INT325

Global Trade Practices and Strategies

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Study Unit 2
Trade Operations and Finance

Learning Outcomes

1. Identify the various aspects of trade operations and their intricacies.
2. Recognise the evolution of trade operations.
3. Describe the different key financial mechanisms in trade.
4. Understand the application of trade finance in current society.

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Chapter 1: Trade Operations and Logistics

Trade Operations and Logistics

- Trade operations ensure goods move securely, efficiently, compliantly across borders
- Logistics links production, transportation, documentation, delivery
- Effective coordination is critical for time, cost, reliability
- Trade is more than a single transaction; it is a sequence of interdependent processes

Role of Logistics in Global Trade

Logistics systems include:

- Transportation (sea, air, rail, road)
- Warehousing and inventory management
- Coordination among suppliers, carriers, and buyers

Key trade-offs:

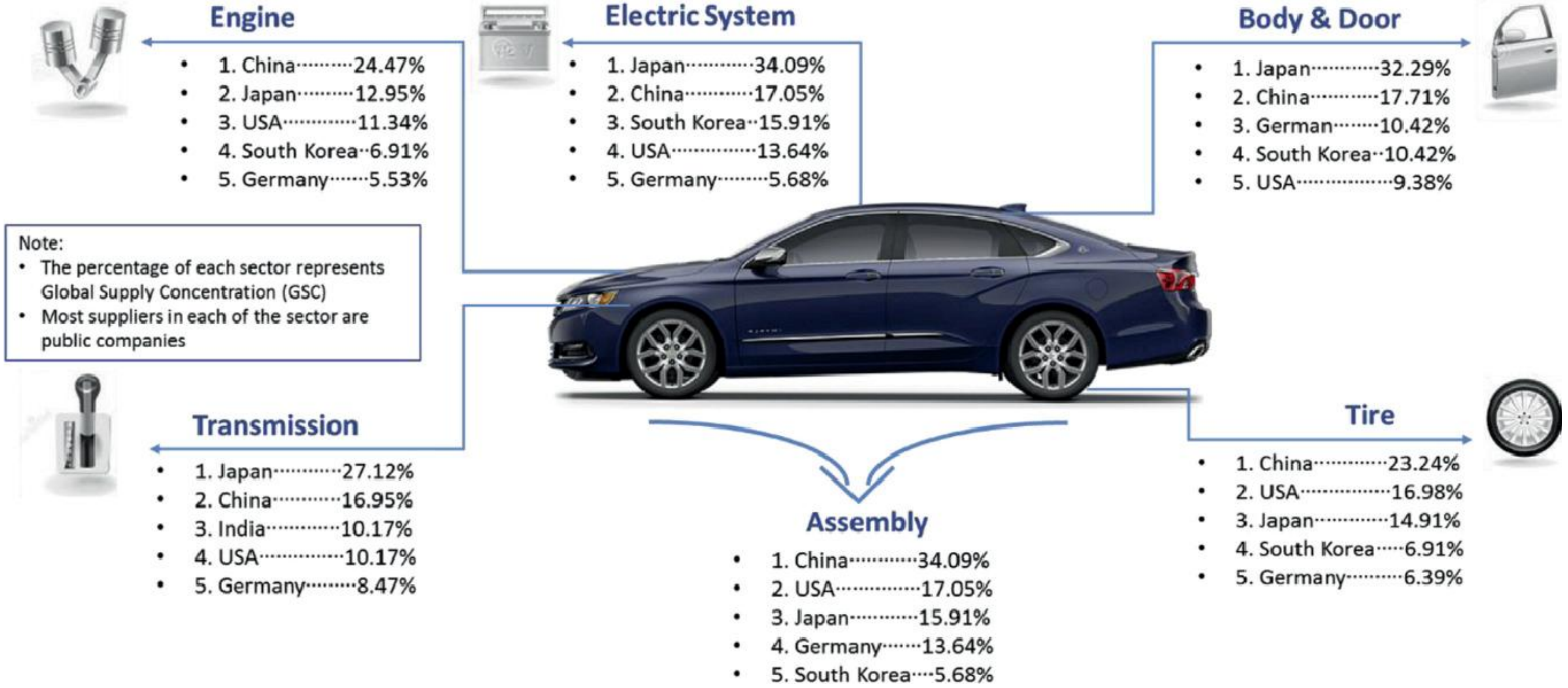
- Cost
- Speed
- Reliability
- Risk exposure

Why Use Automotive Industry to illustrate?

