Section 3 Finance

Introduction

Any small business which is planning to start trading abroad needs to have a sound understanding of the financial issues involved. In this section we look at the following key topics:

Topic 1: The Foreign Exchange Markets

When you have worked through this topic you should be able to:

- describe what is meant by the term ‘foreign exchange markets’
- explain why foreign exchange rates fluctuate
- explain the history of the euro
- list the countries which have now adopted the euro as their national currency.

Topic 2: Foreign Exchange Rate Risk

When you have worked through this topic you should be able to:

- explain the concept of foreign exchange risk
- identify the ways in which fluctuations on the foreign exchange markets can affect your business
- identify ways in which your bank can help you to minimise the foreign exchange risk.

Topic 3: Raising Finance

When you have worked through this topic you should be able to:

- identify the additional expenses your business is likely to incur as a result of beginning to trade overseas
- identify the sources of finance which are available to your business
- access the guidelines which will help you to prepare a professional business plan.

Topic 4: Cash Flow

When you have worked through this topic you should be able to:

- explain the difference between cash inflows and cash outflows
- explain the difference between start-up costs and running costs
- explain the difference between fixed costs and variable costs
- identify the warning signs that signal your customers’ inability to pay your invoices
- identify the start-up costs and running costs you can expect to pay over the next 12 months
- forecast your cash flow for the next 12 months.

Topic 5: Making Payments in Foreign Currency

When you have worked through this topic you should be able to:

- identify the range of services your bank is able to provide, and the associated costs
- choose the most appropriate method for making payments in foreign currency to suppliers.

Topic 6: Receiving Payments in Foreign Currency

When you have worked through this topic you should be able to:

- identify the range of services your bank is able to provide, and the associated costs
- choose the most appropriate method for receiving payments in foreign currency from customers
- explain what is meant by the term ‘factoring services’ and identify whether or not these services would be of value to your business.

Topic 7 The Export Credits Guarantee Department

When you have worked through this topic you should be able to:

- describe the range of services which are available from the Export Credits Guarantee Department
- identify a range of services useful to your business which are provided by other government departments and small business organisations.

Glossary of commonly used financial terms

Cash deficit The money owed by the business and/or needed by the business to meet its running costs and other financial commitments.

Cash surplus The money available to the business when all the running costs have been paid.

Creditor The person (or business) who owes you money.

EMU Economic and Monetary Union.

Exchange rate The value of one currency against another when exchanged – for example, £1, when exchanged, will buy $1.37 US or euro €1.5817.

Fixed term loan A loan, agreed with your bank or other financial institution, to provide a specific amount of money which must be repaid over an agreed period of time, usually by way of specified monthly repayments, at a pre-arranged cost – for example, 12%.

Foreign Exchange Market A generic term which describes the buying and selling of currencies – often referred to as the FOREX or FX.

Foreign Exchange Rate Risk The risk involved in setting a price in a currency which, by the time the customer pays, may have reduced in value.

IBAN International Bank Account Number

Letter of credit Document, issued by your bank, which guarantees your supplier that, providing they meet certain conditions, they will receive payment.

Overdraft A loan which allows you to spend up to a specified limit, for an agreed period of time, at a pre-arranged cost – for example 10.3%.

Payee The person (or business) to whom you are making a payment.

Running costs The day-to-day costs incurred in running a business – for example, wages, utilities, transport etc.

Start-up costs The costs involved in starting up a business, or a part of a business – for example, foreign trading. Start-up costs are usually one-off costs – for example, purchase of equipment, website development etc.

Section 3 Finance

Topic 1 The Foreign Exchange Markets

The term ‘foreign exchange markets’ is used to describe the international institutions around the world which trade – buy, sell and exchange – the currencies of different countries. During each 24-hour period, billions of pounds, dollars and other currencies are traded by individuals, institutions and corporations.

