THE INSTITUTE OF BANKERS OF ZIMBABWE

P O BOX 10521
HARARE

TELEPHONE: 744676
EMAIL: info@iobz.co.zw

14177 Gunhill Avenue

GUNHILL
HARARE

CHAIRMAN: R WATUNGWA A.I.B.Z

SERVICE FIDELITY KNOWLEDGE

INTERMEDIATE LEVEL	
SUBJECT	FINANCE OF INTERNATIONAL TRADE I
DATE	OCTOBER 2020
TIME	3 HOURS
MARKS	100
EXAM TYPE	CLOSED BOOK

AAIOB
Alliance of African Institutes of Bankers

INSTRUCTIONS TO CANDIDATES

1. Read the instructions CAREFULLY before answering the paper
2. This examination has five (5) questions
3. Answer any four (4) questions
4. Each question carries 25 marks
5. Use relevant illustrative practical examples in as far as possible
6. Start each question on a fresh page
7. Please number your answers
8. Please be neat – illegible handwriting cannot be marked
9. Use black or blue ink
10. Ensure that all information on the cover of your answer book is completed in full.
11. Cheating is not allowed. If anyone is caught cheating, disciplinary measures will be taken by the Institute of Bankers.

GOOD LUCK !

Question 1

Outline at least five problems or difficulties associated with international trade. **[25 marks]**

Question 2

Explain the role(s) of each of the following in any transaction using a letter of credit (L/C).

a) Buyer or applicant **[4 marks]**

b) Seller or beneficiary **[4 marks]**

c) Issuing bank or applicant's bank **[5 marks]**

d) Beneficiary's bank or receiving bank **[5 marks]**

e) Advising bank **[7 marks]**

Question 3

Briefly discuss the features, advantages and disadvantages of each of the following international payments methods.

a) Wire transfer **[6 marks]**

b) Foreign checks **[6 marks]**

c) Standby letters of credit **[6 marks]**

d) Documentary collections **[7 marks]**

Question 4

With special reference to the less developed countries (LDCs) like Zimbabwe, explain why free trade can be harmful. **[25 marks]**

Question 5

With the aid of examples, clearly explain the term 'credit insurance.' In your answer make a clear distinction between trade credit insurance and consumer credit insurance. **[25 marks]**

END OF QUESTION PAPER!

SUGGESTED SOLUTIONS

Question 1

International trade is characterised by a number of problems or difficulties including:

- Distance: Due to long distance between nations, it is difficult to establish quick and close trade contacts between nations. Buyers and sellers rarely meet and personal contact is rarely possible. There time lag between placement of order and receipt of goods from foreign nations. Distance creates higher costs of transportation and greater risks.
- Different languages: Different languages are spoken and written in different countries. Price lists and catalogues are prepared in foreign languages. Advertisements and correspondence are done in foreign languages. A trader wishing to buy or sell goods abroad must know the foreign language or employ somebody who knows that language.
- Transport and communication: Dispatch and receipt of goods takes a longer time and involves considerable expenses. In times of war and natural calamities, transportation of goods becomes more difficult. Similarly, the costs of sending or receiving information are very high.
- Risk in transit: Foreign trade involves greater risk than home trade. Goods have to be transported over long distances and they are exposed to perils of the sea. Many of these risks can be covered through marine insurance but increases the costs of goods.
- Trade restrictions: Every country charges custom duties on imports to protect its home industries. Similarly, tariffs are put on exports of raw materials. Both importers and exporters face tariff restrictions. They have to fulfil customs formalities and rules. Foreign trade policy, procedures, rules and regulations differ from country to country and keep on changing over time.

