WHITE PAPER

Exporting Beyond the U.S.: Expanding into OECD Markets

Export Development Canada's (EDC's) research shows that after exporting successfully to the United States for three to five years, the typical next step for Canadian companies is to seek customers in OECD markets such as the EU.

This white paper provides practical, how-to information that can help your company look beyond the United States and begin to develop markets in other OECD countries.

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TABLE OF CONTENTS

1 Venturing Beyond the United States: The OECD 5

1.1 Benefits of expanding into OECD markets 5

1.2 Challenges of expanding into OECD markets 6

2 Trade Barriers in OECD Markets 7

2.1 Tariff barriers 7

2.2 Non-tariff barriers 7

2.2.1 Quotas 7

2.2.2 Licensing 8

2.2.3 Customs clearance 8

2.2.4 Over-stringent regulations and certification standards 8

2.2.5 Discriminatory government procurement 8

2.2.6 Entry taxes and other charges 8

2.2.7 Changing product classifications 8

3 Dealing with Trade Barriers 8

3.1 Establishing a local business 9

3.1.1 Set up an affiliate 9

3.1.2 Set up a sales or marketing office 12

3.1.3 Set up a joint venture 12

3.1.4 Challenges of setting up a local presence 13

3.2 Using free trade agreements 13

3.2.1 The basics of FTAs 14

3.2.2 What to look for in an FTA 14

3.3 Using distributors 15

4 Contracts in International Markets 15

4.1 Negotiating across cultures 16

4.1.1 Cultural attitudes to negotiating 16

4.1.2 Adapting to cross-cultural negotiating 16

4.2 Structuring international sales contracts 17

4.3 Basic best practices 17

4.3.1 Due diligence 17

4.3.2 The language of the contract 18

4.3.3 Compliance 18

4.3.4 Arbitration and litigation 18

4.3.5 Delivery 18

4.3.6 Definition of "acceptance" 19

4.3.7 Use of Incoterms for logistics-related clauses 19

4.4 Essential clauses 20

4.4.1 Who and what is involved? 20

4.4.2 How much is to be paid? 20

4.4.3 When and how is payment to be made? 20

4.4.4 How does delivery work? 21

4.4.5 What penalties and warranties are there? 21

4.4.6 How are disputes to be settled? 21

4.4.7 When does the contract become effective? 21

4.4.8 Who has title to the goods? 22

4.4.9 What law and language(s) are to be used? 22

4.4.10 What documentation is required? 22

4.4.11 How and why can the contact be cancelled? 22

5 Managing Guarantees 22

5.1 Guarantees and working capital 22

5.2 Using EDC performance guarantees 23

5.3 Protecting against wrongful calls 23

6 Obtaining Financing 24

6.1 Commercial lenders 24

6.1.1 Banks 24

6.1.2 Credit unions 24

6.1.3 Term lenders 24

6.2 Asset-based lending 25
6.2.1 Lending against tangible assets 25
6.2.2 Factoring 25
6.2.3 Purchase-order financing 25
6.3 Venture capital financing 25
6.4 EDC financing 26
6.4.1 EDC Working Capital Financing 26
6.4.2 EDC Buyer Financing 26
6.4.3 EDC Direct Lending 27
7 Using Trade Credit Insurance 27
7.1 EDC Select Credit Insurance 28
7.2 EDC Portfolio Credit Insurance 28
7.3 EDC Contract Frustration Insurance 28

1 VENTURING BEYOND THE UNITED STATES: THE OECD

The **Organisation for Economic Co-operation and Development** (OECD) was established in 1961 to “promote policies that will improve the economic and social well-being of people around the world. The OECD provides a forum in which governments can work together to share experiences and seek solutions to common problems.”

The OECD now has **35 members and partners**, including not only major countries such as the United States and Japan, but also smaller nations such as Iceland and Latvia. Its major functions are to collect and analyze economic and social data about its member countries to recommend policies that foster their growth and development. The OECD also helps establish formal agreements among its members in areas such as product standards, capital movement and fighting corruption.

Even if you are accustomed to operating in the United States, expanding into other markets of the OECD will present challenges, such as overcoming market barriers, negotiating contracts in unfamiliar business cultures, obtaining financing and protecting against payment risks. Success will require thorough preparation and planning, together with a long-term commitment to establishing your presence in these markets. But the payoff for a successful venture can be substantial and, in an era when the world’s trade is becoming ever more integrated, it can be essential to your company’s growth.

1.1 Benefits of expanding into OECD markets

A company operating successfully abroad can expect to see any or all of these benefits:

- **Increased sales**

  If you have saturated the U.S. or other regional markets, then exporting to other nations may be the only way to increase sales. If your firm is located in B.C., for example, it may be more cost-effective to expand into Asia than try to develop new customers on the U.S. east coast. Similarly, a Canadian company in Atlantic Canada may find markets in the EU more accessible than California.

- **Lower market vulnerability**

  The more diverse your company’s markets, the less vulnerable it will be to downturns from seasonal sales fluctuations or regional business cycles. Diminishing sales growth in the U.S., for example, can be offset by new sales in OECD markets.

