6.0 THE FUTURE OF THE FORFAIT MARKET

Forfaiting as a short-term trade instrument could be said to be merely another example of the flexibility in this type of trade finance. It is therefore an efficient method of financing because of its flexibility to changing market requirements.

[8] CD= "customs declaration" (form to be filled by the exporter, which must indicate the value of exports, the amount of the commission and the transport charges).

As a result, this non-recourse trade instrument will be used increasingly in the future.

There is now a well established primary and secondary market which in effect, securitizes the receivables of exporting companies and this may be attributed to the following factors;

1. Exporters are increasingly familiar with Forfaiting and being able to offer credit to buyers and potential buyers is always a selling point.

2. Forfaiting can be used within a free market and has a flexibility that government export credit agency sponsored schemes may not have. Driven by the profit motive and a need to maximise shareholders wealth, forfaiters will try and adapt the forfaiting terms and conditions to suit both the exporters and importers needs.

3. In the normal course of business there is no recourse to previous holders or the exporter by the holder at maturity if the negotiable instrument is not met at maturity. Once the sale has been made the exporter takes the money and moves on to the next trade.

4. The growth of the primary non-recourse market is a function of the familiarisation of forfaiting with exporters. To the extent that exporters are willing to accept discounted values for their receivables as alternative to local borrowing, that would translate to growth of the forfait market.

5. The banks have a role in deepening the forfaiting market by considering avalizing notes of their prime clients on one side, as well as discounting the notes on the other hand.

An increasing awareness of the forfait market will see it develop a critical mass and momentum, which will become self-generating. This growth, if it is to continue and develop, needs to be based on forfaiting being perceived as a cost effective and more flexible user friendly alternative for financing a transaction from the perspective of all the participants.

Market traders who evangelize the benefits of forfaiting will not see significant further developments in the market unless;

a) Exporters feel forfaiting is an effective alternative to finance their sales.
b) Importers believe it is an acceptable method of financing their purchases.
c) The discounters and holders feel the returns warrant the risks.
d) The guaranteeing banks can commercially justify their risk on the importer; and

e) Externalises to not restrict or limit international trade flows.

The flexible nature of forfaiting or export receivables has lead to its adoption for funding short-term (90 – 365 days) trade contracts. Commodities such as fuel and grain are also sold on credit and the debt evidenced by Promissory Notes, Bills of Exchange or deferred payments of Letters of credit which are discounted without recourse. Why? Because forfaiting suits the exporter, the importer and is appropriate to that particular transaction.

7.0 WHAT BANKS AND FINANCE HOUSES SHOULD DO

Developing country banks must offer the following services in order to promote the use of finance methods based on export receivables;

1. *Trade Development*

They need to set up Trade Development Departments with the objective of bringing together buyers and sellers wishing to export and import.

The procedure works out as follows; a horticultural exporter in a developing country wishes, for instance, to sell his products abroad, and if his bank makes available a trade development service, he merely gives the bank complete specifications about the product, such as the price, quality and quantity that can be delivered; descriptive flyers and brochures giving illustrations of the product may also be helpful. The bank then sends the information to some of its corresponding banks in countries where the product could most likely be sold. In turn, these branches and correspondents contact some of their customers and others who might be interested in the product. After the initial contact between the buyer and the seller has been established the two negotiate directly and the banks can then finance the transaction using suitable structures.

Usually this trade development service is offered free to existing customers. The buyer and seller will need the banks financial services for completing the transaction.

2. *Publications*

Development country banks must issue periodic and special publications concerning domestic and international economic business and financial conditions. Analytical summaries should be given on new government and central bank regulations, taxes, developments in the foreign exchange market, interest rate trends and similar topics. This section works closely with the risk management department in the bank. It will give an accurate picture of economic, political or social conditions that might affect international trade.

3. ***Credit Information***
Banks' credit departments should furnish customers with needed credit information on buyers and suppliers, such information of course without commitment or responsibility on the banks.

