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RFD. 207

Board of Governors of the Federal Reserve System

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

December 23, 1952

Adequacy of Import Financing Facilities
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11 pages

NOT FOR PUBLICATION

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Adequacy of Import Financing Facilities[1/]

Lewis N. Dembitz

The institutions that now play the largest role in import financing in the United States are the commercial banks. Many small and medium-sized importers feel that bank credit facilities have been inadequate, in the sense that import propositions that they considered safe and profitable have had to be declined because of financing problems. However, it is not clear that U. S. banks could feasibly liberalize their credit policies to any great extent, except over a long period of time, because even where a bank is already engaged in foreign trade financing, it would have to develop additional specialized organization and knowledge if it wanted to extend credit more liberally without assuming undue risks.

An importer may also be able to obtain credit from non-bank sources, especially from factoring firms or from the foreign exporter. Factoring firms appear to exist, at least in New York City, with fairly substantial resources available for import financing. The rates charged by these firms are of course higher than those of the banks.

The development of export credit insurance arrangements under the sponsorship of European governments has enabled many European exporters to extend more liberal credits. The British Export Credits Guarantee Department, in particular, has pioneered in finding ways by which it can help exporters to extend special credit facilities. The question is raised as to whether there are ways in which these organizations could go still further in this direction.

Apart from the problem of an importer in obtaining credit to finance his dealings, he also needs institutional facilities for the issuing of letters of credit, making of foreign exchange remittances and the like. It appears that these facilities are amply provided by the banking system in this country. In addition, many banks perform an important and valuable function in providing a prospective importer with information and advice on problems of international trade. If there were some way of distributing more widely the kind of helpful advice and encouragement that some banks have been giving, this might lead to more imports.

1/ This report was submitted to the Public Advisory Board for Mutual Security in connection with their study on Trade Policy. It attempts to answer the question: Do you believe that a lack of financing facilities impedes the present flow of imports into the United States?

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Nature of the Problem

It would appear that the problem of financing imports into the United States may be divided into two main parts:

(1) The providing of institutional facilities for the issuing of letters of credit, making of foreign exchange remittances, etc., that are necessary in connection with the financing of imports. Often the institutions offering these services would also be prepared to supply information and advice on various problems connected with import business.

(2) The extending of credit to the importer -- that is, the problem of an importer in obtaining money or credit, in addition to his own available cash, to finance his import commitments.

The present note will deal primarily with the financing of the prospective importer in the United States. It will not go into the problem of a foreign exporter in obtaining credit to finance his operations, since this seems to be a field in which any shortcomings can be dealt with by the financial mechanism of his own country. While plans might be devised for extending credits from U. S. sources to foreign exporters, it would appear that the main objective of any such plans would be the advancing of dollars to the country involved, rather than the developing of exports which would not otherwise have flowed.

In preparing this note,1/ an attempt has been made to keep especially in mind the kinds of imports in which there seems to be a considerable degree of elasticity in United States consumption -- that is, in which increased exposure to sales promotion might well lead to a relatively large percentage increase in the consumption and, hence, in the continuing flow of imports. For example, this is probably the case for many lines of European manufactured goods -- as distinguished from raw materials and staple foodstuffs, for which the volume of imports is likely to be affected less by these factors.

1/ Among the sources of information used in drawing up this note, special mention should be made of material collected by the Department of Commerce which undertook a survey of import financing facilities in the summer of 1950. The Department obtained views on a number of questions concerning import financing from importers, bankers and others interested in foreign trade, in 17 commercial centers in different parts of the United States.

At present, the institutions that have the leading role in import financing in this country are the commercial banks. While many importers covered by the survey felt that credit was not readily enough available to them, there does not seem very much that these banks could be expected to do to change this situation, at least in the short run. The present note does point out, however, two other possible sources of credit which are available to an importer and which might be susceptible to further development. One consists of the factoring firms that extend credit to importers, and the other source of credit is the foreign exporters, who in many cases can obtain the backing of their countries' export credit guaranty systems.

Some parts of the financing problem could be obviated if more foreign sellers were in position to open U. S. branches. Sales by the branch to American purchasers could then be handled as ordinary domestic transactions. Similarly, if a foreign product is imported by an American import firm which then resells to scattered American users or distributors, the latter can then buy without having to deal with any special importing problems, although it then becomes more important that the single firm be enterprising and competent and have adequate funds available.

