International Duh Moments – Is This a Payment?

by Bonnie D. Huval

When you do business internationally, there are ways of paying that you might never have heard of when doing business solely in the USA. Some methods require extending credit. Pursuing payment when something goes wrong is more difficult than when you are entirely in the States, too. Avoiding payment problems is far better than needing to resolve such problems across a combination of distance, different legal systems, and in some instances political or economic issues--so how to pay or be paid becomes a crucial choice as soon as you begin doing business across borders.

This article outlines the most common methods that may be new to you. Among these, the least commonly used methods are toward the end. When negotiating an international contract, choose a method where each party is comfortable with its level of risk.

Payment In Advance

Payment occurs: Before shipment.

Usually done via international wire transfer from one bank account to another or bank-to-bank wire transfer (regarded as safer), which takes only a few hours to a few days. Can be done via credit card or telegraphic transfer. Note that it is possible for an imposter to collect payment at telegraphic transfer offices, and documentation via that method is limited. Check clearing time can be as long as two months, so checks are not commonly used.

Highly insecure for buyers, but very comfortable for sellers. Payment transfer services incur fees.

Documentary Letter of Credit</B< p>

This comes in a variety of forms:

- confirmed - sight
- confirmed - date or time
- unconfirmed - sight
- unconfirmed - date or time

A *letter of credit* is a bank-to-bank guarantee to pay the seller (*beneficiary*) upon presentation of specific documents that comply with terms set by the buyer (*applicant*). The documents convey title to goods by showing that specific steps have been taken, or as of a maturity date, or a designated period of time after an event. Terms of payment must be specified clearly and completely to avoid confusion and delay.

International Chamber of Commerce (ICC) publishes "Uniform Customs and Practices" (document number UCP600) to govern letters of credit. Globally, more than 90% of banks honor these rules. There are *revocable* and *irrevocable* letters of credit, although UCP600 only accommodates irrevocable (terms and conditions can only be changed with explicit consent from all parties). If *unconfirmed*, the payment guarantee is by the buyer's bank, and the letter of credit must be irrevocable. If *confirmed*, the guarantee is by the seller's bank.

Banks charge a percentage of the transaction amount as their fee, which is usually but not always paid by the buyer. If fees are charged by both banks in the transaction, price quotes and the letter of credit should specify which party pays each fee.

Sellers tend to like letters of credit as a secure way to get paid. Buyers tend to be less keen about this because of the expense (typically one to eight percent) and processing can take up to a month, delaying order delivery. As parties become more comfortable dealing with each other, payment is likely to change to less expensive payment methods such as drafts.

Confirmed - Sight

Payment occurs: Typically linked to time of shipment.

Example clause: "$15,000 US net 15 days from shipment."

Seller has risk with the confirming bank and documentary risk. Buyer must trust seller to make certain goods are delivered after payment is transferred.

Confirmed - Date or Time

Payment occurs: At maturity.

Example: "$15,000 US net 15 days from acceptance."

Seller has risk with the confirming bank and documentary risk. Buyer must trust seller to make certain goods are delivered after payment is transferred.

Unconfirmed - Sight

Payment occurs: Typically linked to time of shipment.

Example clause: "$15,000 US net 15 days from shipment."

Buyer has assurance that shipment occurs, but must trust seller to ship the goods described in the document.

Unconfirmed - Date or Time

Payment occurs: At maturity.

Example clause: "$15,000 US net 15 days from acceptance."

Seller has risk with the issuing bank and documentary risk. Buyer has assurance that shipment occurs, but must trust seller to ship the goods described in the document.

Documentary Draft (Bill of Exchange)

This comes in a couple of forms:

- against payment - sight
- against acceptance - date or time

A draft is like a foreign buyer's check. As with a domestic check, there is a risk that it might not clear. It differs from a domestic check in that title does not transfer to the buyer until the draft it paid (or at least legal steps are taken to ensure that it will be paid when it is due).

Documentary drafts fall under the category *bills for collection*. In some markets (particularly in Asia), these methods are favored as a cost-effective way to satisfy Exchange Control Regulations. ICC publishes "Uniform Rules for Collections" (document number URC522) to govern these. Globally, more than 90% of banks honor these rules.

The documentation requesting payment is sent from seller's bank to buyer's bank, instead of directly from seller to buyer. The banks can sometimes help resolve any disputes that arise and threaten to disrupt the transaction. If the buyer fails to meet conditions specified in the documents, in some situations the seller can keep title to the shipment and may be able to recover the goods.

Drafts are often used when buyer and seller regard each other as trustworthy, there is no doubt about the buyer's ability and willingness to pay, no constraining foreign exchange controls need to be dealt with, and the buyer is in a politically and economically stable nation.

Against Payment - Sight

Payment occurs: When draft is presented to buyer (often a verbal notification).