Question 2

The five parties have the following role(s) in any transaction using a letter of credit (L/C):

a) Buyer or applicant: applies to his/her bank for issuance of the L/C. If applicant has no credit arrangement with the issuing bank then he/she must pay in cash or other negotiable security.

b) Beneficiary or seller: must ensure that the order is prepared according to the specifications and shipped on time. He/she must also gather and present the full set of accurate documents, as required by the L/C to the bank.

c) Issuing bank: issues the L/C in favour of the beneficiary and then routes the document to the beneficiary's bank. The applicant's bank then verifies that the terms, conditions and documents comply with the L/C and pays the seller through his/her bank.

d) Beneficiary's bank: verifies the authenticity of the L/C and notifies the beneficiary. It or even another bank can act as an advising bank. Where there is an advising bank the beneficiary bank asks the advising bank to confirm the L/C.

e) Advising bank: is used as a trusted bridge between the applicant's bank and beneficiary's bank when the two do not have an active relationship. It verifies the authenticity of the document. It also forwards the beneficiary's proof of performance and the documentation back to the issuing bank. The advising bank ensures the beneficiary is paid when he/she is in compliance with the terms and conditions of the L/C. The advising bank has no liability for the payment of the L/C.

Question 3

Payment method	Features	Advantages	Disadvantages
Wire transfer	Fully electronic means of payment Uses correspondent bank and central bank wire Same convenience and security as domestic wires Use of pin numbers for each authorised individual	Fastest way for beneficiary to receive funds Easy to trace movement of funds from one bank to another	Cost usually more than other means of payment Funds not easy to recover if payment goes astray Intermediary banks charge fees from the proceeds Impossible to stop payment after execution
Foreign checks	Paper instrument sent to beneficiary and is payable in beneficiary's country Uses account relationships with foreign correspondent banks	Convenient when beneficiary's bank details are not known Useful when information/documentation must accompany payment Relatively easy to stop payment if necessary	Mail delivery can be slow Funds must still be collected from the drawee bank If payable in foreign currency funds may change during collection period
Standby letters of credit	A guarantee of payment by a bank on behalf of its client A loan of last resort in which a bank fulfils payment obligations by end of the contract if client fails Foreign bank risk can be eliminated via bank confirmation	May be cheaper than commercial L/C More secure than open account or documentary collection Discrepancies less likely than under commercial L/C Confirmation eliminates both country and commercial risks	Weak language can give beneficiary unintended advantages More costly than documentary collections Reduces buyer's credit facilities
Documentary collections	Seller uses banks as agents to present shipping documents to buyer against buyer's payment or promise to pay	Slightly more secure than open account Cheaper and less rigid than commercial L/C	Country and commercial risk exist No guaranty of payment by any bank

	With Direct Collection Letter (DCL), seller ships and sends shipping documents directly to buyer's bank, which collects and remits funds to seller's bank	No strict compliance rules apply No credit facilities required	No protection against order cancellation No built-in financing opportunity as with commercial L/C

Question 4

The reasons why free trade can be harmful for the less developed countries (LDCs) include:

- Competition under free trade is unfair and unhealthy for LDCs. LDCs find it difficult to compete with developed countries (DCs).
- Under free trade, gains of trade are unequally distributed depending on the level of development of different nations. Terms of trade are favourable for DCs and unfavourable for LDCs.
- LDCs generally experience unfavourable balance of payments. The problem of unfavourable balance of payments cannot be solved under free trade policy.
- Free trade policy advocated by DCs lead to the destruction of small industries in LDCs. LDCs cannot protect their infant industries under the free trade policy.
- Free trade policy may endanger economic and political independence of LDCs.

Question 5

Credit insurance describes both business credit insurance and consumer credit insurance. Examples of consumer credit insurance include credit life insurance, credit disability insurance and credit unemployment insurance. These two types of insurance can be distinguished as follows:

- Trade credit insurance (business credit insurance) is credit insurance that businesses buy to insure payment of credit extended by the business. It is an insurance policy and risk management product that covers the payment risk resulting from delivery of goods and services. It covers a portfolio of buyers and pays an agreed percentage of an invoice or receivable that remains unpaid as a result of protracted default, insolvency or bankruptcy. It is purchased by businesses to insure their accounts receivable from loss due to the insolvency of the debtors. This product is not for individuals.
- Consumer credit insurance is credit insurance that consumers purchase to insure payment of credit extended to the consumer. It is a way for consumers to insure repayment of loans if the borrower dies, becomes disabled, or loses a job. This insurance can be purchased to insure all kinds of consumer loans. Although purchased by the consumer/borrower, the benefit goes to the company financing the purchase or extending the credit to the consumer.