Existing procedures for import financing

The most important method of financing imports into the United States is by means of an import letter of credit, enabling the foreign seller to receive payment by draft on an American bank. Under this procedure the American importer arranges for his bank to issue a letter of credit assuring the foreign exporter that his drafts, if drawn in connection with the shipment as agreed, will be paid upon presentation. In a few non-European countries, in fact, an exporter is required to show such assurance of dollar payment before he can get an export license. If the importer's bank is not one that is equipped to handle the mechanics of foreign business, it may arrange to have the letter of credit issued by its New York correspondent.

The letter-of-credit basis requires that the importer have money or bank credit available to finance the shipment from the time that a draft is paid under the letter of credit until he is able to resell the imported goods and obtain payment for them. Furthermore, the bank will have committed itself on behalf of the importer from the time the letter of credit is issued, even though neither the importer nor his bank actually pays out any money until a draft from the foreign exporter arrives for payment. While the bank knows that it will not have to make any payment except against documents which give it a lien upon the goods being imported, it would not want to extend credit on the basis of the goods alone; therefore, before issuing the letter of credit, the bank has to be satisfied as to the ability of the importer to repay the bank's advances, either out of an eventual successful resale of the imported goods or out of the importer's other resources.

As an alternative to financing by letter of credit, it is possible for an import transaction to be financed by the foreign exporter, perhaps drawing bills directly on the importer for each shipment, or perhaps on an open account basis. Such credit is often extended to importers of high credit standing, especially where there is a longstanding relationship with the foreign shipper.

Much of the importing business is done by large manufacturers or merchandising firms whose import business is ancillary to their other activities and which have no difficulty in obtaining any credit that they need. There are also a number of large and well-capitalized importing firms which specialize mainly in the import of staple or readily-marketable commodities. The problems in the field of import financing are the problems of financing smaller importers, especially in connection with imports of specialty products.

Would-be importers with small resources and without close connection with foreign suppliers, are often said to find transactions obstructed by unavailability of bank credit and costliness of obtaining credit from factoring firms or other sources. The well-established importers consider this phenomenon normal and believe that credit conditions are helping to keep out "fly-by-nights" and bad deals. This viewpoint, of course, may be influenced by a dislike of more competition.

Because of the nature of this business and the special risks involved, most banks in the interior would probably not consider themselves equipped to engage in the financing of such small importers. Import financing tends to be concentrated in banks that have developed a special interest in foreign business. These banks are located in seaport cities and in the more important interior centers. The extending of credit to importers is of special interest to these banks since they can profit not only from ordinary interest earnings but also from fees and commissions on ancillary business such as the handling of documents and trading in foreign exchange. Such banks may welcome business from importers located at a distance from them, and interior banks may be enabled to earn fees or commissions in connection with business that they send in.

Adequacy of institutional facilities

The banks believe that with the variety of arrangements that they provide for handling import documents and making remittances, they have succeeded in making these services available to all kinds of prospective importers. Besides the New York banks, a fair number of banks in other cities have foreign departments which can provide the necessary machinery for almost any type of import transaction. In addition, New York banks have circulated application forms and instructions to their interior correspondents, inviting the correspondent to submit foreign trade problems for handling by the New York bank, with the idea of enabling almost any bank to accept an application and put through a transaction for a would-be importer.

Along with the facilities just described, well-equipped banks customarily provide various supplementary services, not strictly financial, which can greatly assist in the developing of import business. The most important of these is the giving of advice on international trade matters to the prospective importer. This includes advice on procedures and problems of international trade in general, to a prospective importer who has heretofore dealt only with domestic sources of supply; it may also include, in some cases, detailed advice with respect to particular commodities, sources of supply, transport facilities or the like. Unless a bank is ready to offer such help, the businessman who might have some interest in importing may well consider the problems so formidable that he will strongly prefer the simpler course of sticking to domestic sources of supply. The availability of this kind of help might often be the factor causing a firm to undertake an import transaction.

Institutional facilities seem clearly adequate in the sense that an importer who wants to make a remittance, or the like, can always find a bank that can handle the matter. As to the supplementary services, however, it is more difficult to define the term "adequate." In the survey made by the Department of Commerce, there were few complaints by established importers on the adequacy of these services. However, one does not know the extent to which other potential importers might have been deterred from undertaking purchases abroad by the absence of encouragement that a bank could have given. It would be hard to locate such persons in order to analyze the transactions that they might have made under different circumstances, but it seems likely that if there were some way of distributing more widely the kind of helpful advice and encouragement that some banks have been giving, there would be a worthwhile effect in expanding imports.