Some of the buying and selling – for example, selling Euros in exchange for American Dollars, or selling £s in exchange for Japanese Yen – is done in order to finance the international trade of goods and services. If, for example, a British company wants to import a product from Brazil, the Brazilian company which is supplying the product will expect to be paid in Brazilian reals – the currency of the country. The British firm will therefore need to buy reals from an institution which trades in currency … in other words, the foreign exchange market.

Some of the buying and selling of currency is done on a purely speculative basis in the hope that the individual or corporation buying/selling will make a profit. If the value of a currency goes down and is cheap to buy, a speculator may decide to purchase large amounts of that currency and then sell it later, when it is more expensive, thereby making a profit.

Why do foreign exchange rates fluctuate?

Currency prices, e.g. the amount of, say, Turkish Lira you can buy in exchange for £1, are affected by a number of different factors including interest rates, inflation, political stability and, especially, supply and demand.

How supply and demand of £ sterling affect exchange rates

Supply of sterling

The British pound is **sold** on the foreign exchange market when:

- foreign goods and services are imported into the UK – this is because British companies sell £s in exchange for foreign currency in order to pay for the goods and services they want to import
- speculators – like George Soros – sell pounds and buy another currency
- investment capital leaves the UK, looking for an improved interest rate.

Demand for sterling

The British pound is bought on the foreign exchange market when:

- British goods and services are exported out of the UK. This creates an inflow of foreign currency – dollars, yen etc – which has to be converted into sterling
- foreign individuals and corporations decide to invest in the UK
- speculators buy pounds in an attempt to make a profit.

When the demand for sterling is high, the value of the British pound increases or ‘appreciates’.

George Soros and the Foreign Exchange Market

In September 1992 George Soros, the Hungarian born speculator and financial entrepreneur, bet a very large sum of money that the value of the British pound would fall. His instinct was right and, as a result, overnight he made a profit of almost 2 billion US dollars.

Check Point

To get a flavour of the foreign exchange market and how it operates visit:

www.fxcm.com

www.gaincapital.com

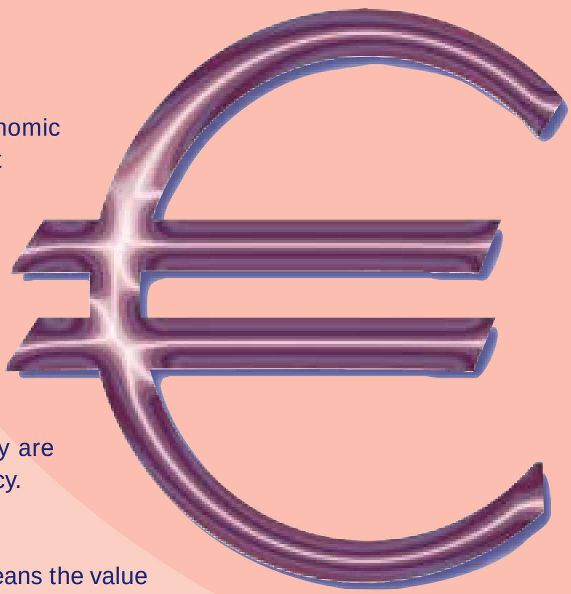
www.bloomberg.com/markets

The Euro

If you intend doing business in Europe you will need to know which countries are now trading in euros. The European countries which have now adopted the euro as their national currency are:

• Austria	• France	• Ireland	• The Netherlands
• Belgium	• Germany	• Italy	• Portugal
• Finland	• Greece	• Luxembourg	• Spain

The history of the euro



On 1 January 1999 the European countries which decided to join EMU (Economic and Monetary Union) introduced a common currency – the euro. From that date until 1 January 2002, these countries continued to trade using their own currency – French francs, German marks, Italian lire, Spanish pesetas etc – alongside the euro.

However, on 1 January 2002 the traditional currencies were completely replaced by the euro. As a result, if you intend to do business with any of the EMU countries, you will have to trade in the single currency. Fortunately, even though, as yet, the UK has not opted to join EMU, banks and other financial institutions in this country are ready, willing and able to assist you to do business using the single currency.

What's one euro worth?

