Getting Paid for Exports to China

Compiled compliments of the
U.S. Commercial Service's Asia Pacific Team

"Any sale is a gift until you have been paid!" This practical business insight is especially true for international transactions where the buyer and seller could be 12,000 miles away. Therefore, be sure to undertake appropriate due diligence when qualifying your Chinese buyers. While it is prudent to make use of the various credit reporting companies active in China, you also should ask for trade references, especially for other U.S. firms that you could easily contact.

That being said, it is important to recognize some significant differences in the Chinese commercial and banking landscape. First, China still has many state-owned enterprises which can have a high degree of government involvement, potentially complicating negotiations and sometimes slowing the release of funds for a given contract. Second, the banking system is not yet as transparent as in Western countries, which means you probably will want the active involvement of your U.S.-based bank's international division to help you through any hurdles. Third, the private sector is still developing in China, so your buyers might not yet have the expertise to smoothly navigate China's internal bureaucracy and regulations on such things as securing foreign currency for their transactions. The net result of these factors is that you could potentially encounter some delay in payments regardless of the payment method used.

Typical Methods of Payment for International Orders:

1) Cash in Advance: If you are **paid in advance** for an export order, there has to be a **great deal of trust** on the part of the buyer that you will perform as agreed. The **buyer's risk** is that you, the exporter, will have the money and he/she will only have a promise of your performance. The buyer could mitigate that risk by insisting that the exporter obtain a **performance bond,** or open a **standby letter of credit** that would serve as a performance bond, so that the buyer could get the advance payment back if the exporter does not perform**.** The issuer of the performance bond or standby letter of credit typically will require collateral from the exporter to provide this financial instrument.

In China: Advance payments may be difficult for the buyer to arrange since foreign exchange must be approved by SAFE (State Administration for Foreign Exchange). However, such terms are not impossible to negotiate, especially for custom-built equipment and when the buyer is a private company. Likewise, it is possible to request progress payments for orders with a long production cycle. In such cases, the buyer might insist on some sort of performance bond to mitigate his risk, so the exporter might be asked to set up a standby letter of credit, with the buyer as the beneficiary.

2) Documentary Letter of Credit: If you agree to ship on **documentary letter of credit** terms, the buyer and seller are both putting their **trust in their respective banks** to honor their obligations under this financial instrument. The exporter will not be paid until there *is documentary evidence* that the product ordered has been shipped according to the terms and conditions of the letter of credit. To that extent, the **buyer has reduced or mitigated his/her risk** through the assurance that his/her money supporting the letter of credit will not be released by the importer's bank until the required documentary evidence is received. In addition, the buyer might require an inspection certificate to assure that the goods meet the requirements of the purchase order.

So, from the buyer's perspective, the letter of credit serves as a **performance guaranty.** For the exporter**, the risk** of never receiving payment—or, of the order being cancelled--has **been mitigated** because the importer's bank has an irrevocable commitment to pay when the required document evidence is presented. The **risk for the exporter** under this payment method has moved from the importer—who might not be well-known by the exporter--to the importer's bank. Generally, that **bank risk** also can be moved to a **confirming bank** in the U.S., which will agree to pay drafts under the letter of credit if the terms and conditions of the letter of credit are met, thus **mitigating the risk** associated with the foreign bank (which might be large or extremely small, depending on the bank and country involved).

In China: Documentary letters of credit are used extensively when selling into China and tend to be the preferred method of payment for most transactions. Only letters of credit from well-established banks in China should be accepted. Generally, that includes the following banks [especially for transactions supported by the Export-Import Bank of the United States (Exim)]: Bank of China, China Construction Bank, Industrial and Commercial Bank of China, China Development Bank, and Bank of Communications, or a branch of well-established American, Asian or European banks. Most letters of credit opened by Chinese banks say that they are "without confirmation," which means the opening bank will not allow another bank to add its "confirmation." With this terminology, the risk remains with the Chinese bank—hence, the caveat to only deal with internationally recognized, well-capitalized banks. However, Exim's **credit insurance program** can be used to insure payment under unconfirmed letters of credit, thereby **mitigating the exporter's risk associated with the foreign bank,** or the exporter's international bank might put the letter of credit under its own **letter of credit insurance policy** that it has with the Exim.