- **Extending product life**

  You may be able to take a product that is falling off in sales in the United States and introduce it (with appropriate updating or other changes) in an OECD market. This strategy could substantially increase the longevity of the product.

- **Improving competitiveness**

  The hyper-competitive nature of the global market means exporters must focus on efficiency, quality and innovation to succeed. Current research strongly suggests that internationally successful companies owe at least part of their success to what they learned in their overseas markets.

1.2 Challenges of expanding into OECD markets

One of the great advantages of exporting to the United States is the relative familiarity of its culture and business environment. In other OECD markets, however, things may be quite different. For example:

- OECD customers may differ from your familiar U.S. buyers. Living standards, social norms, business etiquette and cultural tastes will often diverge in important ways.
- Foreign economic, legal and political systems can also be very different from their U.S. counterparts, especially in markets whose institutions did not evolve out of European traditions.
- Because of the many variations in business cultures, sales contracts must be very carefully structured to prevent misunderstandings and disputes.
- Payment in markets outside North America tends to be slower—sometimes much slower. This can have detrimental effects on your cash flow, and you'll need to plan your financing to allow for this.
- Local regulations and non-NAFTA technical standards may apply to your products, which may have to be modified before entering the market.
- Overseas logistics are more complicated, carry higher risks and are more prone to delays.
- In general, the complexity of trade with overseas OECD nations will add to your company's management tasks.

2 TRADE BARRIERS IN OECD MARKETS

Trade barriers are government-imposed restrictions on the free flow of goods and services among countries. They include both tariff barriers (essentially, a tax on imports) and non-tariff barriers (such as import quotas).

In the North American market, the provisions of NAFTA have systematically reduced or eliminated most of the tariff and non-tariff obstacles to free trade, making it relatively easy for Canadian companies to do business in the U.S. In other OECD nations, however, you will often encounter unfamiliar trade barriers that increase the difficulty and expense of doing business. This section examines the major types of barriers and their effects on the international flow of goods and services.

2.1 Tariff barriers

Governments impose tariffs or duties (the terms are used interchangeably) to pursue various goals. The most important are as follows:

- Tariffs generate government revenues. This, in most cases, is their major objective.
- They can restrict the volume of imports, thus protecting the country's trade balance.
- Tariffs can be used to protect local industries by making imports more expensive.

Tariff rates vary widely from country to country, but in general they are calculated by:

- Specific duties: These are usually levied on the quantity (weight or volume) of the imported product.
- Ad valorem duties: These are calculated as a percentage of the value of the imported goods. This value is normally the landed cost of the shipment, defined as the total of cost, insurance and freight (CIF).

2.2 Non-tariff barriers

Many non-tariff barriers, such as technical standards for products or licensing requirements, provide necessary safeguards against dangerous or substandard imports. However, they can also serve as trade barriers by being so stringent that foreign goods find it difficult to comply. The following are some of the most frequently encountered non-tariff barriers:

2.2.1 Quotas

A quota limits the amount of a product that can be imported. This can either keep the product out of the market or increase its price until it cannot compete at the local level.

2.2.2 Licensing

Some goods may be imported only if the importer acquires a licence. By limiting the number of licences, a government can restrict the import of the product. Licensing procedures can also be so difficult it is not worth the importer's time.

2.2.3 Customs clearance

Slow, complex and expensive customs processes can amount to a trade barrier.

2.2.4 Over-stringent regulations and certification standards

Applying unnecessarily stringent regulations and certification standards to foreign products can make compliance so difficult that non-local goods are effectively denied market entry.

2.2.5 Discriminatory government procurement

Governments can use discriminatory procurement practices (by favouring local suppliers when tendering contracts, for example) to keep foreign competitors out of the market.

2.2.6 Entry taxes and other charges

Entry taxes, which usually help cover the infrastructure costs of a port of entry, can be manipulated to make imports more expensive. Additional taxes and surcharges may also be imposed by the customs authority, for the same unstated purpose.

2.2.7 Changing product classifications

A product's classification is used to determine the amount of duty to be paid on it. By changing the classification from a low-duty one to a high-duty one, customs authorities may make a foreign product locally uncompetitive.

3 DEALING WITH TRADE BARRIERS

While trade barriers can make it more difficult to do business in an OECD country, they are rarely insurmountable. Before committing to the market, of course, you should be reasonably sure expected returns will outweigh the difficulties

The most direct way of dealing with a trade barrier is to comply with it, if the nature of the barrier allows it (by paying entry taxes or obtaining a product certification, for example). However some barriers, such as import quotas or discriminatory procurement, are designed to be impenetrable, so a direct approach won't do. Still, there are a few other ways of dealing with trade barriers:

- You may be able to bypass barriers by establishing a local business presence, such as an affiliate.

- You can restrict international business to OECD countries that have free trade agreements (FTAs) with Canada.
- If customs clearance is a significant barrier, you can work with local distributors whose knowledge may help reduce its effects.