The euro is treated in the same way as any other foreign currency. This means the value of one euro depends on the exchange rate which is offered by your bank on the day on which you want to exchange euros for pounds, or pounds for euros.

It is important to note that this rule applies regardless of whether you want to exchanges pounds for euros, US dollars or any other global currency.

Section 3 Finance

Topic 2 Foreign Exchange Rate Risk

Because of the way in which foreign exchange rates change (from day to day, and even from hour to hour) it is important to understand how this could affect your profits. Say, for example, you are buying goods from a company which is an EMU country – and therefore trading in euros – and you plan to import the goods to the UK.

- You place your order in February, and it is agreed that the goods will be delivered at the beginning of March, and paid for at the beginning of April.
- You agree a price with the supplier of, say, €1000. On the day you place your order, (in February), you see that €1 = £1.5817. Therefore, at this exchange rate, you calculate that the goods will cost you £632.00.
- At the beginning of March you take delivery of the goods.
- At the beginning of April, when it is time to pay the invoice, you check the exchange rate and see that things have changed dramatically. The exchange rate is now €1 = £1.4651. At this new exchange rate the goods will cost you £682. In effect, £50 more than you expected to pay when you agreed the price in February.

One solution to this problem is to agree the price in sterling. This means that if you agree a price of say, £500, then that is the price you will pay – regardless of fluctuating exchange rates.

How might the foreign exchange market affect your business?

Fluctuating currency rates can have a major negative impact on a British business. For example, when Marjorie Owens, a British writer and management consultant, sold a business book to an American publisher, it was agreed that she would be paid $8000 on publication. At the time the price was agreed the exchange rate was $1.37 = £1. This meant that Marjorie thought she would receive almost £6000 for the work she was about to do. In fact, by the time payment became due the exchange rate had changed to $1.67 = £1. The outcome was that because Marjorie was paid in dollars – which were then exchanged into GBP sterling – she received less than £5000. In other words, the fluctuation in the exchange rate cost her £1000.

However, when the exchange rate favours businesses in the UK, it can mean that foreign countries find British goods and services too expensive. Therefore, instead of buying British goods and services, they will choose to buy from countries where the exchange rate is more favourable to them and, consequently, goods are cheaper. When foreign countries choose not to 'Buy British' this can have a major impact on the British economy with the consequent loss of British jobs.

The challenge for the government is to ensure that exchange rates, interest rates and inflation all remain stable so that British goods and services can be sold at competitive prices on the global markets.

Key facts about the foreign exchange market

- **Foreign exchange market is a generic term which describes the buying and selling of currency**
- **Unlike the stock exchanges there isn't a specific physical place that is the foreign exchange market – all currency trading is done over the telephone, and by fax or e-mail**
- **the foreign exchange market is often referred to as FOREX or, sometimes, FX.**

Check Point

Some countries, regardless of whether or not they are trading in the euro, may not be prepared to agree a price in sterling, rather than their own currency.

Contact your bank and find out what options they can offer you in order to help you manage the foreign exchange rate risk. For example, if you have to agree a price in advance in euros, dollars, or any other currency, your bank may have a system which will allow you to:

- fix the rate of exchange on the day you agree the price
- fix the rate of exchange, but keep the option of taking advantage of a strong pound (the bank will probably charge you for this).

Use the space below to note down the outcome of your conversation with your bank, and their suggestions as to how they may be able to help you to manage foreign exchange risk.

Checking exchange rates

You can check current exchange rates by visiting:

www.hmce.gov.uk/business/rates/rates.htm

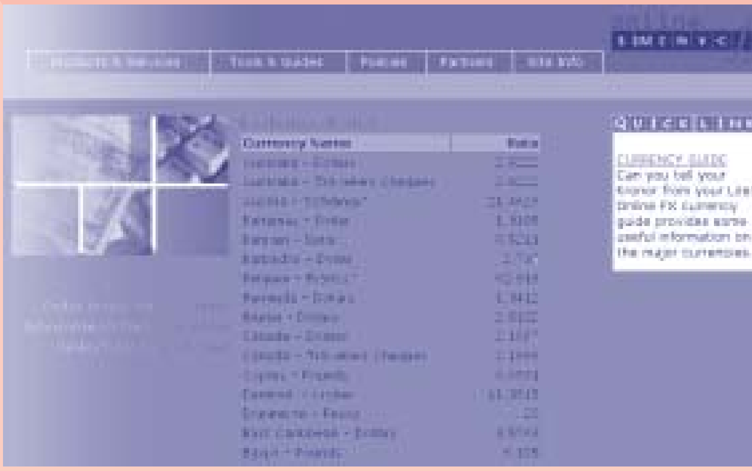
The exchange rates provided on this government website (updated weekly) are the exchange rates which should be used when preparing Customs & Excise documentation.

www.onlinefx.co.uk/content/services/rates.asp

This website provides at-a-glance information on how much £1 sterling is worth at that moment in relation to a range of other currencies.

The currencies for most countries are listed.

You should also be aware that the rates at which currencies are bought and sold are not the same. Hence, when you buy US$, the ‘sell’ exchange rate may be £1 = $1.44, but when you try to change dollars back to pounds, the ‘buy’ exchange rate may be £1 = $1.48. This is in addition to the normal commission charged on each transaction.



Section 3 Finance

Topic 3 Raising Finance

For any small business which is thinking about expanding its scope of operations overseas, finance is a key consideration. The amount of additional finance you will need if you are going start importing or exporting will depend on a number of factors.

- You may plan to:
  – market *existing* products/services
  – develop new products and/or services to sell to your international customers – research and development costs involved can be considerable.
- Marketing products/services costs may include re-writing information, instructions etc. in different languages, and re-packaging.
- You may need to invest in new equipment, e.g. computers and database software; machinery for manufacturing goods to a different specification more suited to your international customers.
- You may want to recruit additional staff with specific language skills or local knowledge of your chosen country, or to retrain existing staff.

Your business will almost certainly incur additional expenses if you start trading internationally. The *check point* opposite will help you to identify some of these outgoings so that you can start to think about:

- whether or not you are going to need to raise additional finance to support the global aspect of your business
- the amount of additional finance you are likely to need.

Sources of finance

The specific sources of finance which are available to you and your business will, of course, depend on a number of factors including the current size of your business, your annual turnover, recent profit and loss accounts and so on. Regardless of the specifics, there are a number of options which may be available to you if you need to raise additional finance to help you expand the business overseas.

Arranging a bank overdraft

Depending on (a) the amount of finance you need to borrow, and (b) the amount of time you will need to repay the loan, arranging an overdraft with your bank may well be the most suitable means of borrowing. Having a pre-arranged overdraft means that you can pay for goods and services as the need arises, up to the agreed amount. To organise a business account overdraft you will need to:

- clarify the amount of money you need, and the length of time you will need it, e.g. an overdraft of £15,000 for a period of six months
- prepare a business plan which shows how you intend to spend the money, and the way in which you intend to repay the money
- organise a face-to-face meeting with your bank manager to make your request for the additional funding.

Your bank manager will need to be persuaded and reassured that you will be able to pay off the overdraft within the agreed time-scale. If not totally convinced, your bank may require some form of security such as a ‘Second Charge’ on your home. This means that (a) you cannot sell your home without the bank’s approval, and (b) if the bank decides to foreclose on the overdraft the bank can, at worst, force you to sell your home to repay the debt.

Although the processes for raising funds for overseas expansion may be very similar to those for any other business expansion, banks etc. may require even more research into your future markets (including the financial stability of the countries you are thinking of trading with), and security for their loans. (See Topic 7)

Check Point

This check point will help you to clarify the additional expenses your business is likely to incur as a result of expanding into foreign trade, and the amounts of these additional expenses. When completed, you should be able to use the chart below as the basis for preparing a request for additional business finance.

