PROFIT

promoting regional opportunities for investment and trade

Getting paid

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Getting paid[1]

1. Introduction

Getting paid is often the hardest part of your international trade transaction. Even if you are used to taking payment up-front in your domestic market, you will find that much harder in an overseas market. Moreover, the method by which your customers agree to pay will have an effect on the likely cost of providing the goods. You will also want to quote the agreed payment method in your sales quotation and sales contract. If your customer is desperate for your goods then you will be in a position to dictate terms — it is far more likely, however, that you will need to compromise on the payment method.

This factsheet outlines a range of payment methods which are open to you. These will be determined by the type of goods or services as well as the country from which the order originated. Some countries have closed or restricted currencies, governing the route by which money travels from the buyer to yourself. The sales and financial contracts will thus need to take into account the laws specific to the country with which you are dealing. And you may want to reflect the perceived financial risk in the price.

2. Managing the risk

Ultimately, exporting[2] is undertaken to make money. However, getting paid is an understandable concern when your customer is thousands of miles away, speaks a different language and 'does things differently' to you. Management of this risk should form an integral part of your exporting plan. Several methods of payment are open to you, each one allowing some degree of risk reduction. The one that you choose will be determined by factors such as the sales agreement, the country in question, the goods involved and the chosen method of distribution. However, it will be worth familiarising yourself with the various methods, and the advantages and disadvantages of each one, before looking at the decisions in front of you. If, for example, you use a confirming house, then payment will become their responsibility, rather than the buyer's. If goods are to be carried by ship then the option to withhold documents for collection becomes much more effective than for

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[1] This factsheet is based on material originally published in Exporting for the First Time by Graham Smith & Paul Sampson and edited by Colin Weatherspoon & David Irwin, copyright Project North East, 1996, and used with permission.

[2] This factsheet tends to talk about 'exporting' and 'exporters' as shorthand for businesses that intend to engage in international trade or investment, on the basis that the business intends to sell something in an international market.

carriage by air, rail or road, where such documents usually accompany the goods themselves. This makes you more reliant on the customer to pay the balance and should therefore be used in conjunction with the more secure methods of payment. Your bank will be able to advise you but keep in mind this general equation: greater risk reduction equals higher costs at this stage.

Once you have established contact with an overseas firm, research it (see factsheet on *Know Your Customer*). Use your common sense; even at home, you would be hesitant to supply goods on credit to a new customer without trade references. References on foreign customers can be obtained through their or your bank, through the embassy, or through a specialised credit referencing agency. There will be a charge for this investigation, but supplying as many details as you can at the start, will help to make the final report more informative. It may also be possible to ask other firms trading with that buyer for references, if you can get hold of this information, but if these are intended to be used to obtain credit and/or insurance they must be accompanied by the bank status or credit reference report.

The choice of payment method will affect cash flow for both parties and if you cannot obtain advance payment, you will need some means of securing this. This is where items such as a Confirmed Irrevocable Letter of Credit come in..

Risk areas

- Commercial.
- Distance — goods do not arrive or are faulty.
- Communication problems — language / cultural / distance.
- Non-payment.
- Political risks.
- Foreign exchange.

Risk management

- Language and communication problems — seek help, use your network, bank, etc.
- Buyer / country risk — insurance is vital.
- Payment risk — involve your bank in committing to uphold the sales agreement, promissory note, an aval (guarantee), Letter of Credit, but make sure that you know where the risk lies.
- Foreign exchange — hedge

Familiarising yourself with suitable payment methods before you negotiate with customers is sensible, but listening to their position and needs will be an important factor in determining which payment method is finally decided upon.

At this stage it will be useful to formulate a *non-payment action plan*, which can be put into effect to recover unpaid invoices. What this involves will depend on the specific sales contract, but it should be clarified before anything is signed and should be included in the sales provisions. Insurance can be taken out against non-payment. However, if this becomes necessary you may well find that you are unable to recover the full amount of the order. While insurance is imperative to ensure that some of the balance is recovered, you should try to minimise non-payment risk within the payment arrangement itself.