- Highly globalised and trade-dependent industry
- Deep and large, multi-tier cross-border supply networks; global production and distribution networks
- Strong exposure to trade shocks, logistics constraints, policy changes
- Makes trade vulnerabilities and resilience trade-offs visible as it is highly sensitive to disruptions and delays

Typical Automotive Supply Chain

- Begins with raw material procurement
- Involves multiple specialised suppliers
- Ends with vehicle sales and aftermarket services
- Requires precise coordination across borders



Source: From "Resilience to pandemics through flexibility in sourcing, in order fulfillment, and production capacity of the automotive supply chain", by M. Gebauer and C. Tangour, 2023. In N. Kiefl, F. Wulle, C. Ackermann, and D. Holder (Eds.), Advances in automotive production technology – Towards software-defined manufacturing and resilient supply chains, p. 369. Open access material.

Typical Automotive Trade System

- Raw materials, components, and vehicles cross borders multiple times
- Trade frictions or disruptions at any point can halt final production
- Interdependence between exporting and importing economies
- Efficiency-driven trade creates dependency risks; firms more vulnerable to external shocks when supply disrupted in key exporting countries
- Concentrated upstream production e.g. semiconductors amplifies shocks
- Logistics capacity and trade infrastructure shape market access (congestion, high freight costs, weak infrastructure act as non-tariff barriers to market access)
- Sustainability increasingly conditions trade participation as ESG standards, carbon requirements, due-diligence rules shape firms' ability to access and remain in international markets

Trade Vulnerabilities Exposed by Recent Shocks

1. Supply chain disruptions

- Cross-border shocks disrupt trade flows, raising costs and delaying production in globally integrated supply chains

2. Semiconductor Shortage

- Concentrated global chip production creates trade dependency risks that directly constrain automotive output.

Trade Vulnerabilities Exposed by Recent Shocks

3. Logistics Bottlenecks

- Port congestion: Causes shipment delays and disrupts production schedules
- Rising freight rates: Increase logistics costs and reduce cost stability
- Longer lead times: Lower supply chain responsiveness and raise operational risk

4. Raw Material Price Volatility

- Fluctuations in raw material prices introduce cost instability across the supply chain, making long-term production planning and contract pricing more difficult.
- Automotive firms must respond through supplier diversification, hedging, or cost pass-through strategies

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Sustainability for Trade Participation

- Firms are redesigning supply chains to meet sustainability-related trade requirements, not just cost target
- Supplier diversification, digitalisation, circularity, audits, long-term partnerships are increasingly necessary to maintain market access, especially in regulated markets
- Sustainability now shapes who can trade, what can be traded, under what conditions
- Trade shifts from “lowest-cost producer” to “most compliant and resilient producer”

Activity 1.1

Recent shocks such as supply chain disruptions, semiconductor shortages, logistics bottlenecks, raw material price volatility have exposed vulnerabilities in globally integrated trade systems.

In your opinion, to what extent should international trade continue to prioritise efficiency and cost minimisation, vs resilience, diversification, strategic autonomy?

In your discussion, consider the implications for firms, governments and the future structure of global trade.

Why Documentation Matters in Trade

- Enables customs clearance and revenue collection
- Determines eligibility for preferential tariffs and trade agreements
- Supports traceability, transparency, enforcement
- Reduces disputes and contractual risk
- What kind of documents?
  - Performa invoice, Bill of lading, Packing list, Commercial invoice, Certificate of origin, Consular invoice, Inspection certificate, Certificate of insurance, Letter of credit (LC), Purchase order, Mate’s receipt (See table 2.6 of Study Guide)

Can Documentation be used as a Sustainability Tool?

- Certificates of origin enable enforcement of rules of origin and sustainable sourcing
- Commercial and inspection documents support product and ESG compliance
- Accurate documentation enhances supply chain transparency and traceability
- Poor documentation can undermine sustainability claims and market access

When is Compliance a Trade Constraint?

