Tutorial Worksheet: Forfaiting Mechanism and Analysis

This worksheet is designed to test your understanding Forfaiting Mechanism and Analysis in a structured format. Answer the following questions based on your study materials. The total marks for this tutorial are 20.

Question	Marks	Answer
1. Define forfaiting and explain how it benefits exporters.	3	Forfaiting is a financial arrangement in which an exporter sells their medium to long-term receivables (such as promissory notes or bills of exchange) to a forfeiter at a discount. This allows the exporter to receive immediate cash, eliminating the risk of non-payment and improving liquidity, without assuming credit or political risk.
2. Differentiate between factoring and forfaiting in terms of duration and risk.	3	**Factoring** typically deals with short-term receivables (up to 180 days) and can be recourse or non-recourse, where the factor may or may not assume the credit risk. **Forfaiting**, on the other hand, handles medium to long-term receivables (up to several years) and is always non-recourse, meaning the forfeiter fully assumes the risk of buyer default.
3. Explain the role of a forfeiter in international trade and the types of risks they assume.	4	A forfeiter purchases an exporter’s receivables, providing upfront cash while assuming various risks such as credit risk, political risk, currency risk, and interest rate risk. This enables exporters to trade without worrying about the buyer’s ability to pay or potential economic issues in the buyer's country.
4. Discuss how forfaiting improves an exporter’s balance sheet and financial health.	3	By selling receivables through forfaiting, exporters remove long-term receivables from their balance sheet, improving liquidity and working capital. This reduces leverage and enhances financial ratios like the debt-to-equity ratio, making the company more financially stable and potentially improving creditworthiness.
5. What are the key differences between forfaiting and a letter of credit (LC) in international trade?	3	A **letter of credit (LC)** is a payment guarantee from the buyer’s bank to the seller, which facilitates trade by reducing payment risk but does not immediately provide liquidity. **Forfaiting**, in contrast, provides immediate cash to the exporter by selling the receivables, with the forfeiter assuming all risks. An LC ensures payment but does not offer upfront liquidity like forfaiting.
6. Explain how interest rates and currency fluctuations impact the cost of forfaiting.	4	In forfaiting, the cost is influenced by prevailing interest rates, as the forfeiter discounts the receivables based on these rates. Currency fluctuations can also affect the cost if the transaction is in a foreign currency, with the forfeiter factoring in the risk of currency depreciation or appreciation when setting the discount rate.