3. Invoices

Invoices are a basic document of any supply situation and, in exporting, are generally used as a record of goods shipped and the terms on which this took place. Details of freight, contents and insurance are usually included, but each country has its own requirements. A 'pro forma invoice' may be used for making quotations and obtaining payment, where this is made in advance. 'Customs invoices' may constitute a *certificate of origin and value* on which a customs duty will be based. These have to presented on a particular form, specified by the country that is importing the goods. When the declaration of the exporter alone cannot constitute a certificate of origin and value 'Certified Invoices' can be used. These will need to be authorised by the Chamber of Commerce and the relevant embassy of the receiving country, who will lay down the exact requirements on what is to be detailed on the form. This process will take time and money and this must be taken into account when compiling information for approaching banks, etc.

4. Foreign exchange risks

One decision that you will have to make regards the currency in which will quote: dollars or the currency of your target country? By quoting the buyer in sterling you will eliminate the risk of fluctuations in exchange rates, which may result in the order gaining or decreasing in value. However, buyers do possess some negotiating power and may be reluctant to undertake a contract quoted in a currency other than their own. One way around the risk that this involves is to establish a contract with your bank to sell the currency to them at a future date and at a set rate of exchange. This will guarantee that you will receive a precise amount of dollars, but also requires you to provide the foreign currency once the balance becomes due whether or not you have managed to secure payment from the original customer. It also removes the possibility of gaining from favourable movements within the exchange rate, but this gamble cannot outweigh the security of obtaining a set amount of dollars. This arrangement will allow you to be encouraging when customers ask to be quoted in their own currency.

Foreign exchange rate risks may have an effect on the end price that is quoted, as you will need to allow for losses involved in the time delay, transaction costs, etc as well as exchange rate fluctuations themselves. Keep tabs on exchange variations as these will effect the prices at which you offer to sell and hence, your competitiveness. Unless you gain payment in advance, or by an irrevocable letter of credit, you run the risk of not having the currency that is paid to you being exchanged for dollars. This can happen for countries of high exchange risk or where there are tight controls on currency leaving the country.

5. Choices of payment

These should be considered in the light of the use of INCOterms and what precisely payment will include.

5.1 Cash in advance

From your point of view, cash in advance is the ideal risk management method, particularly when dealing with an unknown customer.

Payment method

Payment would generally be made in response to a commercial or pro forma invoice and may take several forms:

- By cheque. You should wait until it has cleared before the goods are dispatched. Unless the cheque is in US$ or sterling this method may incur a long delay before money is cleared, making it subject to exchange rate fluctuations and problems within the buyer's country.
- By a bankers draft. This is preferable to payment by cheque, but the exchange rate risk remains until currency items are cleared.
- Society of Worldwide Interbank Financial Telecommunications (SWIFT) is used for the transfer of money between banks. This system is specific to banks, so you will need to approach them if you wish to use it.

Exchange risk

All transfers of currency, cheques in particular, are subject to several days handling time. This is dependent on the efficiency of the banking chain involved and on the correct presentation of requirements and documents by all parties involved.

Non-payment risk

Payment in advance is risky for the customer and you may have to offer some encouragement, such as discounts in exchange for payment in sterling. An arrangement where the customer pays a deposit, and offers to complete the balance on receipt of the goods, should really be avoided unless you can implement a back-up procedure against non-payment (such as withholding future shipments in long-term agreements).

5.2 Open account

Payment method

For a well-known customer you may wish to offer an open account arrangement. All the necessary documentation will immediately be supplied to allow the importer to take delivery of the goods. In effect this is the opposite to the above arrangement; the goods are in advance. The buyer will then pay according to the instructions on the bill.

This system has its advantages and disadvantages for both parties and, despite its drawbacks, is widely used. It is cheap and, in theory, straightforward. However, what you expect from the relationship in terms of payment, insurance, etc should be made clear from the very beginning.

Exchange risk

Within this arrangement, exchange risks are high as payment will be made at a future date. Provision should be made in respect to the expected currency, payment date, penalties, etc within the sales agreement.