4. ***Information on Importers***
When exporters receive orders from foreign buyers, whom they do not know, they must decide under which terms to ship. If the importer is a large, reputable company it may be necessary to quote an open account terms for competitive reasons. If the buyer is less well known and not as financially strong, shipment on foreign collection or even confirmed Irrevocable Letter of Credit basis may be advisable. But this of course, depends on the situation on hand. To find out the size, reputation and financial strength of a foreign buyer, an exporter can check with its bank who might be familiar with the company through its network. The bank may also consult credit agencies for additional information.

5. ***Information on Exporters***
While most credit enquiries are made by sellers to determine the ability and willingness of buyers to pay for the product, it is sometimes useful for a buyer to investigate the honesty and reputation of the seller. A buyer will pay for goods in the expectation of getting a certain grade or quality and on the basis that the exporter will be reliable and can continue deliveries. Hence, it might be advisable for developing country banks to provide information to foreign buyers on the reliability of their home exporters to deliver the exact product as advertised and to assure the buyers of reliable supplies.

6. ***Introductions***
Banks, by virtue of their business have excellent connections with foreign banks, government agencies and central banks. It can therefore be helpful for them to attestation letters to their local clients embarking on missions abroad.

If, for instance, a businessperson is travelling abroad to establish the possibility of new markets, he will have to talk to various people in the agencies about regulatory requirements, chambers of commerce or foreign banks. A customer through an international banker can usually obtain letters of introduction that will open doors.

8.0 WHAT EXPORTERS SHOULD DO

Exporters should develop long term relationships with buyers where the following issues are addressed with all stakeholders.

1. Product Development
2. Transportation and handling
3. Logistics
4. Quality
5. Payment facilitation (especially in a way to attract financiers to provide credit for export transactions)

This means creating a strong Africa-Europe network that facilitates the value chain from product development to quality in order to obtain strong market share. The network should take the form of an association on standards to be maintained in the industry in terms of the value chain. The value chain must assess the needs of the market for new varieties and products. It should carry out extensive trial programs under different African climates and support growers not only with cultural or technical information and back up, but offer management support as well.

The network should be a speciality in understanding the African climate as well as the management of horticulture production in farms.

The network should also create reliable forwarders, clearing agents and air lines – in short a well organised transport system, with competitive rates – to link up African exporter and to facilitate freight thus enabling produce to get as fast as possible to international markets.

Whether the product is sold through the auction, agents or directly to the supermarket chains, the network should keep close contact with the buyers who are in this case very important in ensuring that finance based on export receivables is achieved.

9.0 CONCLUSION

The forfait market is a minute market in the context of world trade. However, in the context of developing countries horticultural trade it should grow and mature over a long time and should be acknowledged as being a free trade export credit finance instrument that can be of great value to exporters, importers, banks and finance houses. For the market to develop, it requires specialised institutions and forfaiting departments in clearing banks to generate primary paper from their customer desk, savings banks that will hold or trade that paper, specialist trading houses that will trade in the market and turnover their forfaiting assets more than six times a year and merchant banks that will advise the professional market makers.

The trade finance deals considered in this Paper fall comfortably into what would be referred to as the primary market. There are two trading parties to the trade; the exporter and the buyer. Under this arrangement the

buyer instructs his bank to pay the exporter's bank within a specified period through the use of non-recourse negotiable instruments. The exporter receives a discounted cash sum from the bank which inherits the future payments flows as evidenced by the promissory notes. This promissory note is an asset that can be sold on to a third party at a mutually agreed price. This buying and selling between successive holders in due course at varying discount rates is referred to as the secondary market.

It may seem rather trite to state the fact that both the primary and secondary markets, like any market, attract a variety of participants with widely differing objectives and structures. For example, in the secondary market large deposit gathering banks with a network of well established client relationships such as German house banks with a knowledge and familiarity of forfaiting may well make this type of non-recourse funding available to their clients and hold the notes to maturity.