It may be that the bankers themselves have tended to be more conservative on the matter of developing foreign business than their own interests would warrant. Of the banks that have set up foreign departments, most reported that their operations were proving generally profitable and satisfactory. However, in view of the technical nature of this business and the training needed for it, a bank wanting to enter this field (or to do any rapid expanding of its foreign activities) must proceed with care.

Adequacy of credit facilities

As to the other major financial problem, that of extending credit to importers, there appear serious doubts regarding the ability of some kinds of importers to get credit as readily as might be economically desirable. "Extending credit" in this sense includes the action of a bank in issuing a letter of credit or otherwise extending a guarantee on behalf of the importer, if this is done without requiring from the importer a deposit of dollars equal to the liability that the bank is assuming on his behalf.

As noted above, it does not appear that firms with large capital and a strong financial position have any difficulty in obtaining credits of this kind -- just as they do not have difficulty in getting credits of other kinds for other purposes. Also, where the proposed import consists of staple materials that are quoted on commodity exchanges or enjoy a similar ready market, many banks are likely to extend credit with some degree of reliance upon the lien that they would hold upon the goods being imported. The problem of credit, therefore, seems to relate mainly to smaller or more specialized importing firms that deal in manufactured or other non-standard goods.

From the viewpoint of the banks, of course, each bank has already been extending credit to all applicants that the bank considers creditworthy. Also, as might have been expected, some banks appear in fact to have been more aggressive than others in finding ways to meet importers' problems. It may be noted that for the same reasons that make it difficult for most commercial banks to extend more liberal credit to importers, it would also be difficult for any U. S. Government agency to operate on any large scale in this field.

It may be well here to review some of the characteristics of the importing business that make financing more of a problem for such firms than for firms dealing in domestic goods. In the first place, because of the time required for physical shipment of most imports, the aggregate amount of goods that the importer has in his inventory, plus in transit at any given time, is likely to be relatively large in relation to his volume of business. Furthermore, there are various technical vicissitudes, not found in domestic transactions, which may delay the arrival of goods in transit and which therefore add to the normal business problem of having goods available at the time and place where they can be sold. Even where the importer already has contracts to resell the goods on delivery, the financing may be considered risky if there is uncertainty as to his ability to obtain the goods and re-deliver them in time to collect under the contract.

And, secondly, whereas a dealer in domestic goods may be able to receive lines of credit from his suppliers, the importer is likely to need a letter of credit arrangement whereby a bank or other financial institution guarantees payment to the foreign seller. This combination of circumstances causes the importer to have a greater need of bank accommodation.

It is said that in most European countries an importer is able to do business with banking institutions that have such a thorough knowledge of international trading, and of the markets for the particular lines in which the importer deals, that the bank can be relatively liberal in taking account of the value of the merchandise itself as a basis for extending credit. This may be possible largely because European banks have traditionally maintained large branch systems and widespread business connections in many parts of the world. It seems clear that most American banks are not prepared to extend this kind of credit, except in some cases on staple materials.

Apart from credits based in this way on the value of the merchandise in transit, bank credits are of course ordinarily based on the banker's analysis of the borrower's character, business ability, financial condition and prospective resources out of which repayment must come. Where the borrower is engaged in an import-export business, this kind of analysis requires a knowledge of the import-export business, the markets involved, etc., that most interior banks would not be likely to have. Thus, it is more difficult for an importer to obtain a line of credit if he is not in the locality of a bank that understands his business well enough to have confidence in its appraisals of the business.

In connection with this question of banks' willingness to extend credit lines to importers, it must also be noted that there are probably many would-be importers who have so little capital that they would not be considered suitable credit risks by any banks at all. It is worth pointing out that the promotional efforts of such people, if put to work on the sale of foreign manufactures needing to be introduced to American markets, might substantially increase the flow of some kinds of imports.

For whatever reasons, a considerable number of importers told the Commerce Department in its 1950 survey that they were unable to get adequate credit from their banks, and that this caused them to forego many import propositions that they considered safe and profitable. Many felt that American commercial bankers were overconservative with respect to import credits; but on the other hand, some were inclined to admit that the particular credits would not have been safe enough for banks to extend with depositors' funds, and they felt that the only solution might be the developing of some other source of credit.

One of the ideas mentioned in this connection was that it would be desirable if this country had well-capitalized merchant banking firms which would be prepared to share in the risks (and in the profits) of a transaction. Along the same lines, some importers reported the obtaining of credit from factoring firms or from other non-bank lenders, paying higher than bank rates. Another idea was that the foreign exporters' terms of payment ought to be more liberal. A few felt that some arrangement for loans or guaranties by the United States Government would be a desirable solution.