Type of expenditure	Approximate amount of finance needed	Estimated length of time finance needed	Most appropriate source of finance
example: *EQUIPMENT: 3 new computers, software and staff training*	*£10,000*	*12 months*	*hire purchase or bank loan*
Premises:			
Equipment:			
Staff and/or staff training:			
Marketing:			
Transport & distribution:			
Other – specify:			

Arranging a fixed-term loan

A small business which needs additional finance in order to purchase specific items of equipment or machinery, or to invest in larger premises, may decide to organise a *fixed-term loan*. If you opt for this route you may find you can borrow money from:

- your bank
- family and friends
- your building society (where the loan can take the form of an increased mortgage on your home)
- a finance company that specialises in providing loans to home-owners (the property is used as security against the loan)
- a finance company that specialises in providing loans to businesses (the business is used as security against the loan).

The key point to remember is that before organising additional finance of any kind from any source, you must be reasonably confident you will be able to meet the repayments.

For detailed guidelines on how to prepare a business plan go to **www.startups.co.uk/planning** and click on Business plan guidelines.

Annual income twenty pounds, annual expenditure nineteen pounds, nineteen shillings and sixpence… result happiness. Annual income twenty pounds, annual expenditure twenty pounds and sixpence … result misery.
Charles Dickens

Topic 4 Cash Flow

Cash flow – the way money flows into and out of the business – is the life blood of any organisation, especially a small business. Shortage of cash, rather than lack of orders, is the main cause of failure in many small and medium enterprises. A business needs a steady stream of money coming in to pay its weekly and monthly outgoings. In many cases, when there is a continuing and serious problem with cash flow, the bank will decide to 'pull-the-plug' and request immediate repayment of the overdraft loan. Where a business is unable to clear its overdraft in accordance with the bank's requirements, liquidation may be the only solution. It is therefore extremely important, before you begin to expand your business abroad, to consider ways your cash flow could be affected.

Cash Inflows and Outflows

Generally, the main cash inflows in a small business result from:

- money received from customers (sales of goods and services)
- borrowed money (overdraft facilities or other loans)
- money paid into the business by the owner, out of the owner's personal resources (if any).

The usual cash outflows from a small business are:

- payments to suppliers (goods, services, utilities and so on)
- staff salaries, National Insurance Contributions, pension contributions, staff expenses etc.
- interest payments (bank charges and other payments on loans)
- payments to the Inland Revenue and Customs & Excise (income tax and VAT).

A business with more money coming in than going out, has a cash surplus; more money going out than coming in is a cash deficit.

Start-up, Running, Fixed and Variable Costs

Start-up costs

- Costs paid out initially in order to get the international trading side of the business up and running.
- Generally, one-off payments.
- If you borrow money to finance your start-up costs remember to add the interest on the repayments to the list of running costs.

Running costs

- Daily, weekly and monthly costs that your business has to pay out in order to survive.

Fixed costs

Also called 'indirect costs' or 'overhead costs', they are fixed and unalterable and can include:

- Vehicle Licensing Tax (Road Tax)
- loan repayments you have agreed to pay on a monthly basis, e.g. a hire purchase or other fixed period loan
- rent or mortgage repayments for your business premises.

Variable costs

These are often related to production, so the more you produce the higher they are likely to be. These are the costs you can make economies on, and can include:

- materials, parts, components
- labour (especially overtime)
- communications (including telephone charges, postage etc.).
- packaging
- transport
- power for heating and lighting

Start-up costs can include:

- new premises, vehicles, machines, equipment
- newly designed stationery, packaging etc.
- new stock
- initial fees connected to raising finance.

Running costs can include:

- telephone, internet access, heating, lighting etc.
- vehicle fuel and taxes
- staff salaries and other related costs
- rent and business rate community charge
- petty cash items – postage, stationery etc.

Check Point

(1) Note any start-up costs your overseas business will incur.
(2) Tick each of the running costs which your business has to pay out on a regular basis. Add any additional running costs you have to pay which are not mentioned in our list.

