Terms of Payment for Export Orders

There are a four common ways through which you can negotiate payment from your foreign buyers:

1. **Cash in Advance**

   This would be the most preferred way to get payment for your export orders. Unfortunately few foreign buyers are willing to pay cash in advance, with the exception of custom orders. Most foreign buyers will prefer to pay after the goods have been received, unless they have established trust in you over a period of time.

2. **Open Account**

   Selling on "open account" is the norm. This is where goods are dispatched, an invoice is sent and the seller "trusts" that the buyer will pay for the good once they are received. This is how most SMEs do business at home and it may seem safe, especially when dealing with major industrialized trading partners in developed countries. However, this is the riskiest method of selling on the export market because the importer may pretend that goods have not been received in order to buy time.

3. **Letter of Credit (L/C)**

   Letters of Credit (L/C) are more secure after cash in advance and it is the safest bet for an exporter. To close an export deal a foreign buyer gets his own bank to essentially guarantee payment with a letter of credit. In turn the exporter can have his bank "confirm" the letter, which essentially guarantees that the exporter gets paid regardless of the actions of the foreign bank.

Exporters need to be aware that not all L/Cs are alike and it is wise to have your bank or an experienced financial institution verify them. An exporter has to be aware that some L/Cs from countries that are experiencing political unrests may not be worth anything especially when the banking sector is negatively affected.

An L/C can also be seen as expensive, cumbersome and time-consuming. For a SME with a growing export business the paperwork for L/Cs can also be a challenge.

Letters of credit offer two further opportunities for exporters looking to generate cash from their orders as quickly as possible.

Discounting of a term L/C

Sometimes you need to extend terms to a buyer in order for them to buy your goods. If you have a letter of credit that will only be paid in 30, 60, 90, or 180 days after you have shipped the goods but need your money immediately your bank may be able to help. Once you have shipped the goods you will receive an Acceptance Advice that indicates you have the right to receive payment after the negotiated term.

You simply take the Acceptance Advice to a bank and ask them for the best discount rate they can give. The bank will advance you the money you would have received at the end of the term of the L/C less a percentage the bank keeps as a fee. This fee is to offset the risk that the buyer or buyer's bank won't pay when the term is up and to account for the present value of the funds owed to you in the future (this is the "discount percentage.")

L/Cs available by deferred payment

In some countries, the issuance of a term L/C means the applicant (the importer) would have to pay stamp duties to the local government on the physical drafts. In order to avoid these additional costs for your buyer (the importer), another type of L/C has been developed, namely an L/C available by deferred payment.

You can get this type of L/C discounted by a bank in exactly the same way as a term L/C (see above).

4. Documentary Collections (the managed account)

A fourth payment option costing less than an L/C is a "Documentary Collection." This includes a bill of exchange — an unconditional request from the exporter for payment on demand or at a specified future time — as well as other documents transferring ownership.

Banks act as intermediaries. An exporter instructs his or her bank to transfer ownership only upon full payment. If payment is not made, the document of title, usually the Bill of Lading, is held by the importer's bank awaiting instructions.

The main question in export financing is when and how to receive the money while sending out the goods. There are different ways of doing this. The table below summarizes a number of payment methods and the associated risks to the importer and exporter.

Table 1: Methods of Payment and Associated Risks

Method of Payment	Time of payment to the exporter	Availability of goods to importer	Risks for exporter	Risks of importer
Commission	When presenting a bill of exchan-ge, normally when part of the goods are sold by importer	By delivery	Full trust into the importer that he will pay the bill of exchange	None
Open claims	When the bill has	By delivery	Full trust into	None

	been paid		the importer that he will pay the bill of exchange	
After sight bill ○ Documents against accept	When the after sight bill becomes due	When accepting the after sight bill	Like above but the importer is the owner of the products	As by credit
Sight bill ○ Documents against payment ○ Cash against documents	When presenting the bill of exchange to be cashed in	After payment	Possible not payment of bill of exchange in case of economic or political problems	Same as sight credit
Credit	When the after sight bill becomes due or when the bank accept is discounted	When accepting the after sight bill, which had been drawn under the credit of his bank	Like above	The payment will take place after owning the product, but has no connection to the quality
Sight credit	When the negotiating or paying bank receives matching documents	When paying	Small or none depending on the conditions of the credit	Assurance of sending goods is there, but the importer has to trust regarding the actual sending of the products
Cash in advance	Before sending	After payment	None	Full trust in exporter that he will sent goods