3.1 Establishing a local business

As a Canadian company, you may be able to bypass many (if not all) trade barriers by establishing a business entity within the country. In most OECD markets, these entities are treated exactly the same as locally owned equivalents. Effectively, then, each entity becomes a domestic business, and is thus not subject to the government-imposed trade barriers that affect foreign firms.

Note that bypassing trade barriers is only one of several benefits that operating a local business can offer. Depending on the market, other advantages may include:

- Increased sales and market share
- Ability to serve local customers better
- Lower labour and operating costs
- Better access to supply chains and regional trade networks
- Reduction or elimination of legal and regulatory barriers
- Better access to human capital and new technologies

If you decide to establish an overseas business entity, there are several ways to do so.

3.1.1 Set up an affiliate

An affiliate is a company that your parent Canadian firm establishes in a market to serve its interests there. The affiliate operates as a local business with respect to regulations, laws and taxes.

In principle, an affiliate's size is unimportant, since this depends mainly on the parent's goals when setting it up—the Canadian business may simply want a modest legal presence in the market, or it may intend to build a full-scale manufacturing firm. Even a small affiliate has advantages. Not only will it allow local customers to deal directly with your company, but will also reassure them of your commitment to the market.

Many Canadian businesses use affiliates to sell their goods and services locally; others use them to warehouse Canadian-made products for local distribution, or to produce goods for the target market. Affiliates can

be especially important for service businesses—depending on the local rules for foreign investors, the Canadian parent may have to establish a company in the market before it can deliver services there.

Governments vary widely in their attitudes to foreign-owned affiliates. Some are welcoming and offer incentives such as tax and duty relief, simplified customs clearance, development financing, real-estate price reductions, long-term land leases and warehousing and logistics facilities. Others may treat foreign-owned businesses unfavourably—by imposing heavier taxes, for example, or by putting some sectors of the economy out of reach. Some governments do not allow wholly owned foreign affiliates at all, so you will have to set up some kind of partnership with a local firm.

There are two common methods of setting up an affiliate in a target market: acquiring or merging with a local business, or building from the ground up (sometimes called a greenfield investment).

- **Method 1: Acquire or merge with a local business**

  In this approach, the Canadian parent buys some or all of a local company's shares and/or assets. To be effective, the level of ownership must be large enough to give the parent a significant influence over the local company's activities. A general rule of thumb is a minimum of 10 per cent. If you acquire 100 per cent of the local firm, of course, you will have complete control over its operations. Note, however, that acquisitions are complex and require careful due diligence as well as expert legal, accounting and tax advice.

  Mergers are a little different. In a merger, the Canadian company already owns a business in the foreign market. To carry out a merger, it combines that business and a local company into a new firm that owns the resources of both companies. Both the original businesses disappear and the new firm continues as their successor. As with an acquisition, the new business functions as a wholly owned affiliate of the Canadian parent company.

  An acquisition or merger can be the fastest way to enter a market. Advantages are:

  - Through the new affiliate, the Canadian parent has immediate access to an established market.
  - The Canadian parent acquires the local company's revenues as well as its knowledge base, technology, customers, suppliers and workforce.

    - Licensing and compliance requirements are already met.
    - The affiliate's branding is already established.

  Acquisitions and mergers do have certain disadvantages, however, including these:

    - The Canadian firm may pay too much for the local company's shares or assets because it is unfamiliar with the market.
    - Cultural differences may make it difficult to manage the new business.
    - The Canadian parent may need to upgrade the affiliate's technology, workforce or operational processes, and train both local and Canadian management to handle the new firm.
    - The acquisition or merger process may turn out to be longer and more expensive than planned.
    - Integrating the business processes and technologies of the Canadian and local companies can be challenging.

- **Method 2: Build from the ground up**

  This can be the most complex and expensive way to enter a market. It involves acquiring real estate, building the facility, hiring personnel and (if it is a manufacturing plant) installing machinery and ramping up production. It can, however, provide advantages such as these:

    - You get exactly the facility you need in terms of equipment, marketing, finance, R&D, logistics and purchasing.
    - You retain complete control of the business, its branding, staffing and long-term strategy.
    - Local governments may provide investment incentives such as tax breaks, reductions in real-estate costs, lower import fees and various forms of administrative relief.

  The ground-up approach does have drawbacks, however, including:

    - It can take a long time to build the facility and make it profitable.
    - It is expensive and may require hard-to-find financing.
    - If the government isn't investor-friendly (or becomes so), your company may find itself at a disadvantage compared to local competitors.

3.1.2 Set up a sales or marketing office

If you merely need a basic legal presence in the market, you can open a sales or marketing office (sometimes called a branch office). In most countries, these offices are restricted to tasks such as market research and identifying customers, and can be penalized if they do anything more.

Setting up a sales or marketing office has several advantages:

- It provides greater control of the parent's business activities in the local market.
- The office provides a point of communication and marketing for customers.
- It may be easier to attract customers who want to deal exclusively with a local representative.
- Later expansion can be easier if your company obtains a foothold in the market, however small.