Non-payment risk

Insurance can be obtained against non-payment, but this will not recover the full value of the goods. In this situation, credit references are vital, and you should make it absolutely clear to the buyer *what* will become due, *when* and in what *currency*. The implementation of a non-payment 'action plan', as with the credit reference, becomes even more urgent in the case of an open account.

5.3 Documentary Letters of Credit

Payment method

Under this method the buyer will approach their bank to open credit in favour of your goods. Conditions for this credit will be laid down at this point; such as the dispatch of goods being arranged according to the importer's instructions. The overseas bank will then request a UK bank to advise you of the credit and conditions. Once the conditions have been fulfilled on your part, the bank will pay you accordingly. Obtaining the credit, especially if you wish it to be confirmed (see below) depends on you presenting the correct documents, in accordance with the terms of credit, to the confirming bank. The credit, and hence payment, is partly reliant on yourself to fulfil these requirements.

Different types of credit include:

- *Transferable credit* — may be transferred, in whole or in part, to a third party; eg the exporter may use the money to pay a supplier. Must be opened as such.
- *Revolving credit* — for continuous trade one credit can automatically be reopened; removing the need to open credit several times.

- *Back-to-Back credit* — the exporter, will open credit in favour of a supplier, using the original buyer's credit as security. Similar to transferable credit, this method carries with it a greater risk but allows more variables from the terms of original credit.
- *Counter credit* or *countervailing credit* — similar to back-to-back credits but the second credit, in favour of the supplier, is seen as completely separate and is more dependent on the exporter's relationship with his bank than on initial buyer.
- *Red Clause credit* — allows the advising bank to advance some money to the exporter.
- *Stand by credit* (SBLC) — a form of guarantee, this becomes operative in the event of some other type of payment not being honoured.

When a letter of credit is received, ensure that it is checked extremely carefully. Make sure that you can comply with the conditions and that all details are correct. It will be easier to make changes and correct mistakes at this point and many problems arise because exporters agree to terms which are not fully or correctly understood. If you do not, or cannot, meet the dates laid down for shipping, etc. then you run the risk of the credit expiring. It might be worth going through the document with your financial adviser at this point. The total credit given should cover everything that you expect to receive. Go through the details with a fine tooth-comb and then supply a copy of the letter to those involved in producing, packaging and shipping the goods and those the preparation of documents, insurance and the credit.

Once the goods have been dispatched, the seller will take the documents to the confirming bank to collect payment. Hence, payment will take place *after* the goods have been dispatched but possibly *before* they have reached their destination. Once the bank has checked that all the documents are in order payment will be made immediately, or at a set future date.

Exchange risk

Payment and exchange rate risks can be reduced by making the credit both *irrevocable and confirmed*. Being irrevocable, once agreed it cannot be altered in any way without the consent of all four parties involved. It should also be confirmed by a reputable bank; that is, the money is credited to a domestic bank before it will be paid to you and is not held in the bank abroad. This will help to prepare against any obstacles which may block the transfer of the money. As highlighted above, thoroughly check that all details are correct and acceptable at every stage of the transaction. Any errors, be they on your part or on anyone else's, can lead to lengthy delays in payment, increasing the exchange rate risk.

Non-payment risk

The security of this method lies in the theory that the importer is receiving the goods under his conditions and that you can be sure of payment if these conditions are met. As above, a confirmed, irrevocable letter or credit serves to minimise the effects of any disputes that may arise. Insurance may be taken out against non-payment of an unconfirmed letter of credit, but you are unlikely to be able to redeem the full value if this occurs. An irrevocable letter of credit constitutes an agreement between the buyer's bank and you, separate to the initial sales contract made between yourself and the buyer. In this you will be assured of payment; the issuing bank will pay no matter what happens to the buyer, provided that you fulfil your part of the contract.

The request for confirmation will come from the overseas bank to yours and the domestic bank must be sure that it will be reimbursed for payments made to you. The buyer may be billed by their bank for the confirmation processes, but it is likely that you will redeem this cost in return for the extra security that it brings. It is important that the procedures are gone through in the correct order; any letter pre-printed as "Irrevocable and Confirmed" is assuming that the domestic bank will add its confirmation before it has agreed to do so!