The following sections of this paper will undertake to discuss two of these possibilities somewhat further. One is the use of factoring firms which, charging higher rates, are often willing to assume credit risks that banks would not be willing to take. The other relates to the obtaining of credit by an American importer from his foreign supplier, especially where the foreign country has an export credit insurance arrangement, as most European countries have.

Use of factoring firms

Staff members of the Federal Reserve Bank of New York have conducted a survey of non-bank sources of credit available to smaller importers in the New York area. There are about ten firms in New York that are engaged almost exclusively in the financing of foreign trade, with a combined capital of around $15 million; the lending potential of these firms can further be expanded about threefold through bank credit available to them. With some additional capital supplied to foreign traders by factoring firms that operate in both the domestic and the foreign field, and by customs brokers and freight forwarders, a total of over $50 million is probably available from non-bank lenders. These factors seem to have had enough funds at their disposal to finance all the business offered to them which they considered sound enough to take. While a large part of the financing done by these lenders has been exports, their volume of import financing has also been substantial, fluctuating over a range of perhaps $35 to $75 million a year.

These sources of credit have been used not only by small and medium-sized importers who do not have access to bank credit but also as an additional or alternate credit source by other importers. These include, for example, importers who specialize in commodities with a marked seasonal pattern and who need more credit at certain times of the year than their banks will allow them. While some banks may be reluctant to have importers use their lending facilities and those of factors at the same time, other banks have referred customers to factoring firms for additional amounts that the banks were unwilling to finance. A bank may refer an otherwise entirely creditworthy client to a factor if the bank feels that the proposed financing would go beyond the amount warranted by the importer's capital and general credit standing, and hence would rely too heavily on the successful resale of the particular goods, or if the proposed transactions fail in some other way to fit the traditional "pattern" of the transactions usually financed by the bank, such as exports or imports involving "switch" deals.

A factor depends, of course, on his knowledge of commodities and of supply conditions and his contacts in the foreign-trade field, to put him in position to extend credits where a commercial bank would not feel able to assume the risks. Frequently these contacts also enable the factor to give the importer special advice and guidance on the details of the transaction.

It should be borne in mind that the discussion here relates to firms that operate in New York exclusively, i.e. extend credits only to foreign traders who are near enough to New York for direct contact with the factoring firm. It is believed that similar firms are active on a smaller scale in at least a few other port or inland cities, but no estimate is available as to the size and importance of their business.

Charges by factors for the extension of credit usually consist of two items. A flat fee, ranging from 5/8 to 1 1/2 per cent of the amount involved, is charged for the opening of an import letter of credit through the factor's regular bank, whether the credit is used or not. Once the letter of credit is drawn upon, the charges on the amount outstanding may run anywhere from 3/4 to 2 per cent per month, or 9 to 24 per cent on an annual basis.

While costs of factor financing are thus far in excess of those incurred under bank financing, these charges probably do not often prevent a transaction from being consummated, since the kinds of import transactions that are customarily financed by factors would ordinarily involve high enough profit margins to support such charges. These imports have consisted in the main of consumer goods (such as toys, giftware, and household articles); certain textile by-products (such as cotton waste and wool waste); and non-perishable food products. Imports of raw materials are rarely factor-financed, partly because they tend to be made in great bulk by a few established firms and partly because the small profit margin on these commodities makes recourse to factors too costly.

Export credit insurance arrangements

Under normal arrangements, as outlined in the first part of this paper, foreign exporters have most often expected payment on a "letter of credit" basis, whereby the importer must provide a guaranty of payment by a Bank before the goods will be shipped. Sometimes the exporter may be willing to ship goods against payment on delivery, but even in this case the importer would have to arrange for financing from U. S. sources by the time the goods arrive.

The biggest obstacles to the more liberal extension of credit by the foreign exporter would seem to be (1) his difficulty in getting information as to whether or not an ordinary American customer is creditworthy and (2) the difficulty, expense and delays of collecting an account at long distance, if any kind of difficulties or questions should arise. Even if an exporter has plenty of capital or credit available, he may not want to risk his own funds by extending credit to American purchasers about whom he does not know very much. If the exporter's country has an export credit insurance system, and if the system can arrange to accept the burden of collection problems and collection risks, then it would seem possible to obviate these difficulties.