- Customs, product standards, and sustainability rules increasingly function as non-tariff measures
- Non-compliance can lead to:
  - shipment delays
  - penalties and fines
  - rejection or confiscation of goods
- Compliance capability becomes a competitive advantage in sustainable trade

Role of Trade Intermediaries

- Freight forwarders, customs brokers, banks reduce compliance complexity

- Intermediaries help firms with
  - documentation accuracy
  - regulatory requirements
  - payment and risk management

- Critical for SMEs engaging in sustainable trade

Activity 1.2

You are a small exporter trying to enter a highly regulated overseas market that requires extensive trade documentation and sustainability compliance (e.g. origin verification, inspection certificates, ESG-related disclosures).

Discuss in your groups:

- In what ways do documentation and compliance requirements help you and in what ways do they disadvantage you?
- Which requirements feel necessary for sustainable trade and which feel excessive? Why?
- Do these rules promote sustainable trade, or do they mainly filter out smaller players?
- Who do you think benefits more from these requirements: large firms or small firms? Why?

Chapter 2: Financial Mechanisms in Trade

Trade Finance

- Think of trade finance as not just about payment; it reduces risk, enables trust and determines who can participate in international trade
- Time gaps between shipment and payment create financial risk
- Trade finance instruments help bridge risk across borders
- Common instruments include:
  - Letters of Credit (LCs)
  - Documentary collections
  - Open account transactions
  - Factoring

Key Parties

Source: From Types of documentary credit | A comprehensive guide, by D. Meynell, 2024, ICC Academy, https://academy.iccwbo.org/trade-finance/article/types-of-documentary-credit-a-comprehensive-guide/

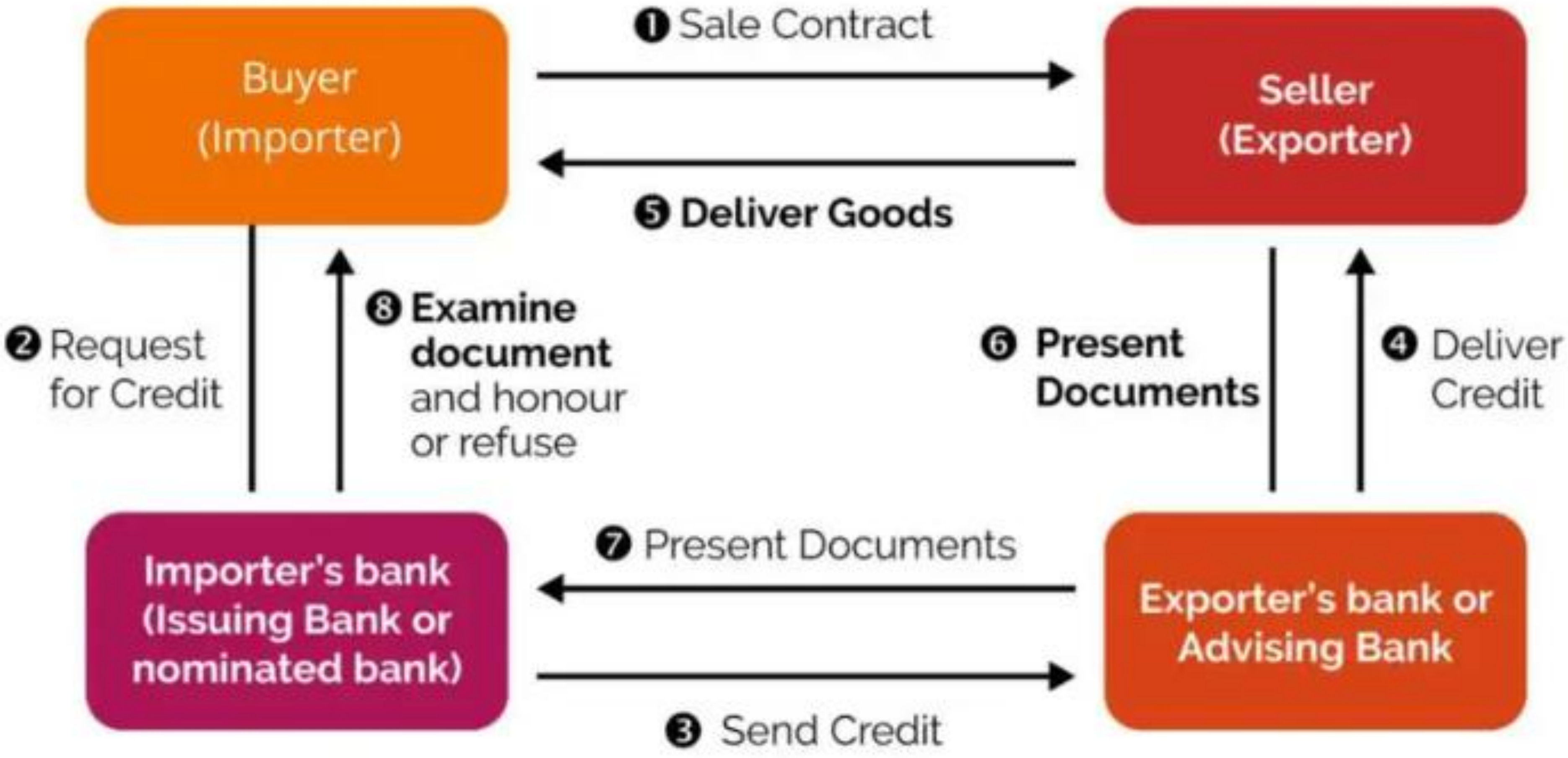
Letters of Credit (LCs)

