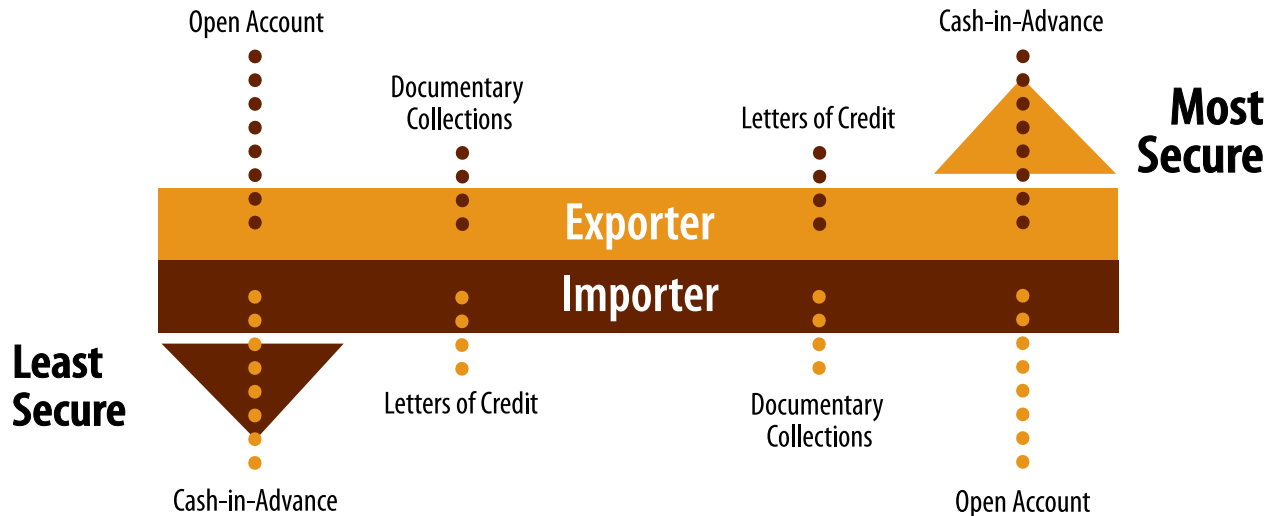


Chapter 1

Methods of Payment in International Trade

To succeed in today's global marketplace and win sales against foreign competitors, exporters must offer their customers attractive sales terms supported by appropriate payment methods. Because getting paid in full and on time is the ultimate goal for each export sale, an appropriate payment method must be chosen carefully to minimize the payment risk while also accommodating the needs of the buyer. As shown in figure 1.1, there are four primary methods of payment for international transactions. During or before contract negotiations, you should consider which method in the figure is mutually desirable for both you and your customer.

Figure 1.1. Payment Risk Diagram



Key Points

- To succeed in today's global marketplace and win sales against International trade presents a spectrum of risk, which causes uncertainty over the timing of payments between the exporter (seller) and importer (foreign buyer).
- For exporters, any sale is a gift until payment is received.
- Therefore, exporters want to receive payment as soon as possible, preferably as soon as an order is placed or before the goods are sent to the importer.
- For importers, any payment is a donation until the goods are received.
- Therefore, importers want to receive the goods as soon as possible but to delay payment as long as possible, preferably until after the goods are resold to generate enough income to pay the exporter.

Cash-in-Advance

With cash-in-advance payment terms, the exporter can avoid credit risk because payment is received before the ownership of the goods is transferred. Wire transfers and credit cards are the most commonly used cash-in-advance options available to exporters. However, requiring payment in advance is the least attractive option for the buyer, because it creates cash-flow problems. Foreign buyers are also concerned that the goods may not be sent if payment is made in advance. Thus, exporters who insist on this payment method as their sole manner of doing business may lose to competitors who offer more attractive payment terms.

Letters of Credit

Letters of credit (LCs) are one of the most secure instruments available to international traders. An LC is a commitment by a bank on behalf of the buyer that payment will be made to the exporter, provided that the terms and conditions stated in the LC have been met, as verified through the presentation of all required documents. The buyer pays his or her bank to render this service. An LC is useful when reliable credit information about a foreign buyer is difficult to obtain, but the exporter is satisfied with the creditworthiness of the buyer's foreign bank. An LC also protects the buyer because no payment obligation arises until the goods have been shipped or delivered as promised.

Documentary Collections

A documentary collection (D/C) is a transaction whereby the exporter entrusts the collection of a payment to the remitting bank (exporter's bank), which sends documents to a collecting bank (importer's bank), along with instructions for payment. Funds are received from the importer and remitted to the exporter through the banks involved in the collection in exchange for those documents. D/Cs involve using a draft that requires the importer to pay the face amount either at sight (document against payment) or on a specified date (document against acceptance). The draft gives instructions that specify the documents required for the transfer of title to the goods. Although banks do act as facilitators for their clients, D/Cs offer no verification process and limited recourse in the event of non-payment. Drafts are generally less expensive than LCs.

Open Account

An open account transaction is a sale where the goods are shipped and delivered before payment is due, which is usually in 30 to 90 days. Obviously, this option is the most advantageous option to the importer in terms of cash flow and cost, but it is consequently the highest risk option for an exporter. Because of intense competition in export markets, foreign buyers often press exporters for open account terms since the extension of credit by the seller to the buyer is more common abroad. Therefore, exporters who are reluctant to extend credit may lose a sale to their competitors. However, the exporter can offer competitive open account terms while substantially mitigating the risk of non-payment by using of one or more of the appropriate trade finance techniques, such as export credit insurance.