In further exploring this general subject it would seem useful to have in mind especially the British Export Credits Guarantee Department. This is not only because of Great Britain's importance as an exporter but also because the British system is probably the oldest and best developed of these systems and has, to a considerable extent, served as a model for other European systems.

A British exporter can submit all or a part of his foreign credits for inclusion under one of these guaranties. Each proposed debtor is subject to acceptance or rejection by the Department, whose representatives in the United States would check on the credit standing of American debtors, except that if the exporter has an over-all policy covering all his export credits (or all credits to American importers), he need not consult the agency in advance regarding any small credit where it is below some agreed amount and where the exporter has obtained a favorable report on the importer from an American rating agency or banker. If a credit is accepted and a loss occurs, the percentage covered by the guarantee would be between 80 and 90 per cent, depending on the circumstances of the particular guarantee contract. The rest of the loss would fall on the British exporter, but this would correspond roughly to his profit on the transaction, with the guarantee assuring full reimbursement of his out-of-pocket costs.

The Department seems to have been resourceful in finding ways by which it can help exporters to extend credit beyond the usual orthodox arrangements. It is not uncommon for it to guarantee credits with maturities running to four months or even six months after the arrival of the goods. It also makes special arrangements for such cases as a desirable importer who has only $10,000 of capital and who requires a credit of perhaps $50,000; the Department will make the necessry special investigations and in appropriate cases will approve such credits, subject to the collecting of a higher rate of premium from the British exporter.

It may now be asked whether the Department could properly go any further than it already does in guaranteeing credits of types that a conservative banker would not be inclined to accept. It would seem to be in the British interest to go as far as possible in extending credit wherever this will increase the flow of exports, and particularly where it may be instrumental in opening up new channels of trade, provided there is reasonable expectation of the credits being repaid. On the other hand, it would obviously be undesirable, from many points of view, if credit standards were lowered to the point where a large volume of defaults would result. Furthermore, of course, if a policy of liberalization proceeded to the point where the premiums collected could not reasonably be expected to cover the prospective losses, this would amount to a subsidization of the exporters concerned, which would raise questions of conflict with U. S. Government policies on this subject.

This question of further liberalization needs to be examined by the British authorities themselves. A relevant factor would be the existing relationship between the premiums collected on guaranties of American credits and the losses sustained on this category of business. If it appeared that the premiums were considerably in excess of the losses, this would suggest the possibility that credit standards could be further relaxed.

One special respect in which there may be room for liberalization, relates to the credit terms that are acceptable to the insuring agency. In the beginning, with respect to ordinary current export transactions, these agencies' readiness to issue guaranties was limited to cases where the maturity and other terms of the credit would be in line with the current custom for international transactions. To give the maximum help to the exporters in their countries, it might be desirable if they were prepared to guarantee credits that would be extended on the more liberal terms that their American domestic competitors offer to American customers.

Apart from the question of more liberal credit standards, there would seem to be several respects in which the present export credit guarantee arrangements could perhaps be changed so as to increase their effectiveness. First, increased publicity for the available credit facilities might be helpful. There must be many potential importers in the United States who have the impression that imports necessarily involve complicated arrangements for letters of credit, foreign exchange remittances, or the like. If businessmen generally were aware that a foreign exporter, with the backing of some insuring agency, might be in a position to ship goods on open account terms, as so much domestic business is done, this might be very helpful.

Also, it may be worthwhile for foreign official insuring agencies to review the extent to which they should adhere to the principle of dealing primarily with the foreign exporter rather than directly with American importers. The British agency has at least to some extent departed from this principle in order to develop more flexibility in arranging to cover special situations. Perhaps this sort of dealing between the foreign insuring agency and the American prospective importer might usefully be carried further - for example, possibly, resulting in some arrangement whereby the importer could be told in advance that credits to him from that country's exporters would be accepted for insurance up to some stated amount.

Arrangements for collaboration by the foreign insuring agency with the local bank where the American importer does business, would also seem worth considering. For example, some arrangement might conceivably be worked out whereby the importer's local bank would extend credit to him under a guaranty arrangement, with the export credit agency of the foreign country agreeing to reimburse the bank for some percentage of any loss. Such an arrangement not only would bring in more fully the local bank's knowledge of the local standing of the debtor but it would also have several incidental advantages: it would result in an earlier transfer of dollars to the exporters' country and, perhaps very important, it might help to arouse further interest in foreign trade on the part of the American bank. However, the arrangement might be too complicated to be worthwhile unless a very substantial volume of transactions were foreseen.