Start-up costs

Start-up costs	Approx amount
Total:	

Running Costs

Running Costs	Approx amount
Premises – rent, mortgage etc.	
Premises – business rate community charge, water, etc.	
Electricity and gas – heating, lighting etc.	
Communications – telephones, mobiles, internet access etc.	
Staff – wages and other costs.	
Transport – petrol, road tax, insurances, rail fares, haulage etc.	
Marketing – advertising, packaging, brochures, web site design etc.	
Professional fees – consultancy, accountancy etc.	
Loan repayments – including interest.	
Raw materials.	
Total:	

(3) Note down your anticipated cash flow figures (income and expenditure) for the next twelve months. You should take into account:

- money you expect to **receive** from foreign orders (take account of any seasonal variations you are likely to experience)
- money you expect to **pay out** as a result of doing foreign business.

Cash flow forecast for the next 12 months:

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Cash in bank												
Revenue from sales												
Total cash in hand												
Running costs												
Total cash out												
BANK BALANCE												

From this cash flow forecast you should be able to see, roughly:

- the times of the year (if any) when you are likely to have a cash surplus, i.e. money in the bank
- the times of the year (if any) when you are likely to have a cash deficit – an overdraft situation.

(4) Finally, note the remedial action you could take to avoid financial problems e.g. cutting back on variable cost outgoings or pre-arranging a bank overdraft for a limited period to cover the cash flow deficit.

The art of prophecy is very difficult ... especially with regard to the future.
Mark Twain

Remember, however, that the most likely cause of cash deficit is late payment of invoices by your customers (see Section 6 Topic 2).

Section 3 Finance

Topic 5 Making Payments in Foreign Currency

If you are planning to globalise your business, you will certainly need to know how to transfer money out of the UK in order to make payments using currencies other than £sterling (often also referred to by other countries as GBP).

International drafts

You can ask your bank to send out an international draft for any value, in any currency, direct to your payee. An international draft is a guaranteed, indefinitely valid cheque which is payable at a specific bank in a specific country.

International money orders

You can purchase an international money order over-the-counter at most branches of Barclays Bank. Barclays will provide international money orders for any amount up to £10,000 (or the equivalent) in any of the following currencies:

- £sterling
- US$
- Canadian$
- Australian$
- € euro

Credit card

If your payee has the facility to accept payment by credit card, you can pay for goods and services using:

- MasterCard
- Visa
- American Express.

A foreign currency bank account

A foreign currency bank account operates in the same way as a regular current account, the only difference being that it uses a foreign currency rather than £sterling. HSBC offer:

- US$ check account – pay American suppliers with a US$ cheque drawn on an American bank.
- € euro account – pay suppliers in euros direct from your own € euro bank account.
- Multi-currency account – pay suppliers with a cheque from your own multi-currency account made out in Australian dollars, Bahrain dinars, Canadian dollars, Danish krone, Euro, Hong Kong dollars, Japanese yen, New Zealand dollars, Norwegian krone, GB pounds sterling, Saudi Arabian riyals, South African rand, Swedish krone or Swiss francs.

An electronic fund transfer

This is a payment, sent electronically, from your bank to your payee's bank. Once you have given your bank your instructions, the payment can be sent anywhere in the world. Electronic fund transfers are particularly useful if you need to pay suppliers in developing countries because these kinds of payments can be made in *any* currency.

WorldLink®

WorldLink® is described by Citibank as a *cash management and treasury solution* which, they say, allows you to make payment online – via your internet service provider – to anywhere in the world, in any currency.

Check Point

When paying a supplier's invoice or making any other payment abroad, you will need to know the £sterling value of the currency you are sending out of the country. Fast and very easy to use, currency converters can be found at:

www.Bloomberg.com/markets/currency/currcalc.html

www.travlang.com/money/

To find out more about these methods of making payments in foreign currencies go to:

www.corporate.barclays.co.uk

www.ukbusiness.hsbc.com

www.citibank.com/e-business

www.co-operativebank.co.uk

Also:

- contact your own bank and find out what services they are able to offer
- talk to people in other small businesses and find out which methods of making foreign currency payments they prefer.

Bear in mind that all of these services come *at a price*, so you will need to shop around to find the service that, for your business, will be the most efficient and economical.