Further information

The ICC 'Uniform Customs and Practice for Documentary Credits' (UCP 600) and their supplement for electronic presentation (eUCP) aims to govern the use of letters of credit world-wide. If a letter of credit does not show that it has been issued in accordance with this 2007 revision, query this to avoid problems in interpretation. The ICC provide checklists and advice for buyers submitting an application for credit. If things are done correctly first time a lot of time and effort can be saved. Your bank should be able to advise you about this.

Letters of credit are used extensively, and in principle are relatively secure. However, any errors can lead to lengthy delays in payment and the procedures themselves are intricate and time consuming. Exporters may find themselves out of pocket in regard to interest lost during the time taken to process payment. When collating documents to be presented at the bank, be as thorough as possible; this is an area where many people fall down and the submission has to be made time and again. If you decide to use letters of credit it will be worth having a member of staff trained in the terms and procedures of UCP, etc. Mistakes can result in losing the security for which the credit was opened in the first place.

5.4 Bills of exchange

Payment Method

Letters of credit require the customer to commit finances before any goods are received and they may prefer to make payment after delivery. A Bill of Exchange will allow you to credit customers and dispatch the goods yet still secure payment by sending the documents needed to take delivery through the banking system. The initial document is referred to as a *draft*. Your bank will forward this to the overseas bank, who will then present it to the customer. If payment is agreed, documents enabling them to take delivery of the goods are handed over.

In this instance the banks act only as agents for the delivery of the documents. However, the simple use of the banks does present some additional security in that the buyer will then be reluctant to earn himself a bad name by delaying payment. The draft constitutes a legal document which can be used to extract payment if problems arise (although litigation will be required).

The two main types of draft used are:

- *Sight drafts* or *Documents against Payment* (DP) — payable immediately by the person on whom it is drawn. Once paid, the delivery documents can be handed over.
- *Term drafts* or *Documents against Acceptance* (DA) — payable at a set future date after sight. If the customer agrees to the terms, 'Accepted' is written on the form in exchange for the delivery documents. The bank will then return the draft (now a Bill of Exchange) to you via your bank. You can then retain it until payment is made.

Clean collections — all commercial documents, except the bill of exchange which is sent via the banking system, go direct to the buyer. This avoids delay in clearance, but involves a putting a higher degree of trust in the buyer to fulfil his obligations.

Cash against documents (CAD) — commercial documents forwarded through the banking system with instructions to release payments, but without the bill of exchange and therefore, with limited legal protection. For the buyer this will avoid taxes on bills of exchange which are imposed in certain countries.

Exchange risk

In this respect, term drafts (DA) carry a higher degree of risk; payment may not be made on time and fluctuations within exchange rates may occur during the delay. A '*Bills for collection form'* can help to minimise these risks, informing your bank of what action should be taken in the case of non-payment/acceptance.

Non-payment risk

However, when it comes to legal weighting, term drafts carry more strength than sight drafts. If the buyer refuses immediate payment in response to a sight draft, banks may be unwilling to become involved in a legal dispute. Additional security can be obtained by using a draft that is signed by the buyer's bank; the risk then becomes theirs.

Bills of exchange are more secure for goods sent by ship, when documents for collection can be withheld. For goods sent by rail, road or air these documents generally accompany the goods to aid clearance at the destination.

Further information

The International Chamber of Commerce 'Uniform Rules for Collections' (URC 522) and its electronic supplement (eURC) outline procedures and responsibilities of those involved.

5.5 Countertrade

Payment method

An option which is popular with countries which lack the foreign exchange to pay for imports, countertrade involves export sales becoming conditional on the acceptance of goods from the importing market. Within this several options are available:

- *Barter* — The exchange of goods between firms, to pay for imports. This may involve some exchange of cash and may make use of intermediaries and brokers. Goods to be exported may be retained until sufficient funds have been raised from the onward sale of goods received in exchange. Barter is fairly rare as it is unusual that the exact needs of the two parties will coincide.
- *Counterpurchase* — In this common form of countertrade, the exporter buys goods/services from the importing country. Two separate contracts are involved; the initial sales contract containing standard cash/credit terms, and a second contract for the counterpurchase agreement. The goods or parties involved in the second arrangement may be unrelated to the first.
- *Compensation/buyback* — Payment for the provision of technical know-how or equipment is made in respect of the buyer's future trade. The exporter may even buy goods past the amount involved in the original supply. This type of countertrade is most commonly found within the export of processing plant or mining equipment, involving longer-term arrangements and large amounts of funding.
- *Offset* — export sales are conditional on the incorporation of specified materials/components from the importing market, into the final product. This is generally applied in situations involving advanced technology, defence, aircraft systems, etc, although it is becoming more common within other areas. Offset may form part of a larger, long-term contract.
- *Evidence accounts* — Exporters who have established an ongoing and significant level of business within a certain market may be asked to set up a counterpurchase arrangement with that market. Accounts are kept of what is imported and exported.
- *Switch trading* — This arrangement can be extremely complex; involving a chain of buyers, sellers and brokers in various markets and dependent on international trade relationships.

Factors or barter brokers can provide assistance for companies wishing to enter into such agreements. Barter brokers use computerised databases to pair businesses with matching needs. These brokers are growing in number and can be useful in that matching your needs with an overseas firm would be extremely hit and miss without this type of information. Factors may agree to sell on the goods that you take from the importer; allowing the deal to go ahead even if the 'return' goods are not ideal for your own needs. The factor will quote you a price for the goods, less commission, and this will determine your quote to the importer. Your goods will then be shipped according to the factor's instructions, who will pay you when money is received from the buyer.

Done correctly, countertrade can work very well, but mistakes can be costly. You will need to carefully assess the needs of the other parties/countries and which arrangement is most suitable for the goods involved. What is frequently mis-calculated is the cost involved in the process itself and this can eat into profit margins; for this reason the use of a third party is recommended. The two strong advantages that it brings are: it bestows on the exporter (you) the powers associated with the buyer's position in obtaining better trade terms, etc and it provides finance for trade which might otherwise not have been possible.

6. Maintaining cash flow

Although not a replacement for one of the payment methods, you may choose to use factoring, invoice discounting or forfaiting to speed up payment and improve your cash flow. If you do this, which is effectively a way of borrowing working capital, or if you borrow working capital directly from the bank, there is a cost which must also be taken into account in your pricing.

If you do need additional working capital to cover your exports, it is recommended that you keep your export finance separate from any internal credit management already in place. Until trade is established keep this as a subsidiary, or part of, the latter. Include staff at all levels of the export drive and do not pass a decision on an order before undertaking some kind of credit assessment on the buyer. This applies both to new and existing customers. Initial advice on foreign firms can be obtained from your bank, or from the ECGD (see below) who will not insure shipments to customers that they consider to be a high risk. All departments will need to be consulted as payment terms will affect the cash flow and operations of them all. Agree on a plan which may be implemented if payments become overdue and distribute the details of this to staff. Maintain a programme of regular checks on the buyer, their trading record and the results of your partnership.

Credit management is an area where the smaller company has the advantage of being able to implement a plan within all departments. Methods of payment that you can offer are often tied in with the attraction of large orders from overseas and the trading terms that can be used, and so it becomes an issue of equal importance for both the sales and accounts team. Methods of payment may also affect the end price of your product. In order to obtain maximum benefit from an order, and avoid costly disputes, it is important to have the correct trade terms established right at the start.

Err towards caution when adding in payments to cash flow forecasts, even 'sight drafts' or DP does not necessarily guarantee immediate payment as there may be unforeseen problems. When calculating the costs of the new venture you will need to take care to include all outlays; including costs for documentation, storage, transportation, service charges for the various agencies used and the loss of interest due to the delay involved in obtaining and exchanging the payments.

Late payments can cut into profit margins extremely quickly and you must be prepared to refuse business. Even where goodwill exists on both sides there may be unavoidable delays in either direction for many reasons, eg weekends and public holidays, as well as standard 2 day processing of currency. Make sure you are up to date with your own payments and obligations, eg reimburse the buyer for charges involved in obtaining confirmation of letter or credit. If you find several buyers in one country, you may consider opening a local account which buyers pay into, providing local exchange controls permit.

