

## Taking the Plunge into Global Market Opportunities

Companies expand their market reach beyond their domestic borders for various reasons. These include recognition that opportunities exist in foreign markets; a key customer has locations abroad; extending the return on research and development by introducing established products into new markets; extending the life cycle of an existing product; increasing the size of its offering market; and also for defensive reasons when a foreign competitor enters a company's domestic market.

Finance, marketing, sales and operations need to work closely together in analyzing the risks and potential rewards that arise from pursuing international opportunities. Companies need to understand the foreign country's economic and political environment, as well as competition, ease of entry, taxes and duties, business practices, currency risk, banking and cash flow concerns, legal and accounting, logistics and labor and compensation issues.

Most larger businesses in the US have become multi national enterprises and this trend continues to grow. Smaller businesses are also experiencing benefits of looking outside of our domestic borders. When considering doing business in a foreign market, seek the advice of individuals who are experienced in those markets. Also the US government offers services through the Department of Commerce and other sources to companies seeking opportunities in foreign markets.

The biggest risk for doing business in foreign countries, especially for small companies, is the risk of not getting paid. Cash in advance is the best approach to avoid this risk. However, your foreign customers may demand credit terms. When credit is extended, the letter of credit (LC) offers companies the greatest degree of safety. If your customer is not a well known company, or if exchange restrictions exist or are possible in the customer's country, a company selling on credit may wish to have the foreign customer's promise of payment backed by a foreign or domestic bank. On the other hand, your foreign customer may not wish to pay your company until it is reasonably certain that the merchandise has been shipped in good condition. An LC satisfies both of these conditions.

In essence, an LC is a letter addressed to your company, written and signed by a bank acting on behalf of your foreign customer. In the letter, the bank promises it will honor payment drafts drawn on it if your company conforms to the specific conditions set forth in the LC. Through an LC, the bank substitutes its own commitment to pay for that of your foreign customer.

Advantages to utilizing an LC are as follows:

1. An LC eliminates credit risk if your foreign customer's bank that opens the LC is in good financial standing. Therefore, company's need only to check the financial standing of the issuing bank.
2. An LC reduces the danger that payment will be delayed or withheld due to exchange controls or other political acts.
3. An LC reduces uncertainty as the requirements for payment are clearly stipulated in the LC.
4. An LC can also guard against preshipment risk as a manufacturer of specialty equipment has the risk of contract cancellation prior to shipment. Opening a letter of credit will provide protection during the manufacturing phase.

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Country's currencies fluctuate in value, similar to any commodity or investment. Coupled with extended credit terms, the actual amount of US dollars received for transactions in foreign currencies may differ substantially than the expected amount when the transaction was entered into. Transacting foreign contracts in US dollars shifts the currency exposure to your foreign customer, who may be in a better position to hedge this risk. However, if your foreign customer insists business be conducted in its home currency, then hedging against potential exchange losses requires careful planning. Hedging means establishing an offsetting currency position such that whatever is lost or gained on the original currency exposure is exactly offset by a corresponding foreign exchange gain or loss on the currency hedge.

The most common forms of hedging are producing natural hedges by having offsetting accounts receivables, accounts payable or borrowings in the foreign currency, currency forward contracts and currency options. Each option has costs and risks that need to be carefully analyzed for contract pricing as well as hedging. Forecasting expectations of cash flows under different exchange rate scenarios allows management to understand the potential currency exchange loss if a position is left unhedged. This information will allow decisions to be made to reduce this expected risk in a cost effective manner.

If you need assistance with pursuing international markets, please contact Harvest CFO Consulting by telephone 724-934-4752, or e-mail [dhillier@harvestcfo.com](mailto:dhillier@harvestcfo.com). Also, please visit our website at [www.harvestcfo.com](http://www.harvestcfo.com).

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