On the downside, there are several legal and financial issues associated with setting up a local sales office. For example:

- They can be expensive to establish and operate.
- If the office uses local employees, you must comply with foreign labour codes and standards.
- If you send Canadians to work in the office, you will have to deal with immigration issues such as restrictions on using non-local labour.

In some jurisdictions, setting up a sales office has no real advantages over establishing an affiliate. Obtain professional advice before assuming a sales or marketing office is the presence you need.

3.1.3 Set up a joint venture

Some governments don't allow foreign companies to establish affiliates, but do permit them to operate within the market if they form joint ventures with local businesses. In these countries, you may be able to use the joint-venture strategy to access the market without facing onerous trade barriers such as high tariffs or stringent licensing requirements.

In a joint venture, your company and another firm cooperate to achieve a specific business objective. This cooperation might be a simple partnership that is limited in scope or duration, or it could involve setting up a separate joint-venture company by means of a long-term

investment of funds, facilities and resources. Common purposes for these separate firms include operating local manufacturing plants, setting up marketing and distribution presences and using complementary technologies held by the partners.

3.1.4 Challenges of setting up a local presence

The initial challenges of establishing an overseas business presence include a lack of financing, problems in finding local business partners and a dearth of high-quality information about the market and its potential local and cultural barriers.

Once you do set up a local presence, you face further challenges: dealing with bureaucracies, getting financing to maintain the investment and putting the right people in place (in both Canada and the overseas market) to oversee operations. Other challenges include managing the local workforce, maintaining partner relationships and complying with local laws and regulations.

Given the issues, you should carefully consider whether establishing an overseas business presence is the right thing to do. Some pertinent questions include:

- What competitive advantages might your business presence provide?
- Are there political risks in the market? Does the government want to attract international investment? Does it make it easy for foreign companies to do business?
- What are the alternatives to a business presence? Would it make more sense just to ship products from Canada, or work with a local representative to sell them?
- Is the investment a good match for your business model and growth plans?
- Do you have the people and financing to set up the presence and keep it going?
- When considered overall, do the advantages outweigh the risks?

3.2 Using free trade agreements

The chief purpose of an FTA is to make it easier for the participating countries to trade with each other. In its most basic form, an FTA does this by reducing or eliminating the tariffs on goods that originate in one nation and are sold in the other. This helps increase bilateral trade, which in turn strengthens the economies of the partner countries.

As of 2016, Canada had FTAs in force with the following OECD nations or groups of nations (other than the United States and Mexico):

- **Chile**
- **Israel**
- **Korea**
- **European Free Trade Association** (Iceland, Norway, Switzerland)

Soon expected to be in force is the **Canada-European Union Comprehensive Economic and Trade Agreement** (CETA), which is to cover trade between Canada and the EU.

3.2.1 The basics of FTAs

While tariff elimination is the basic goal of an FTA, these agreements can be extended into many other areas of international trade, including non-tariff barriers such as product standards and labour mobility. They may also regulate bilateral investment between FTA participants, so that the rules are the same for investors in both countries.

An FTA between Canada and your market may make it much easier to do business there. Depending on your sector and the FTA provisions, the agreement may help you compete as an equal with local firms.

3.2.2 What to look for in an FTA

The complete, official texts of all of Canada's FTAs are **posted online** by **Global Affairs Canada**, including agreements that are still under negotiation or elsewhere in the pipeline. For FTAs in force or close to being so, this resource includes supplementary information to help understand how the FTA applies to your company's sector.

FTA rules can be extremely complex, so always obtain professional advice about applying them to your company's products or services. You can also refer to the **Canadian Border Services Agency**, the E**xport and Import Controls** section of Global Affairs Canada and the **Canadian Trade Commissioner Service**.

To find out how the FTA may help strengthen your bottom line, begin by examining the FTA itself, considering issues and questions such as the following:

- **Tariffs**

  If the FTA eliminates tariffs, will this help you obtain enough market share to justify market entry? Could competitors respond in ways to neutralize your advantage?

- **Product compliance**

  Does the FTA include provisions that make it easier and cheaper for your products to comply with local standards and regulations? How much would this contribute to your profitability in the market?

- **Service personnel qualifications**

  If you provide services, does the foreign market recognize Canadian qualifications under the FTA? Would this make it easier to send employees to the market to deliver the service there? Or would it be better to set up a local affiliate?

- **Rules of origin**

  Will complying with the FTA's rules of origin give you favoured access to the market? Will this translate into more market share?

- **Direct investment**

  Does the FTA have investment provisions that level the playing field between local and foreign investors? Will this allow you to compete effectively? If some sectors do not permit foreign investment despite the FTA, would this restriction apply to you?

Given the overall complexity of FTA provisions, you may find it difficult to obtain clear answers to these questions. Smaller firms, in particular, may not have the resources to do so. In these cases, it is highly advisable to use outside expertise to obtain an accurate picture of your FTA situation.

3.3 Using distributors

In a market where the customs process is slow and cumbersome, using a distributor may help you reduce the effects of this trade barrier.

