

Chapter 5

Open Account

An open account transaction is a sale where the goods are shipped and delivered before payment is due, which is usually in 30 to 90 days. Obviously, this option is the most advantageous to the importer in terms of cash flow and cost, but it is consequently the highest-risk option for an exporter. Because of intense competition in export markets, foreign buyers often press exporters for open account terms. In addition, the extension of credit by the seller to the buyer is more common abroad. Therefore, exporters who are reluctant to extend credit may lose a sale to their competitors. However, though open account terms will definitely enhance export competitiveness, exporters should thoroughly examine the political, economic, and commercial risks as well as cultural influences to ensure that payment will be received in full and on time. It is possible to substantially mitigate the risk of non-payment associated with open account trade by using such trade finance techniques as export credit insurance and factoring. Exporters may also seek export working capital financing to ensure that they have access to financing for production and for credit while waiting for payment.

Key Points

- The goods, along with all the necessary documents, are shipped directly to the importer who has agreed to pay the exporter's invoice at a specified date, which is usually in 30 to 90 days.
- The exporter should be absolutely confident that the importer will accept shipment and pay at the agreed time and that the importing country is commercially and politically secure.
- Open account terms may help win customers in competitive markets and may be used with one or more of the appropriate trade finance techniques that mitigate the risk of non-payment.

How to Offer Open Account Terms in Competitive Markets

Open account terms may be offered in competitive markets with the use of one or more of the following trade finance techniques: (a) export working capital financing, (b) government-guaranteed export working capital programs, (c) export credit insurance, and (d) export factoring. More detailed information on each trade finance technique is provided in Chapters 6 through 9 of this guide.

CHARACTERISTICS OF AN OPEN ACCOUNT

Applicability

Recommended for use (a) in low-risk trading relationships or markets and (b) in competitive markets to win customers with the use of one or more appropriate trade finance techniques.

Risk

Significant risk to exporter because the buyer could default on payment obligation after shipment of the goods.

Pros

- Boosts competitiveness in the global market
- Helps establish and maintain a successful trade relationship

Cons

- Significant exposure to the risk of non-payment
- Additional costs associated with risk mitigation measures

Export Working Capital Financing

Exporters who lack sufficient funds to extend open accounts in the global market need export working capital financing that covers the entire cash cycle, from the purchase of raw materials through the ultimate collection of the sales proceeds. Export working capital facilities, which are generally secured by personal guarantees, assets, or receivables, can be structured to support export sales in the form of a loan or a revolving line of credit.

Government-Guaranteed Export Working Capital Programs

The U.S. Small Business Administration and the Export-Import Bank of the United States offer programs that guarantee export working capital facilities granted by participating lenders to U.S. exporters. With those programs, U.S. exporters can obtain needed facilities from commercial lenders when financing is otherwise not available or when borrowing capacity needs to be increased.

Export Credit Insurance

Export credit insurance provides protection against commercial losses (such as default, insolvency, and bankruptcy) and political losses (such as war, nationalization, and currency inconvertibility). It allows exporters to increase sales by offering liberal open account terms to new and existing customers. Insurance also provides security for banks that are providing working capital and are financing exports.

Export Factoring

Factoring in international trade is the discounting of short-term receivables (up to 180 days). The exporter transfers title to short-term foreign accounts receivable to a factoring house, or a factor, for cash at a discount from the face value. It allows an exporter to ship on open account as the factor assumes the financial ability of the importer to pay and handles collections on the receivables. The factoring house usually works with exports of consumer goods.

Trade Finance Technique Unavailable for Open Account Terms: Forfaiting

Forfaiting is a method of trade financing that allows the exporter to sell medium-term receivables (180 days to 7 years) to the forfaiter at a discount, in exchange for cash. The forfaiter assumes all the risks, thereby enabling the exporter to offer extended credit terms and to incorporate the discount into the selling price. Forfaiters usually work with exports of capital goods, commodities, and large projects. Forfaiting was developed in Switzerland in the 1950s to fill the gap between the exporter of capital goods, who would not or could not deal on open account, and the importer, who desired to defer payment until the capital equipment could begin to pay for itself. More detailed information about forfaiting is provided in Chapter 10 of this guide.