Letters of credit

A *letter of credit* is a document issued by your bank, on your behalf, which undertakes to pay:

- a specified amount
- to a specified beneficiary (a named individual or a company)
- on presentation of certain documents at a specific place.

A letter of credit is a guarantee to your supplier that, providing they turn up at their bank with the correct documentation and within a specified time, the bank will pay them the specified amount. So, if you are buying from a foreign supplier and organise a letter of credit, your supplier can be sure that they will be paid. In addition, if you are exporting goods abroad and want to be certain that you will be paid, you can ask your buyer to organise a letter of credit.

To organise a letter of credit you will need to:

- agree, with your supplier, the cost of the goods you are purchasing
- ask your bank to prepare a letter of credit which will be sent to your supplier.

To see a sample letter of credit go to
www.tradenet.gov/Process/Negotiat/Finalize/Letter.htm

The man who has no imagination has no wings.
Muhammad Ali

Section 3 Finance

Topic 6 Receiving Payments in Foreign Currency

Clearly, once you begin to do business abroad, you will also need to be able to receive payments in US$, euro, zloty or whatever. Most of the leading banks offer a number of options for receiving payments in foreign currencies. However, be aware that many currencies are not readily transferable and should not be accepted.

Cheques

Your bank will almost certainly be happy to accept a cheque, payable to you or your business, in any currency. Cheques which are received from outside the UK will be dealt with on the basis of negotiation or collection.

Negotiation

This service is used when the cheque is made out in the currency of the country in which it is drawn – for example, euros drawn on a French bank. Here, the bank immediately credits your account with the appropriate sterling amount. This service usually needs to be set up by prior arrangement with the bank and a charge will be made.

Collection

This service is used when the cheque is made out in a currency other than the currency of the country in which it is drawn – for example, a cheque made out for US$ drawn on an Italian bank. However, it could take up to six weeks for this kind of cheque to clear into your account and a charge will be made for the service.

It is particularly important, when accepting a cheque from a customer that:

- the cheque amount does not exceed the limit on the guarantee card
- you do not accept multiple cheques for the same transaction, which, added together exceed the card limit, as the cheque guarantee will not apply.

International Banker's Drafts

If you are sending goods abroad and require a large payment in settlement of your invoice, you may decide to ask for a banker's draft, rather than a regular cheque. A banker's draft is generally a guaranteed method of payment which, unlike a cheque, will not 'bounce', or otherwise fail to be honoured. However, check first that this is the case with the country you are dealing with

Lockbox or Retail Lockbox

If your business receives more than 500 postal payments each week ask your bank about lockbox arrangements (see check point).

The Lockbox system can save you a great deal of time but, like all banking services, will attract a service charge.

Letters of Credit and Electronic Fund Transfer

These can be used for receiving as well as making payments from abroad (see Topic 5 in this section).

International Bank Account Number (IBAN)

From January 2002 IBANs (International Bank Account Numbers) are being introduced to facilitate the automatic processing of cross-border payments, so that payments are made faster and more efficiently. Anyone who makes or receives payments from abroad will benefit from having an IBAN.

Factoring to ensure fast payment

Slow paying customers can cause terrible cash flow problems for a small business. One solution can be to use an outside company which, for a fee, will *factor* your invoices.

> I love deadlines. I like the whooshing sound they make as they fly by.
> **Douglas Adams**

What is involved in factoring?

Factoring involves a third party (the factoring company):

- buying your outstanding invoices from you
- paying you immediately – usually up to 80% or 85% of the value of each invoice
- seeking payment of the invoice direct from the debtor.

The upside of this arrangement is:

- you will receive payment within 24 hours from the factoring company, rather than having to wait for your customer to pay
- you will not need to speed time chasing bad debts – the factoring company will do that
- some factoring companies offer a service which includes sales ledger management, credit control and credit checking on your behalf.