Distributors buy your product and then sell it to their own customers, who may be wholesalers, retailers or end users. Once a distributor has made the purchase, it will handle all the details of importing the product, such as clearing customs and paying duties and taxes. Distributors also deal with in-market logistics, which can be an important selling point if the local customs process is prone to delays.

4 CONTRACTS IN INTERNATIONAL MARKETS

The importance of a comprehensive, clearly written contract can hardly be overemphasized, especially in international markets. By getting sales agreements right, you can avoid a wide variety of potential difficulties, from non-payment to litigation.

The process of setting up a robust contract in OECD markets can be fairly complex. When working out a sales agreement, it's advisable to obtain help from legal, accounting and other professionals who are familiar with the local business environment.

4.1 Negotiating across cultures

The difficulties of negotiating contracts when buyer and seller are from different cultures are proverbial. Besides language barriers, other cultural traits can make the negotiation process demanding. In Japanese business meetings, for example, people seat themselves in a strict order of hierarchy that a Canadian may be unfamiliar with. Punctuality can also create problems: in some Latin American countries it's not vital to be precisely on time, whereas being even a little late in Germany is viewed with deep disapproval.

4.1.1 Cultural attitudes to negotiating

Attitudes to contract negotiations can also differ significantly. In the United States, for instance, the parties focus almost exclusively on completing the sale and finalizing the contract, with any personal relationships between sellers and buyers being merely incidental. In many other cultures, in contrast, company executives may be reluctant even to begin negotiating until they get to know the people with whom they are doing business. Some cultures see the negotiation process as a struggle between adversaries, while others feel it is a cooperative effort.

If the negotiating parties come from cultures with conflicting approaches, they may find themselves at cross purposes—unless both sides understand their underlying differences and are willing to make allowances.

4.1.2 Adapting to cross-cultural negotiating

Given the wide range of behaviours, it is unrealistic to propose a one-size-fits-all prescription for cross-cultural negotiations. There are, however, some general principles to remember when working out a deal. For example:

- Find out as much as possible about the negotiating styles in the target market.
- Ensure both parties clearly understand what is expected from the negotiation. Is it a signed contact? A commitment to negotiate further at a later date? Or is it to lay the foundations of a long-term business relationship?
- Explain the decision-making processes you use in Canada, and elicit the same information from your customer. This will help clarify, for both parties, the respective power hierarchies.

- You may decide to adapt to the negotiation style of the customer. How to do this should be worked out in advance.
- Don't jump to conclusions during negotiations. Depending on your customer's culture, a statement such as "We will consider this" may actually mean "We have no interest in this."
- Avoid colloquial or idiomatic language, even with an interpreter. Clear, simple language is the ideal.
- Asking questions is appropriate whenever something is not clear. You should also understand what the answers mean before going on.
- Remain calm and professional no matter how the discussions are going. Apparent provocations by the customer may be accidental or may be a test of your character.

4.2 Structuring international sales contracts

In general, any well-designed international sales contract must meet at least the following requirements:

- It must identify the parties to the contract. If affiliated companies, agents or representatives are involved, the contract should include them as well.
- It must specify the law that governs the contract. The business laws of Canada and the target market will always differ in at least a few ways, which can lead to disagreements over what a clause in a contract actually means. To make disputes less likely, the contract should specify which country's laws will govern the agreement.
- The contract must be comprehensive. It must include all the essential terms that the parties have agreed on, since leaving one out may lead to disputes.
- All the parts of the contract must be clearly written and readily understood by all parties. Ambiguous language in a contract invites disagreement.

4.3 Basic best practices

When setting up sales contracts, pay particular attention to the following areas:

4.3.1 Due diligence

There is one crucial preliminary to negotiating a contract with an international customer—due diligence. Without this, the underpinnings of a contract can be very shaky.

Basic due diligence should be done *before* contract negotiations begin. It should include checking into the company's creditworthiness, financial situation, quality of management, business history and reputation in the local and international marketplace.

Legal, consulting and credit-reporting firms may be able to help you in these areas, but in many overseas markets it can be difficult to obtain a clear picture of a customer's reliability and robustness. The **Canadian Trade Commissioner Service** may be able to help with some of the checking, since its trade teams are familiar with local business conditions.

4.3.2 The language of the contract

You and your customer should formally agree on the language to be used in the contract and on the meaning of each clause. If the contract is in English, but the customer wants a native-language translation, both contracts must specify which version has legal precedence. If the non-English version is to take precedence, your legal counsel should verify that the intent of the translated contract agrees exactly with the intent of the English one. This will reduce the likelihood of the customer claiming that a clause was not properly translated.

4.3.3 Compliance

Serious difficulties can be encountered if you neglect to have the contract reviewed by legal counsel familiar with local laws, regulations, tax regimes and other areas where compliance is mandatory. Obtaining professional advice before finalizing the contract is a must.

4.3.4 Arbitration and litigation

If your company does get into a serious disagreement with an overseas customer, do your best to avoid litigation in a local court, as this will usually put you at a severe legal disadvantage. You will be much safer if the contract specifies that any disputes will be resolved through arbitration. The contract should also state that arbitration will take place in a neutral country. This is to ensure that the arbitrators will not be swayed by local interests.

