Methods of payment

in international trade
METHODS OF PAYMENT

- Credit card
- Bank transfer
- Bill of Exchange
- Letter of Credit
- Cheque
- Open account
- CWO
- COD
- CAD
- D/P
- D/A
Cheque

• Written order to a bank to pay money to a named person or organisation;
• Three parties are involved:
  • The drawer – the person giving the order;
  • The drawee – the bank that will pay the money;
  • The payee – the beneficiary, i.e. the person who cashes the money.
Cheque

• Cheques can be:
• “Open” – i.e. they can be cashed by anyone claiming that they are the payee; they only have to endorse the cheque.
• “Crossed” – i.e. with two lines drawn across the middle meaning that they can only be paid into a bank account.
• “Order” cheques – the word "or order” written on their face. They are payable to the person specified therein as the payee, or to any one else to whom it is endorsed (transferred).
Cheque

• In international trade cheques are only used to pay small orders;
• International clearing of cheques takes too long – from three to four weeks;
• To shorten the time necessary to clear cheques banks offer a lock box service:
  • Cheques are sent by the buyer to a post office box number and collected by a bank in the buyer’s country
  • The bank transfers the amount to the seller’s account in his own country.
Credit card

• It is issued by companies (banks and/or card issuing companies) that guarantee payment for the goods or services bought by cardholders.

• Once a month, a statement of account is sent to the cardholders and the amount spent is debited from their accounts.
Bank Transfer

• It is an irrevocable and unconditional order of payment issued by the debtor’s bank to a correspondent bank in the creditor’s country.

• The money is taken by the debtor’s bank account and transferred to the creditor’s account.

• When payment is urgent swift transfers can be arranged.

• SWIFT – acronym for “Society for Worldwide Interbank Financial Telecommunications” - is a fast telematic system for inter-bank transfers.

• Thanks to Swift banks can make same-day international exchanges.
Bill of Exchange or Draft

- It is a written document that orders a bank to pay a sum of money on demand or on a certain date to the company specified.
- There are three parties involved:
  - The drawer
  - The drawee
  - The payee
- A draft can be:
  - At sight
  - At 30/60/90/120 days after the date specified in it;
  - At a fixed date specified in it.
- To make a draft legally valid the drawee must accept it by writing “accepted” and his/her signature across the face of the draft.
- A draft can be:
  - “domiciled” with a bank;
  - “negotiable”.

Letter of Credit or Documentary credit

• The safest form of payment for the exporter but ...
• also the most expensive one.
• only used when a lot of money is involved in the transaction.
• two banks are involved:
  • the buyer’s bank – the issuing bank;
  • the seller’s bank – the advising bank;
Letter of credit or Documentary credit

1. The importer asks his bank, the issuing bank, to open a credit in favour of the exporter;
2. The letter of credit contains all the instructions the exporter has to follow regarding the shipment;
3. The L/C is issued and sent to the exporter’s bank – the advising bank;
4. The advising bank informs the exporter of the credit opened in his favour and the conditions under which he will be paid;
5. the exporter dispatches the goods to the importers and presents the shipping documents (invoice, document of carriage, insurance policy, etc.) to the advising bank;

6. the advising bank checks the documents and if they are in order pays the exporter;

7. the advising bank forwards the documents to the issuing bank;

8. the issuing bank also checks the documents and then reimburses the advising bank;
Letter of credit or Documentary credit

9. the issuing bank debits the amount from the importer’s account;
10. the issuing bank gives the documents to the importer;
11. the importer can finally collect the goods.

- two types of L/C:
  - revocable;
  - irrevocable;
Letter of credit or Documentary credit

• a letter of credit can also be “confirmed and irrevocable”:

• this means that an additional guarantee of payment is provided by the advising bank in case the buyer and the issuing bank fail to pay.
Documentary Collection or CAD - Cash Against Documents

- Used when the exporter trusts the buyer;
- Two different types:
  1. Documents against Payment (D/P);
  2. Documents against Acceptance (D/A);
- In the first case, the seller sends his bank the shipping documents, which show ownership of the goods, and a draft at sight;
Documentary Collection
or
CAD - Cash Against Documents

• The seller’s bank sends the documents to the buyer’s bank;
• The buyer’s bank informs the buyer that the documents have arrived;
• The buyer accepts the draft at sight and payment is made immediately;
• The buyer’s bank gives the documents to the buyer;
• The buyer can collect the goods.
Documentary Collection
or
CAD - Cash Against Documents

• D/A involves a draft on which payment is due at a future date;
• The seller draws a draft, payable at a future date, on the buyer;
• The draft is sent, together with the shipping documents, to the buyer’s bank;
• The buyer accepts the draft and the documents are handed over to him and he can collect the goods;
• When the time of payment – the maturity date – arrives the buyer honours the draft.
COD – Cash On Delivery

• The goods are delivered to the importer at the exporter’s expense, together with an invoice.
• The importer pays the invoice when the goods arrive;
• COD saves time and avoids lengthy procedures involving banks but....
• It involves some risk for the seller who, after he has delivered the goods, may discover that payment has not been made.
CWO - Cash With Order

• safest method of payment for the seller.
• The buyer pays for the goods when placing the order;
• CWO is only used for small purchases and when the goods are made to order.
Open Account

• These sales terms are granted by sellers only to long-standing and reliable customers.
• Goods are delivered without any pre-payment or payment security.
• Payment is generally made 30 to 120 days after the invoice date.
• In case of repeated delivery of goods, a statement of account with a list of all transactions and the amount due, is periodically sent to the buyer.