- An LC is a bank's payment guarantee issued on behalf of the buyer; widely used in international trade due to risk reduction
- Seller is paid only if documents comply with LC terms
- Key features
  - Irrevocable
  - Documentary
  - Strict compliance
  - Independent

Letters of Credit (LCs)

- Main parties in LC transaction
  - Buyer (Applicant)
  - Seller (Beneficiary)
  - Issuing Bank (buyer’s bank)
  - Advising Bank (seller’s bank)
  - Confirming Bank (adds payment guarantee, if required)

Letters of Credit (LCs)



Source: From Introduction to Letters of Credit | 2025 Guide, by Trade Finance Global, 2025, https://www.tradefinanceglobal.com/letters-of-credit/.

Why Currency Risk Matters in Trade

- Trade contracts often involve foreign currencies
- Exchange rate movements able to:
  - change profit margins
  - affect competitiveness
  - create cash-flow uncertainty
- Goal of risk management: certainty, not speculation

Types of Currency Risk

1. Economic Risk

- Exchange rate changes affect export competitiveness
- Stronger home currency, then exports become more expensive
- Can affect firms even without direct foreign transactions

2. Translation Risk

- Arises when foreign subsidiaries' accounts are converted
- Mainly affects:
  - financial reporting
  - valuation
- Limited cash-flow impact unless assets are sold or profits repatriated

Types of Currency Risk

3. Transaction Risk

- Occurs between:
  - contract agreement
  - payment receipt
- Exchange rate changes alter actual cash received or paid
- Most relevant risk for exporters and importers

Managing Transaction Risks

Risks can be managed by:

- Shifting risk (e.g. invoicing in home currency)
- Offsetting inflows and outflows (netting, matching)
- Fixing rates (forward contracts)
- Insuring uncertainty (options)

Key Insights

- Effective global trade requires
  - secure payment mechanisms
  - manageable currency risk
  - financial stability across transactions
- Firms without access to trade finance or hedging tools may
  - avoid exporting to new or higher-risk markets
  - face constraints in scaling cross-border operations
- Finance therefore affects firms' market entry decisions, risk exposure in international trade and decides who can participate in global trade

Activity 1.3

Two firms want to enter a new international market:

- Firm A: large, financially sophisticated, strong banking relationships
- Firm B: smaller, competitive product, limited trade finance experience

Both face documentation requirements, trade finance decisions (e.g. LC vs open account), foreign exchange risks.

Discuss:

- Which firm is better positioned to trade successfully?
- Are trade practices and financial requirements neutral? Do they favour certain firms?
- How should firms adapt their trade strategies to manage these constraints?

Summary of Learning Outcomes

1. Identify the various aspects of trade operations and their intricacies.
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THANK YOU