

Foreign Trade Settlement Changes in Global Banking Network Environment

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Abstract: This article analyzes the changes in trade settlement methods then points out the effect of global banking network on trade settlement. Finally we give out solution on how to avoid the risk of foreign trade settlement matters.

Keywords: Global Banking Network; Foreign Trade Settlement; Risk Aversion.

1 Forward

Settlement in foreign trade is an important issue to the parties concerned, since the correct selection of settlement or not, will be related to the collection of payment and even the normal running of trading companies. 1990s have seen a sharp decline in the use of letter of credit (L/C), and telegraphic transfer (T/T) rapidly becoming the mainstream way of trade settlement. This paper is going to carry out a preliminary study on the recent trend of foreign trade settlement, the effect of global banking network on changes in trade settlement and risk aversion under network environment.

2. The trend of foreign trade settlement in recent years

In international trade, as letter of credit embodies bank credit it is one of the mostly used settlement methods. Most of our "International Trade Practice" textbooks believe that letter of credit is still the preferred way of trade settlement, because the risk of it are very small. According to statistics, from 1960s to 1970s, more than 85% of world trade use letter of credit as settlement method. While in 1990s the usage of L/C dropped dramatically and the proportion of telegraphic transfer settlement increased greatly. According to the statistics in Table 1, in early 21st century, developed countries in Europe and the United States the proportion of the L/C usage has dropped to 10-20%, the usage of L/C in developing countries and regions remain higher proportion, but has also dropped to below 50%, except the Middle East.

During the period from 2002 to 2007, Shanghai's export growth in most years is higher than the national average, showing a good ascending trend. In the context of the rapid growth of Shanghai's exports, we analyzed the composition of its settlement, in order to find the characteristics of Shanghai's export enterprises and preferences.

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Table 1. International Usage Proportions of L/C

No.	Countries and regions	Proportion	No.	Countries and regions	Proportion
1	Middle East	52%	5	EU	9%
2	Africa	49%	6	Other European Countries	20%
3	Asia	46%	7	North America	11%
4	Australia & New Zealand	17%	8	Latin America	27%

Data origin: Ninth Survey Of International Services Provided TO Exporters, Commissioned By The Institute Of Exporters, 2003

Table 2. International Usage Proportions of L/C

Year	Settlement L/C (%)	Collection (%)	T/T (%)	Other (%)
2004	36.6	4.2	50.5	8.7
2005	32.2	3.7	59.3	4.8
2006	33.6	4.7	55.5	6.2
2007	34.6	4.9	55.6	4.9

Data origin: Shanghai Foreign Exchange Administration 2004-2007

Table 2 reflects the composition of the 3 settlement methods in Shanghai: telegraphic transfers accounted for more than 50% , and ratio of collection is below 5%, while the ratio of letter of credit is between 32% to 37%, or about one-third. Obviously, telegraphic transfer has become a mainstream form of settlement in Shanghai exports. We must point out that the actual proportion of T/T should be higher in Shanghai's import and export enterprises, since some payment carried by T/T are entered directly into the individual accounts, but according to bank statistics, this part of the amount can not be recorded in the trade statistics.

Shanghai is China's window, Shanghai's condition can reflect the status of our country to a certain degree, espe-

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cially the basic situation in the eastern coastal area.

3. Reasons of the change in foreign trade settlement method

Changes in foreign trade settlement has its own advantages and disadvantages.

Although the letter of credit means less risk, but there is no denying its shortcomings: First, there are still risks, such as the importer or the issuing bank may use "soft clauses" causing difficulties for the exporter to collect the money or non-substantive discrepancies as an excuse to refuse to pay the purchase price; Second, the cost of letter of credit is very high, including not only the additional bank charges, such as issuing fees, notification fees, meeting fees, cable fees, confirmation fees, discrepancies fees, cable fees, and document processing fees, but also requires importers to use bank credit commitments cost of capital; Third, under the letter of credit, process to open letter of credit is complicated, time-consuming procedure, low efficiency, and only the documents in line with the letter of credit "on the surface", do not involve goods.

T/T as a kind of commercial credit, though have greater risk to exporters, but in practice the risk is still controllable. For example, according to data from Shanghai Foreign Exchange Administration, from 2004 to 2007 T/T methods as the main settlement were: 98.93%, 99.03%, 100.12%, 99.99%. 2004 is the year with highest proportion of export exchange for bad debt, account for only 1.07%, compared with only 0.01% in 2007. In other words, by selecting T/T method companies actually increased trade opportunities, thus improving the competitiveness; as telegraphic transfer do not deal with documents through bank, the cost is much lower compared to the letter of credit, which is the main reason for people willing to use T/T; and one more important reason is the telegraphic transfer procedure is simple, fast, it adapted to the modern requirements of the settlement.