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- Barclays Bank
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- Tesco
- Marks and Spencer
- Exporters:
  Wingflora
  Zurrell
  Florimark
  J Gardenier
- Horticultural Promotion Council of Zimbabwe
- Factoring Company of Zimbabwe
- Trust Merchant Bank, Zimbabwe
- NMB, Zimbabwe
- Reserve Bank of Zimbabwe
- Rabobank

ANNEX

Draft Indicative Term Sheet for a USD xx million Note Purchase Facility

For Discussion purposes only

The following is an outline of a proposed note purchase facility. It is at this stage for discussion purposes only and should not be construed as an offer either by the Arrangers or the Note Buyers

Terms and Conditions

Type of Facility:	Note Purchase Facility (the Facility)
Note Issuer:	xxx Ltd, a Special Purpose Company created for the sole purpose of buying receivables from African exporters (the Company)
Purpose:	Proceeds of the facility will be used by the Company to purchase export receivables arising from exports already made by African exporters to acceptable buyers in the OECD countries.
Facility Amount:	USD xx million.
Arrangers:	An internationally reputable African multinational bank.
Note Buyers:	International banks to be contacted by the Arrangers.
Agent:	A reputable international bank to be nominated by the Arrangers and acceptable to the Note Buyers.
Structure:	The Note Issuer will purchase debt instruments arising from exports made by African exporters to entities in OECD countries. Those debts will be evidenced by Eligible Debt Instruments issued in international format (see eligible instruments below) by buyers of those exports. The Company will issue Promissory Notes which the Note Buyers will purchase, proceeds of which will be used by the Company to purchase the Eligible Instruments. The Company will, by way of security to the Note Buyers, endorse the Eligible Instruments purchased with the proceeds of the Facility, to the Note Buyers. Those Instruments will be

held by the Agent for presentation and redemption at maturity.

Eligible Instruments The eligible instruments that the Company can purchase with proceeds of the Facility are:

Promissory Notes
Bills of Exchange
Drafts
Letters of Credit (done by way of Assignments)

Eligible Importers: a) Prime corporates acceptable to the Arrangers
b) Other corporates, provided that the instruments so issued will be avalized or guaranteed by a bank, corporate or sovereign acceptable to the Arrangers.

Final Maturity: 360 days from date of signing of Facility Agreement.

Tenor of each Note: 360 days, provided that no Note will mature after Final Maturity

Repayment: Through the redemption of Eligible Instruments at maturity

Fees (calculated on facility amount):

Arrangement: --%
Underwriting: --%
Facility: --%

Discount/Coupon Rate: 1.25% above relevant LIBOR

Security: i. Eligible Instruments issued by Eligible Importers and endorsed to Note Buyers and held by the Agent.
ii. Assignment to the Note Buyers of all assets owned or held by the Company.

Documentation: The Facility Agreement will contain clauses customary for transactions of this type.

Taxes and Deductions: All payments by the Company will be made free and clear of any present and future taxes and levies.

Assignments: The Note Buyers will be entitled to sell, transfer or grant participation in the facility to any investor at any time without the prior consent of the Company. The

Company may not assign its interest to third parties without the prior written approval of the Arrangers.

Conditions Precedent To utilization: Utilization of the Facility will be subject, inter alia, to satisfactory documentation including, but not limited to:

i. The Facility Agreement and/or Note Purchase Agreement having been duly executed.
ii. Payment of the relevant fees.
iii. All necessary security documents, including the Eligible Instruments having been executed in a manner acceptable to the Arrangers.
iv. Opinion of both Local and English (or as appropriate) Counsels having been received, etc.

Approvals: The Company will ensure that all governmental and corporate consent approvals and registrations necessary for the utilization of the Facility are made available as required.

Expenses: All reasonable expenses involved in putting the Facility in place are the account of the Company.

Governing Law: As appropriate.

Force Majeure: This offer is subject to there being, in the opinion of the Arrangers, no material adverse change in the World financial markets or in the financial conditions of the Company prior to the date of signing the Facility Agreement.

Xxxxxx
For: the Arrangers

Terms and Conditions are agreed

For: The Company (the Note Issuer)

Xxxxxxx(Signature, name designation and date)