4.3.5 Delivery

In most overseas markets, your company should deliver goods to the port of entry but no farther. If you agree to transport the goods within your customer's country, it will be at the mercy of unfamiliar and possibly unreliable logistics systems, and you will be responsible for damaged goods or late delivery. In addition, the customer should accept full responsibility for moving the goods across the border, including dealing with customs clearance and paying all taxes and duties.

4.3.6 Definition of "acceptance"

In any sale where customer acceptance—and thus payment—depends on the product's specifications or performance, you should include a "deemed acceptance" clause in the contract. This should tie the acceptance of the goods to specific conditions or events, never to something as vague as "customer satisfaction." Such ambiguous wording can give a customer an excuse to delay or avoid payment because they are not "satisfied."

4.3.7 Use of Incoterms for logistics-related clauses

Contract wording can be such a source of confusion that the international trade community has developed a set of formal terms, with commonly agreed meanings, to deal with the problem. These Incoterms, as they're called, deal with specific responsibilities in international trade transactions. They cover the following general issues:

- Costs: Who is responsible for the expenses associated with a shipment at any given time during its transit?
- Control: Who owns the shipment at any given time during its transit?
- Liability: Who is responsible for the shipment at any given time during its transit?

In more detail, the various Incoterms set out the key obligations and responsibilities of the seller and buyer in the following areas:

- General obligations of both parties to the contract
- Licenses, authorizations and formalities
- Contracts of carriage and insurance
- Delivery and taking delivery
- Transfer of risks
- Allocation of costs
- Notices to the buyer and the seller
- Proof of delivery
- Checking, packaging and marking
- Inspection of goods
- Assistance with information and related costs

When wording a contract, use Incoterms wherever applicable. Because they have very precise meanings, these terms will help the parties avoid ambiguous language and reduce the risk of disagreement. These terms are covered in full on the Incoterms website.

4.4 Essential clauses

International contract clauses fall into the following categories:

4.4.1 Who and what is involved?

The contract must:

- Identify the parties to the contract and their full legal names
- State that the customer has an obligation to purchase and pay for the vendor's goods or services, and that the vendor must sell and deliver them to the customer
- Describe in detail the goods or services being sold to the customer

4.4.2 How much is to be paid?

The contract must:

- Identify the currency to be used
- State whether the price is fixed or adjustable and, if the latter, how adjustments will be made
- State the total amount to be paid (fixed or adjusted)

4.4.3 When and how is payment to be made?

This should state:

- The date by which full payment is due
- Progress payments, if any, and the amount of each
- Discounts to the customer for early payment
- Bonuses to the vendor for early completion of the contract.
- Interest charges for late payment
- The documentation that will trigger payment, such as transportation documents or commercial invoices
- The method of payment, such as open account or letter of credit.
- The payment terms, such as net 30 days
- Whether there are holdback payments.

4.4.4 How does delivery work?

Incoterms should be used, wherever applicable, in these clauses. They should state:

- Who is responsible for the costs of carriage, insurance, import and export clearance, packing, documentation and so forth
- Who is responsible for the transfer of risk or for damages to goods during their transit to the customer
- How the goods are to be delivered and who is responsible for the delivery costs
- Which port of entry is to be used
- How delivery is to be scheduled and what penalties apply to late delivery
- How many shipments are involved in the total order

4.4.5 What penalties and warranties are there?

This should state:

- The compensation provided to the other party if either vendor or customer fails to fulfil the contract terms
- The interest applied to the invoice amount if the customer pays late
- What warranties apply

4.4.6 How are disputes to be settled?

This should state:

- The process for dispute settlement, such as negotiation, arbitration or litigation
- If arbitration is to be used, the country and place where it will occur, the rules of arbitration that will apply and how the costs of arbitration will be divided
- If litigation is to be used, the country and place where the litigation will occur, and the court in which it will be heard
- A time frame for settling disputes

4.4.7 When does the contract become effective?

This should state:

- The conditions and/or events under which the contract becomes effective, such as on contract signing or on the receipt of an advance payment

- How the timing of the above conditions and/or events may affect the contract schedule

4.4.8 Who has title to the goods?

This should state:

- When the title to the goods is transferred to the customer, such as on full payment
- Any legal requirements that apply in this area

4.4.9 What law and language(s) are to be used?

This should state:

- The legal system that governs the contract
- Whether a suitable translation will be provided if the contract is not in English (or French, if applicable)

4.4.10 What documentation is required?

This should specify the documents and procedures required over the course of the contract, such as technical documentation and delivery documents.

4.4.11 How and why can the contact be cancelled?

This should state:

- Who has the right to cancel the contract, and under what conditions they may do so
- What payment and performance obligations apply to either party if the contact is cancelled
- How any loss due to contract cancellation will be defined

5 MANAGING GUARANTEES

Your international customers may require various forms of guarantees as conditions of the contract. A guarantee is essentially a promise that your company will meet its obligations under its agreements, and provides for financial penalties if it fails to do so.

