How to raise contract bonds

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When exporting, it is common for your customer to require a bond or guarantee. These are an internationally-recognised way of ensuring buyers and sellers keep their promises to each other.

How do they work?

A bond or guarantee is issued by the guarantor – usually a bank – on behalf of the exporter. If the exporter fails to deliver the goods or services as described in the contract, the importer can 'call' the bond and receive financial compensation from the bank. Under a counter-indemnity, the bank can then reclaim the full amount from the exporter, including costs and interest.

Bonds and guarantees fall into two classes. Most overseas buyers require **on-demand** bonds, which can be called at the buyer's sole discretion without contest. **Conditional** bonds give greater protection to exporters, but are unacceptable to many overseas buyers. Within these two classifications, there are bonds to support each stage of the trade cycle.

Bid or tender bonds

These are required by your potential buyer to show that you, the supplier, are serious in your intent; will not withdraw your tender before adjudication; will sign contracts if awarded; and provide any subsequent bonding. Bid bonds typically cover 2% to 5% of the value of the tender and remain valid for three months after the bid closure date.

Performance bonds

These guarantee that if you fail to carry out the terms of the contract, the importer will be paid a sum in compensation – typically around 10% of the contract price. The bonds are purely financial guarantees and carry no warranty that the bank will complete the contract if its customer fails to do so.

Advance payment and progress payment guarantees

These give protection to the buyer by guaranteeing that any advance payment and progress payment guarantees that have made will be refunded if the exporter fails to complete a contract.

Retention bonds

These enable retention monies, which would otherwise be held by the buyer beyond completion of the contract, to be released early.

Warranty bonds

These provide a financial guarantee to cover the satisfactory performance of equipment supplied during a specified maintenance or warranty period.

Overdraft guarantees

These guarantee the borrowing requirements of UK exporters or contractors who need finance in the importer's country. The guarantee covers the local bank against the exporter defaulting. Without such security, the local bank would be unwilling to lend monies where the UK exporter is unknown to them.

Standby letters of credit

An exporter and his customer may arrange that goods will be paid for in an agreed manner after they have been despatched. But if such payment is not forthcoming, the exporter will need another way of getting paid. A standby letter of credit (also referred to as 'standby credit') can provide this security backup.

For all types of bonds or guarantees, make sure you obtain an estimate of the likely costs early, so that you can take it into account in your bid price.

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