From the above analysis we can concluded that compared with the letter of credit, telegraphic transfer procedure is simple, fast, low cost, and the actual business risk is acceptable. These features of T/T eventually become key factors that importers and exporters are more willing to accept as main settlement method in global banking network environment.

We can see the rise of T/T method is the inevitable result of development of information economy. In 20th century human society entered the information society, computers and the Internet has been popular and widely used. Essential requirements of the information economy is the speed. Enterprises in order to win the competition in the modern society, need to be fast on business, and quick to respond. In the traditional trade settlement, the

credit risk is a major risk, operational risk is only a minor risk; in the case of rapid transfer of information, as the time for document preparing process is so short, operational risk become the first risk to banks and enterprises, credit risk can only be relegated to secondary status, thus importance of the Letter of Credit are reducing and their application in the financial settlement will inevitable decline with the development of information technology.

Changes in foreign trade settlement finally decided by the formation of the global banking network environment. With the wide use of information technology in finance, in late 20th century the SWIFT (Society for Worldwide Interbank Financial Telecommunication) symbolizes the formation of global banking network. The completion of the global banking network promotes the adoption of digital currency. Digital currency has huge advantage in transferring costs, issuing size, speed, convenience, manageability and controllability. For example: The advantage for SWIFT's price is clear, the communication price of cable is 540 yuan per 150 words, fax is 25 yuan per minute, and SWIFT makes every 325 characters as a unit, and charges only 2.2 yuan per unit; from the transmission speed view, a SWIFT message only cost 15 seconds to reach the other side, the transmission speed is unmatched by any other means; in particular through the SWIFT message transmission of information between banks, the authenticity of their message is controlled by SWIFT code number, compared with traditional fax code number, SWIFT code number are more reliable and more confidential. In the global banking environment, T/T clearly has more advantages than the letter of credit. Banks and foreign trade enterprises finally shift from the slow, cumbersome, costly letter of credit to fast, cheap, convenient T/T method.

In conclusion the reasons for T/T becomes the mainstream form of trade settlement are not only the advantages of it, but also are the formation of the global banking network environment.

4 The risk aversion for T/T method in global banking network environment

In summary, in the global banking network environment, speed and convenience for the settlement become the first need, operational risk becomes the biggest risk. However, T/T method still has risks. First, operational risk, under the conditions of network, the possibility of error correction is greatly reduced, thus cautious, careful examination should be the first principles of T/T procedure. At the same time, as T/T belongs to commercial credit, with great credit risk, the loss suffered by the T/T also occurred time by time. Therefore, when use the global banking network system to collect the payment we must pay attention to credit risk control, and use effective means to reduce risk. In general, choose this payment

method need buyers and sellers have good credit, and are willing for cooperation. The risk aversion method for T/T are mainly in the following way:

4.1 To use transport document to prevent payment collection risk

After the cargo is loaded in the port of shipment, the exporter can usually get bill of lading (B/L) and full set of shipping documents. But in order to avoid payment collection risk, unless the importer has sufficient credit, the exporter should not be immediately delivered the original bill of lading to the importer, to prevent the importer escape from payment responsibility after get the original bill of lading. The export side is: You can first copy of the bill of lading submitted to the importer to prove that the goods have been shipped in accordance with the contract. In access to bank wire transfer payment issued by the importer after the receipt, then a full set of original bills of lading and other shipping documents delivered to the importer. Exporters can prevent risk like this: Send a copy of B/L to importer to prove the goods have been shipped according to the contract at first. After get the receipt issued by the bank, the exporter can send the full set of transport documents to the importer. The exporter should also take care that: make sure that there should be a certain time gap between the receiving of the payment and the sending of the original B/L access to the telegraphic transfer receipt by fax importers and carriers to deliver the original bill of lading, to ensure the bank will remit funds.

4.2 Through export credit insurance to control risk

Export credit insurance is a form of protection for exporting firms against nonpayment by customers abroad. Further, it can protect exporters from customers who become insolvent. When the exporter enter into the international market they need not to bear the losses caused by these risks, so that the insurance can promote exports, reduce the risk, at the same time, insurance may improve the export's credit rating, and help to obtain packing

loans from bank, also it can promote the collection financing, factoring and other financial support and accelerate cash flow. Export Credit Insurance can also provide customers for business credit investigation, collecting overdue payments and other business affairs.

4.3 To control risk by selecting the appropriate T/T term

Companies should select the appropriate settlement method to control the risk. Remittance by telegraphic transfer can be divided into 2 modes: "T/T before delivery" mode and "T/T after delivery" mode. If 50% of the payment paid by "T/T before delivery" and the rest 50% by "T/T after delivery", then, it is fair to both buyers and sellers on the amount of funds used. If the importer is new a customer, the use of full "T/T before delivery" mode is more appropriate, it can largely reduce the risk. For the familiar and good credit customers, "T/T after delivery" mode (such as T / T after 30 days or T/T after 60 days) may be more easily accepted by customers.

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