5.1 Guarantees and working capital

Guarantees are issued to your customer by your bank, usually as a standby letter of credit (LC) with a cash value equal to a percentage of the contract amount. If your company doesn't fulfill its obligations, the customer can "call the guarantee" and your bank must pay the customer the value of the guarantee as specified by the LC.

The possibility of a call against the guarantee means the bank is exposed to financial risk. To protect itself, the bank will require you to provide collateral equal to the LC's value. If you don't have the cash to do this, the bank will freeze an equivalent portion of your company's operating line. This can leave you short of working capital at the very time it is most needed, and could even force you to decline a profitable contract.

If your company's credit line and cash reserves are large enough, maintaining working capital while posting collateral for guarantees may not be a problem. But if your company begins to approach credit capacity, you may have to reconsider your guarantee strategy. If, for example, you have a surge of new or repeat business and several customers are simultaneously demanding guarantees, the total cash outlay for the collateral may erode working capital to risky levels.

5.2 Using EDC performance guarantees

If your company is encountering financial stress because of demands for guarantee collateral, using EDC's **Account Performance Security Guarantee** (Account PSG) can help. Because Account PSG provides a 100 per cent, unconditional third-party guarantee that covers the LC issued by your bank, no collateral needs to be posted to obtain the LC. As a result, the bank can issue the guarantee to your customer while leaving your company's cash or credit line untouched.

Account PSG can be more than a financial tool—in its blanket form, which offers a pre-approved limit that covers your company's guarantee needs for a year, it can also become a vital part of your sales strategy. With the blanket policy in place, you can easily provide guarantees as needed, which will enhance your company's creditworthiness and reliability in the eyes of potential customers.

5.3 Protecting against wrongful calls

A company that posts guarantees from its own resources also accepts the risk of being exposed to a "wrongful call." This happens when a customer decides your company has failed to meet its obligations and "makes a call" under the guarantee. Your bank must immediately pay the customer the cash value of the LC even if you are not, in fact, at fault. If the collaterall has been posted from your company's cash reserves or credit line, that money will then be gone—possibly for good, since proving a call was wrongful can be very difficult in international markets.

A solution to protect against wrongful calls is EDC's **Performance Security Insurance** (PSI), either in conjunction with Account PSG or by itself. PSI can cover up to 95 per cent of a company's losses from a call, which means cash holdings and/or credit line remain intact.

6 OBTAINING FINANCING

There are numerous sources of financial support for exporters that want to operate internationally. These sources include both private-sector institutions such as banks, factoring houses and venture capital firms, and public-sector organizations such as EDC.

6.1 Commercial lenders

Companies with established track records in Canada will typically turn to a commercial lender (banks, credit unions and term lenders) to obtain capital for daily operations, overseas expansion, capital expenditures and other financial needs. This support usually comes in the form of term loans, operating lines and other forms of credit.

A commercial lender is likely to be the least costly private-sector option because your company can lower the lender's risk by pledging various forms of collateral for its loans. If your company has a stable, successful business history, this type of financing may be your best choice. However, commercial lenders are usually stricter about issuing credit for a business's foreign operations, as there is inherently more risk.

6.1.1 Banks

Banks can provide term loans, leasing, mortgages, factoring, letters of credit, letters of guarantee and more. Before they agree to lend, you will need to assure them that the company is stable, is performing well and is likely to go on doing so, and can generate enough revenue to repay the loan. The lender will require some type of security or collateral for the loan, usually in the form of accounts receivable, work in progress, inventory or tangible assets such as machinery.

6.1.2 Credit unions

Credit unions are governed by provincial legislation. They can offer mortgages, term loans, working capital loans and revolving lines of credit to qualified businesses. Like banks, they will require collateral before agreeing to a loan.

6.1.3 Term lenders

These lenders specialize in term loans, which are repaid through regular, periodic payments, usually over longer terms of up to 25 years. Term loans are used to finance working capital, facilities construction, capital improvements, capital investments such as machinery, and the purchase of other businesses. Insurance companies, trust companies, mortgage companies, acceptance companies, finance companies and banks are common sources of term loans. Collateral is required, as usual.

6.2 Asset-based lending

Asset-Based Lending (ABL) is a form of secured lending that uses your company's assets as collateral. These assets could be tangible, such as equipment or inventory, or financial, such as accounts receivable or signed purchase orders.

Businesses use ABL to finance growth or acquire other businesses. It is usually more expensive than commercial borrowing but can be easier to obtain. Lenders base the loan amounts on the net realizable value of the assets pledged as collateral.

6.2.1 Lending against tangible assets

With this type of ABL, your company provides collateral for the loan in the form of inventory, work in progress, machinery, equipment or other tangible assets. Lenders usually require an independent appraisal to determine the net value of these assets.

6.2.2 Factoring

Factoring means that a factoring house purchases your company's receivable(s) at a discount. The factor accepts the risk of non-payment, so you don't have to reimburse the factor if your customer defaults. The advantage of factoring is that you receive payment, minus the discount, as soon as you invoice the customer. This can help maintain company cash flow if you have given the customer a long payment term.

