

Why traders borrow

*Dr Alexander Ressos, TEP
Attorney-at-Law (Switzerland), Solicitor (Hong Kong),
Solicitor (England & Wales)*

A commodity trader needs money to buy the goods it sells. Between the moment it pays the seller and the moment it receives payment from the buyer, which may be weeks or months, the trader must finance the value of the cargo. The sums involved are large. A cargo of crude oil on a large tanker can be worth more than one hundred million dollars, so a trader that handles dozens of such cargoes at the same time needs financing in the billions. No trader holds enough equity to finance its business on its own. The trade therefore depends on banks and other lenders, which makes the availability and cost of financing among the most important factors of competition between traders.¹

The financing of the trade has a characteristic feature that distinguishes it from ordinary corporate lending: it is secured, directly or indirectly, by the commodities themselves and by the receivables from their sale. The lender finances a specific transaction or a pool of transactions, takes security over the goods and the proceeds, and is repaid when the buyer pays. This self-liquidating character of trade finance explains why banks are prepared to lend large sums to traders whose balance sheets are thin in relation to their turnover. It also explains why the documents that represent the goods, above all the bills of lading, the warehouse receipts and the inspection certificates, matter so much and why the frauds that manipulate them are so grave.

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1 Notes

1. Craig Pirrong, The Economics of Commodity Trading Firms, abridged white paper (Trafigura, 2015), p. 14, trafigura.com: firms "rely extensively on bank borrowings" to finance their activities, largely through short-term borrowings and unsecured syndicated credit lines; five banks are reported to provide 75 per cent of the commodity trade finance for Swiss-based trading firms. Public Eye, "The Intricacies of Commodities Trade Finance", September 2020, publiceye.ch, p. 5: the five main Swiss traders borrowed a total of USD 363.8 billion between 2013 and 2019. See also the Geneva volume, Part H. ↩

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