Typical Methods of Payment for Int'l Orders (continued):

3) Documentary Collections: Payment under **documentary collections** terms requires a greater level of **trust between the buyer and seller**. Instead of requiring the buyer to open a documentary L/C, the exporter is basically trusting that the buyer will have the money and integrity to pay when the documents evidencing shipment have been received. If the order is transported by sea, the bill of lading serves as a title document, which will not be released to the importer until the importer has paid (cash against documents) or agrees to pay (documents against acceptance). Exporter **performance** is evidenced by the documents, so the **buyer mitigates his/her risk** by not paying in advance for an order that has not been shipped or delivered. And, equally as important from the buyer's perspective, the importer has not tied up his/her own working capital during the order fulfillment cycle. In addition, the buyer might require an inspection certificate as proof that the goods meet the requirement of the purchase order. The **exporter mitigates his/her risk** by not releasing the title document (at least for ocean shipments) until payment has been received, or an agreement or promissory note has been signed to make such payment.

In China: As elsewhere, this is not an advised method of payment for commodity-type products, especially for contracts that might extend over several months, since commodity prices can fluctuate significantly over time. The **exporter's risk** under this payment method is that the buyer may not come in to pay, or agree to pay, because the contract price is now significantly above current market prices. Under this scenario, documentary collection terms would give the importer leverage and an opportunity to renegotiate the contract price. Likewise, this method of payment is discouraged for sales involving time-sensitive (perishable) or custom-built goods for the same reason. In particular, the buyer would have significant leverage if the goods were about to spoil or if no other buyer could be found for a custom-built product. However, this method could be used for small dollar amount shipments to China or for items that are critical to the importer's operations (especially when the exporter must provide critical technical support or installation), or when **significant trust** has been developed over time between the buyer and seller.

4) Open Account Terms: Offering **open account terms** is all about **trust between the buyer and seller.** The exporter trusts that, having shipped an order, the buyer will pay for it, hopefully within the negotiated time (terms)**.** The **exporter's risk** is that the importer will default, in whole or in part, on that obligation. The **buyer has no risk,** since he/she has the product and **exporter performance** has been met. In fact, after shipment, **the exporter has all the risk.** However, **that risk can be mitigated** by buying **credit insurance,** either through the Exim or a large private insurance company, to insure the foreign accounts receivable against default.

In China: Open account terms are being requested more-and-more frequently by importers in China. Both Exim and private insurance companies have become more aggressive in underwriting credit insurance for open account transactions. Buyers in China are looking for longer terms for payment, so that is frequently a buyer's starting point in negotiations. However, it is strongly advised that open account terms only be offered to buyers for which credit insurance coverage has been pre-approved. Exporters can work with credit insurance brokers to obtain a range of policy options.

Some banks will buy, or "factor," their customers' insured accounts receivable, as will commercial factoring houses. For longer open account terms, typically 6 months - 7 years, *forfaiting* may be an option. International banks, especially European banks and also some banks in China, buy these medium-term receivables on a non-recourse basis, cashing out the exporter and collecting payment directly from the buyer. Frequently, the importer's bank is required to guaranty the underlying promissory note.

Medium-term and long-term credits: While the four international methods of payments outlined above cover the majority of export transactions to China, some capital goods exports can benefit from medium- or long-term financing offered by lenders and the Eximbank. The Exim's guarantee and insurance programs can support loans made by a domestic or foreign bank to a Chinese buyer by providing a 100% guarantee on a loan financing the lesser of 85% of the value of all eligible goods and services, or 100% of the U.S. content included in all eligible goods and services in the U.S. exporter's supply contracts. Exim also may finance certain local costs and the exposure fee premium. The buyer would have to come up with a 15% down-payment. Capital goods loans typically exceed $300,000 and extend from 2-7 years (medium-term) to up to 18 years (long-term) for some environmental exports. However, the program requires audited financials from the foreign buyer, which has been difficult to obtain from medium-sized Chinese companies. As a result, this program has not been actively used. However, it is available and, if your importer is requesting medium- or long-term financing, you should approach Exim to discuss details.

Both the SBA and the Eximbank have **Export Working Capital Guarantee loan programs** which can be used for financing export transactions from purchase order to final payment, including any needed standby LCs. Both provide a 90% guarantee to the lender. SBA's maximum loan amount is $2 million and is available only to small businesses, which is typically 500 or fewer employees for manufacturers. (For a complete listing of size standards by NAIC, see: www.sba.gov/sizestandards.) Eximbank's program is available to all U.S. businesses and has no maximum loan amount. In addition, credit insurance and medium-and long-term financing is available through the Eximbank.

Information & Contacts

For more information on U.S. government export financing programs for export sales to China, visit:

- SBA: www.sba.gov/international
- Export-Import Bank: www.exim.gov

Find a ***Trade Finance Guide*** with these concepts at:

- www.ita.doc.gov/td/finance/11.html

Find your closest U.S. Export Assistance Center at:

- www.buyusa.gov/home/us.html