With a sight draft, the seller keeps title for the goods until they reach their destination and payment occurs. If shipment is by sea, the ocean bill of lading is endorsed by the seller. Then the seller's bank sends it to the buyer's bank, along with the sight draft and supporting documents such as invoices, consular invoices, certificates of insurance or packing lists. The buyer is notified when these documents arrive. When the draft is paid, the bank turns over the bill of lading so the buyer can claim the shipment. (Air bills of lading and railway or road transport have less rigorous requirements before the buyer can take the shipment, so a sight draft brings more risk if shipment is not by sea.)

The buyer could have a change of mind between the time when the goods are shipped and the time when the draft is presented for payment. The bank is not obligated to pay in this case, or in a case where governmental policies change and interfere with delivery. When such problems lead to the buyer not paying for or not receiving the shipment, the seller is stuck with the problem of what to do with the goods.

Against Acceptance - Date or Time

Payment occurs: At maturity.

A date draft stipulates a date on which payment is due.

A time draft stipulates that payment is due by a specific amount of time after the buyer accepts the time draft and receives the shipment, such as "20 days after acceptance." (When the buyer writes "accepted" on the draft, that is trade acceptance.)

Open Account

Payment occurs: As agreed.

Goods are shipped. Seller sends a bill to buyer and buyer is expected to pay under agreed firms. This is much like having an open account for a customer within the States. Some large companies will only buy this way. There are markets, notably Europe, where buyers often expect Open Account. However, open account is appropriate only when the buyer has a long, good record as a payer and is definitely creditworthy.

Open account can be thought of as meaning "open to risk." The ongoing nature of an open account raises the odds that political or economic situations may deteriorate. Legal enforcement to collect payment may be hindered because the extensive documents and banking involvements of other methods are missing--not to mention that pursuing collections abroad tends to be expensive and difficult. Factoring or export credit insurance may be advisable to reduce risk.

Highly insecure for sellers, but very comfortable for buyers.

Standby Letter of Credit

Payment occurs: If necessary.

This is a bank guarantee of payment that is triggered only if the buyer fails to pay in the normal manner, such as defaulting on payments due under Open Account. Note that this lacks the documentary controls in Letters of Credit.

Consignment Sales

Payment occurs: After sale of goods.

On the surface, this looks like consignment sales within the States. The seller sends goods to a distributor in another country, and the distributor sells them on behalf of the seller. The seller keeps title to the goods until they are sold, after which the distributor pays the seller.

Despite legally having title until goods are sold by the distributor, the exporting seller has considerable risk: practically no control over the merchandise, and delay before payment arrives. Appropriate insurance is highly advisable, including property coverage over the goods until they are sold and payment occurs.

International Countertrade

Payment occurs: Variable.

One party accepts goods, services, or something else other than money as partial or complete payment. Beyond that vague description, there are many variations.

Most forms of countertrade can be thought of as forms of barter. However, direct barter is not common internationally. The two parties rarely have balanced needs for each other's products, and agreeing upon the value of goods may be difficult. To get around that, the parties can trade through an intermediary. (There are brokers and export management companies that handle such transactions.)

Transaction cost and risk are often higher than with other types of international transactions. However, countertrade may be the only way to do business with a company that does not have access to foreign exchange or is in a nation whose currency is not readily exchangeable.

Escrow

Payment occurs: As agreed, typically after acceptance.

Buyer deposits funds, property or other tangibles in an escrow account that is supervised by an escrow agent (a neutral third party trusted by both buyer and seller). When the terms of the escrow agreement are met (such as satisfactory delivery of goods to the buyer), the escrow agent releases the funds to the seller.

This mechanism is low risk for both buyer and seller if a reputable escrow agent is used. However, it adds cost (the escrow agent's fee), takes time to set up, and can be difficult to set up internationally. It is normally only used for large transactions. Caution against fraudulent escrow agents is advised.

Remarks

Whenever payment relies upon presentation of documents attesting that specific conditions have been met, the shipping and documentation requirements in the sales contract and letter of credit or draft must agree precisely. If they do not, the bank may refuse to pay. Reportedly, more than half of document presentations for letters of credit have discrepancies. This is expensive--banks charge extra for each discrepancy, and resolution delays payment.

If this overview leaves you needing to know more, your commercial banker can help you sift through the options and set up the method that best fits your situation.

About the author: Bonnie D. Huval has been a consultant since 1992, helping companies make more money, especially with their automation and transaction systems. Her USA and UK business interests also include real estate, property management and a restaurant. Go to http://www.makesureyougetpaid.com for her materials help small businesses be more successful. If you want more, go to http://www.seneschal.biz for consulting services.

Article Source: http://EzineArticles.com/?expert=Bonnie_Huval