The downside of this arrangement is:

- you will lose a proportion of every outstanding invoice – this is the fee taken by the factoring company and can be 15% or more of the value of the outstanding amount. You will also be required to pay a further 1% to 2.5% of your annual turnover to the factoring company, and there may be other conditions.
- you will need to prove to the factoring company that your business is financially in good shape and that your annual turnover falls into line with their guidelines.

The key point here is that factoring is definitely not for every small business, but it may be worthwhile checking out what is on offer, and how much it will cost.

Check Point

To find out more about the Lockbox/Retail Lockbox services contact your own bank, or visit:
www.royalbankscot.co.uk
www.corporate.barclays.co.uk
www.ukbusiness.hsbc.com

To find out more about factoring services contact your own bank or financial adviser, or visit:
www.factors.org.uk – the Factors & Discounter Association
www.alliance-leicesterinvoicefinance.co.uk/companies.asp

To find out more about International Bank Account Numbers contact your own bank, or visit:
www.apacs.org.uk/IBAN/iban/default.html

> Whenever you see a successful business, someone once made a courageous decision.
> **Peter Drucker**

Section 3 Finance

Topic 7 The Export Credits Guarantee Department

The Export Credits Guarantee Department – often referred to as the ECGD – is the UK's official export credit agency, and is a government department which reports to the Secretary of State for Trade and Industry.

The main role of the ECGD is to help UK exporters compete in overseas markets where the private sector – banks and other financial institutions – may not be able to help. The ECGD is able, where appropriate, to arrange finance facilities and credit insurance for contracts valued from £20,000 up to millions of pounds. They also provide overseas investment insurance for UK exporters.

Export credit insurance

The ECGD can provide your small business with export credit insurance which will cover three basic risks:

- buyer default – where your customer is unwilling to pay
- buyer insolvency – where your customer is unable to pay
- country risk – where political or other upheaval causes trading problems in your customer's country.

With most credit insurance you are required to show due diligence and chase the debts for a period of time before you are paid.

Export Insurance

Export insurance can usually be obtained from the private insurance market in respect of consumer goods or commodities on short payment terms. The ECGD, though, are able to offer an export insurance policy which is suitable for transactions involving capital goods, major services and construction projects.

Supplier credit finance facility

As a small business planning to export goods or services abroad you will almost certainly have two key concerns:

- How can I keep my cash flow in good order if foreign customers want credit and time to pay?
- What can I do if, for whatever reason, foreign customers refuse to pay?

These are, of course, major concerns for small businesses everywhere, whether or not they are involved in exporting. But for most people, the idea of chasing non-paying customers in their own country is slightly less daunting than trying to chase bad debts abroad.

ECGD offer a Supplier Credit Finance Facility – (SCF) – which, in effect, allows the small business to pass these risks onto their bank and the Export Credits Guarantee Department. Using SCF, if your customer defaults on payment, then ECGD will pay your bank, in line with their guarantee of payment.

Lines of credit

Obtaining a line of credit allows you to tap into the finance made available to support UK exports. The line of credit is made available by a UK bank to an overseas bank. Overseas customers can then purchase goods which are being exported out of the UK. Once the goods are exported, or the services are provided, the UK exporter is paid and if the customer fails to pay any part of the loan, the guarantee provided by ECGD means that the bank still gets paid in full.

All of these – and other – financial services are available to small businesses at:
www.ecgd.gov.uk

SCF
ECGD

Check Point

In addition to the Export Credits Guarantee Department there are a number of other UK government departments and associated organisations that specialise in providing support and assistance to small businesses.

To save you time we have listed these below and strongly advise you to visit each of the websites we mention. By taking some time now to identify what is available, you may be able to save yourself a considerable amount of time and trouble in the future. You may also find it helpful to make some notes below.

Government departments:

www.tradepartners.gov.uk Government export information web site

Notes:

www.dfid.gov.uk Department for International Development

Notes:

www.hmt.gov.uk HM Treasury

Notes:

Support for small businesses:

www.businessadviceonline.gov.uk Small Business Service/Business Link site

Notes:

Creditors are a superstitious sect – great observers of set days and times.
Benjamin Franklin