6.1 Credit insurance

Non-payment may arise for several reasons: from international events such as war or a politically based ban on the export/import of those goods; from a reason specific to the buyer's country or from circumstances arising from the buyer themselves. Credit insurance must be included as part of your financial plan, and for some established exporters it has become integrated as part of their cash flow protection programme and balance sheet. However, many exporters still neglect this vital issue. Insurance is actively encouraged by the government of most countries as it is seen as a mechanism by which more exports are made possible. An increasing number of policies are available to choose from, but many private insurers are hesitant to provide cover for political risks as well as commercial causes of non-payment. Obtaining insurance should be taken into account when researching potential markets.

As well as insurance, many brokers offer a range of support services and have access to a huge amount of credit and trading reference information on potential buyers. This will help them to advise you of the risk attached to a specific order. Five per cent to twenty per cent of any loss must be covered by yourself to avoid misuse of the cover. Once a claim has been made, the insurer may attempt to recover the funds from the buyer, through the courts or British Embassy of the relevant country. Alternatively they may try to resell reclaimed goods, or reclaim a proportion of the funds if resale is overseen by yourself.

6.2 Fraud and non-payment

It is an unfortunate fact that fraud is on the increase. However, problems can be avoided by establishing a policy of caution and the methodical checking of orders and payments. If an 'original' letter of credit or bankers draft, arrives direct from a buyer, double-check its authenticity with the named bank, not an overseas 'enquiry' number; even if the buyer claims that a domestic bank has added its signature. Sometimes these can be spotted by mistakes in the spelling and address of the banks. It would be good policy to develop a system of checking any documentation received, particularly letters of credit which do not show that they are subject to the ICC UCP 500. The *Commercial Crime Service* of the ICC investigates and reports on international fraud of all types and can provide advice on methods of protecting against fraud.

Fraud can also arise from carriers; remember, there is no such thing as cheap and secure freight! One example of fraud that is on the increase is the sending of threatening invoices for advertisements or directory entries placed in publications overseas. If you receive any 'surprise' invoices it should be safe enough to ignore them. If you employ a local agent, you can consider paying them to take the risk of non-payment by the customer. Make sure that all departments understand what decisions are being taken and what action to expect, in this way the whole company can become involved in keeping an eye out for any discrepancies that occur.

If payment problems arise, ask your bank to liaise with buyer's bank. Weigh up cost of protest (in time and money) against the reason behind non-payment by the buyer. If he has no money, pursuing this may be a waste of your efforts. It will also ruin your relationship for future trading — whether this is a factor or not will depend on the value that you place on the customer and the size of the order in question.

You will probably already have basic procedure in place for checking new orders, but it may be worthwhile establishing a specific administrative procedure for export orders. The plan will need to be as thorough as possible, taking into account all the actions taken and time/money invested in fulfilling an order and can be done in consultation with professional advisor. Things to look out for include:

- the addresses and details of banks, etc on documents received from the importer. Payments to and from foreign countries should be made through a bank and any details which seem unfamiliar should be checked out.
- 'once in a lifetime' opportunities which need quick decisions; any deal worth its while will allow each party time to consider the implications. Opportunities to be grabbed may present themselves, but smaller companies cannot afford to risk substantial amounts of money and caution is the best policy in these early stages.
- letters of credit or bank transfers may cover stolen amounts!

Much can be done simply by being sensible and methodical!

7. Further information

The International Chamber of Commerce has developed many of the rules on tings like letters of credit. See https://iccwbo.org/global-issues-trends/banking-finance/access-trade-finance/.

For electronic supplements, see https://iccwbo.org/media-wall/news-speeches/icc-banking-commission-releases-new-erules-use-electronic-documents/

Whilst ICC aims to sell many of its documents, eURC and eUCP are both available in full electronically: https://cdn.iccwbo.org/content/uploads/sites/3/2019/06/icc-uniform-rules-for-collections-v1-0.pdf and https://cdn.iccwbo.org/content/uploads/sites/3/2019/06/icc-uniform-customs-practice-credits-v2-0.pdf website

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