6.2.3 Purchase-order financing

Factoring can be advantageous if your company can wait for its money until it invoices the customer. But if you need to pay suppliers up front, or need a long time to fulfil the order, cash flow may sink to undesirable levels. The solution may be purchase-order financing, in which a factoring institution provides a loan as soon as your customer signs the purchase order. Not all factors provide purchase-order financing, however.

6.3 Venture capital financing

Venture capital financing typically comes from high-net-worth individuals and venture capital firms. These venture capitalists (VCs) specialize in providing capital to small private companies with the potential for rapid growth. They will accept higher risks than traditional financial institutions and may be willing to provide financing for a business that is too new or too risky for a bank to support. Most VCs concentrate their investments in particular high-growth industries, such as energy or biotechnology, and are not interested in sectors outside their specialization.

In return for accepting higher risk, VCs expect high rates of return on their investments. They will normally demand an equity stake in your company, often in the range of 20 to 40 per cent, and will require a considerable degree of control over planning, policy, financing and budgeting.

6.4 EDC financing

Financially speaking, export sales follow the same general path as domestic sales, but are more complex and carry higher risks. Because of these increased hazards, your lender can be reluctant to provide financing for purposes such as fulfilling an international contract, setting up a business presence abroad, offering attractive credit terms to an international customer, or obtaining loans to help your company expand its overseas operations.

If your lender can't support these needs, it may be difficult or impossible to carry out your export plans. However, EDC can often help, via solutions such as working capital financing, buyer financing and direct lending.

6.4.1 EDC Working Capital Financing

Like most exporters, there will likely come a time when you need more financing than your bank is willing to provide—unless you can find a third-party guarantee that protects the bank if you default on repayment.

This kind of support can be provided by guarantees obtained through EDC's **Working Capital Financing** program. Once a guarantee is in place, your lender may be willing to extend the financing you need for overseas business plans. Moreover, the program's flexibility means it can support a wide range of financing scenarios, such as:

- Increasing your operating line
- Margining foreign receivables
- Margining foreign inventory
- Margining R&D credits
- Financing single or multiple export contracts
- Financing term loans for capital expenditures
- Supporting the purchase of an overseas firm

6.4.2 EDC Buyer Financing

Buyer Financing can help you gain a competitive advantage by offering international customers flexible payment terms for purchasing capital

goods and/or services from your company. An additional benefit is that you can be certain of prompt payment, since the Buyer Financing guarantee ensures your customer will have the necessary funds available.

6.4.3 EDC Direct Lending

For many Canadian companies, the greatest barrier to international investment is an inability to obtain financing from their lender. The bank may want to support the firm's international expansion program, for example, but may be unable to extend the necessary credit facilities.

If this happens to your company, EDC's **Direct Lending** program may be the solution. It can offer support by means of a secured loan made either directly to your company, or directly to your overseas affiliate and secured by its foreign assets. Note that EDC's **Working Capital Financing** can also help you make international investments.

7 USING TRADE CREDIT INSURANCE

Payment risks are inherently higher in international markets. To protect receivables, it's always prudent use an effective credit management system and carry out systematic due diligence on international customers.

Even with these precautions, you may sometimes feel compelled to forego a potentially lucrative deal because the risk of non-payment is too high. Using trade credit insurance, however, can help you take a more confident approach.

Trade credit insurance offers numerous benefits, including the following:

- You can safely expand sales to new and existing international customers and markets.
- Payment is ensured even if a customer defaults.
- You can free up working capital by reducing bad debt reserves.
- You can extend more flexible credit terms to customers.
- You may be able to secure better borrowing terms from lenders because your receivables are insured.

EDC offers three major types of credit insurance that can be tailored according to your needs, from single-contract protection to blanket coverage for all your overseas customers.

7.1 EDC Select Credit Insurance

Select Credit Insurance can be an ideal trade credit solution if you have a small number of overseas customers you want to insure against non-payment. It will typically cover up to 90 per cent of the company's losses if a customer doesn't pay after receiving the purchased goods or services. You can apply for a Select Credit Insurance policy quickly and easily online, with very little paperwork. If it becomes necessary to submit a claim, this can be done online as well.

7.2 EDC Portfolio Credit Insurance

If you want to protect all your international sales against a wide range of risks, consider using **Portfolio Credit Insurance**. It can cover up to 90 per cent of losses if a customer doesn't pay, with monthly premiums based on the type of coverage, the kind of goods or services being sold and the customer's credit risks. It can insure against perils such as customer bankruptcy or default, customer refusal to accept goods, cancellation of import/export permits and currency transfer or conversion risks.

7.3 EDC Contract Frustration Insurance

EDC's C**ontract Frustration Insurance** provides coverage for up to 90 per cent of costs incurred or receivables lost in association with a specific export contract for services, capital goods or projects. It can protect against numerous risks, including customer bankruptcy or default, contract cancellation, payment delays and cancellation of permits.

For more information, please visit **edc.ca**

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