Chapter 5
Open Account

An open account transaction means that the goods are shipped and delivered before payment is due, usually in 30 to 90 days. Obviously, this is the most advantageous option to the importer in cash flow and cost terms, but it is consequently the highest risk option for an exporter. Because of the intense competition for 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 face the possibility of the loss of the sale to their competitors. However, while this method of payment 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 nonpayment associated with open account trade by using such trade finance techniques as export credit insurance and factoring. Exporters may also wish to seek export working capital financing to ensure that they have access to financing for both the production for export and for any credit while waiting to be paid.

Key Points

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

CHARACTERISTICS OF AN OPEN ACCOUNT

Applicability

Recommended for use (1) in secure trading relationships or markets or (2) in competitive markets to win customers with the use of one or more appropriate trade finance techniques.

Risk

Exporter faces significant risk as the buyer could default on payment obligation after shipment of the goods.

Pros

- Boost competitiveness in the global market
- Establish and maintain a successful trade relationship

Cons

- Exposed significantly to the risk of nonpayment
- Additional costs associated with risk mitigation measures

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: (1) Export Working Capital Financing, (2) Government-Guaranteed Export Working Capital Programs, (3) Export Credit Insurance, (4) Export Factoring, and (5) Forfaiting. More detailed information on each trade finance technique is provided in other sections of the *Trade Finance Guide*.

Export Working Capital Financing

To extend open account terms in the global market, the exporter who lacks sufficient liquidity needs export working capital financing that covers the entire cash cycle from purchase of raw materials through the ultimate collection of the sales proceeds. Export working capital facilities can be provided to support export sales in the form of a loan or revolving line of credit.

Government-Guaranteed Export Working Capital Programs

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

Export Credit Insurance

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

Export Factoring

Factoring in international trade is the discounting of a short-term receivable (up to 180 days). The exporter transfers title to its short-term foreign accounts receivable to a factoring house 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 consumer goods.

Forfaiting

Forfaiting is a method of trade financing that allows the exporter to sell its medium-term receivables (180 days to 7 years) to the forfaiter at a discount, in exchange for cash. With this method, the forfaiter assumes all the risks, enabling the exporter to extend open account terms and incorporate the discount into the selling price. Forfaiters usually work with capital goods, commodities, and large projects.