

How to Get Paid When Selling Overseas

Export payments are not quite what you're familiar with domestically. In the U.S., if your buyer has good credit, you'd probably sell on open account; if not, you'd want cash in advance. These methods are rarely used in exporting. Foreign buyers expect to pay only when the goods arrive, or later still if possible; certainly not in advance. Open account is risky for you. You'd only use it for your most loyal and long-standing overseas customers. Most commonly, you get paid by Letter of Credit (L/C) or documentary draft (sight or time draft). L/Cs are the closest to cash in advance and better for you. However, many buyers prefer more time to pay. Since they can often get better terms from your competitors, L/Cs are not always an option if you want the business. Thus, documentary drafts (payment after a specified time period) are frequently used. If you want to be competitive, but still need the money right away, you can "discount" the receivable through methods known as factoring or forfaiting.

To some extent, you're always at risk at payment time, even with domestic sales. Checks can bounce, etc. It's always important to check out your buyer. The less you know about the buyer, the more demanding you should be about payment methods. Also, in export sales, there are foreign exchange risks. You would normally require payment in U.S. dollars to protect yourself. That way, if the buyer's currency depreciates, you're still owed the dollar amount specified. However, the buyer would have to put up more local currency than expected, and might default as a result. You can reduce these and other payment risks through export insurance. Policies are available from the U.S. Export-Import Bank.

The different export payment methods are described below from the most to the least secure:

Cash in advance. This would give you faster access to your money and avoid collection problems. However, even checks take time to clear, possibly up to four to six weeks. Foreign buyers usually won't agree to advance payment, because it creates cash flow problems and increases their risks.

Letter of credit (L/C). With L/Cs, a bank takes on the obligation to pay—first the buyer's bank (the buyer having pledged the money); then a cooperating U.S. bank if it confirms the L/C. Your obligation is to comply with all the terms and conditions specified in the L/C. An L/C can be either irrevocable (no changes without the consent of both the buyer and the seller); or revocable (either party can unilaterally make changes). You want an irrevocable L/C. An L/C can be at sight (immediate payment upon presentation of documents); or a time or date L/C (payment to be made at a specified future date). You get paid when the confirming bank receives the funds from the buyer's bank and determines that you've met all the terms and conditions.

Here's a typical L/C scenario:

1. You and the buyer agree on the terms of a sale; the buyer arranges for its bank to open an L/C.
2. The buyer's bank prepares an irrevocable L/C, including all instructions concerning the shipment.
3. The buyer's bank sends the irrevocable L/C to a U.S. bank, requesting confirmation.
4. The U.S. bank sends a letter of confirmation, along with the irrevocable L/C.
5. You review and accept all conditions in the L/C
6. You arrange with the freight forwarder to deliver the goods to the appropriate port or airport.
7. When the goods are loaded, the forwarder completes the necessary documents.
8. You or the forwarder present documents to the U.S. bank showing full compliance.
9. The U.S. bank checks that documents are in order and sends them to the buyer's bank for review.
10. The buyer gets the documents from his bank and uses them to claim the goods.
11. The confirming U.S. bank pays you by draft at the time specified.

Compliance with all L/C terms is crucial. When you first get an L/C to review, make sure the price and terms are the same you've agreed to in price quotes and other documents. If you don't meet the L/C terms precisely, the bank might not pay. Also, the bank will only pay the amount in the L/C, even if higher charges for shipping, insurance, or other factors are documented. If you find you can't meet the terms of the L/C, or it has errors or even misspellings, contact the buyer immediately and ask for an amendment to the L/C to correct the problem. To get paid, you must provide documentation showing that the goods were shipped by the date specified. Check with your freight forwarder about any unusual conditions that might delay shipment. Similarly, you must present documents by the date specified. Check with your bankers to make sure there's sufficient time for a timely presentation. You should always request that the L/C specify that partial shipments and transshipment will be allowed. This will avoid unforeseen problems at the last minute.

Documentary drafts. These are also known as bills of exchange and are analogous to a foreign buyer's check. Like checks used in domestic commerce, drafts sometimes carry risks of default. A **sight draft** is used when you want to retain title to the shipment until it reaches its destination and is paid for. Before the cargo can be released, the buyer must properly endorse the original ocean bill of lading and give it to the carrier, since it's a document that evidences title. Air waybills of lading, on the other hand, do not need to be presented in order for the buyer to claim the goods. Hence, there is a greater risk when a sight draft is being used with an air shipment.

In actual practice, the bill of lading or air waybill is endorsed by the shipper and sent via the shipper's bank to the buyer's bank or to another intermediary along with a sight draft, invoices, and other supporting documents specified by either the buyer or the buyer's

country (e.g., packing lists, consular invoices, insurance certificates). The bank notifies the buyer when it has received these documents; as soon as the amount of the draft is paid, the bank releases the bill of lading, enabling the buyer to obtain the shipment.

There's some risk when you use a sight draft to control transfer of title, because the buyer's ability or willingness to pay may change between the time the goods are shipped and the time the drafts are presented for payment. Also, the policies of the importing country may change. If the buyer can't or won't pay for and claim the goods, you'll have to dispose of or return them.

You should also consider which foreign bank should negotiate the sight draft for payment. If the negotiating bank is also the buyer's bank, the bank may favor its customer's position, putting you at a disadvantage. Consult with your bank on an appropriate strategy for negotiating drafts.

If you want to extend credit to the buyer, you can use a **time draft** to state that payment is due within a certain time after the buyer accepts the draft and receives the goods (e.g., 30 days after acceptance). By signing and writing "accepted" on the draft, the buyer is normally obligated to pay within the stated time. When this is done the draft is called a *trade acceptance* and can be either kept by you until maturity or sold to a bank at a discount for immediate payment.

A **date draft** differs slightly from a time draft in that it specifies a date on which payment is due, for example, December 1, 19XX, rather than a time period after the draft is accepted. When a sight draft or time draft is used, a buyer can delay payment by delaying acceptance of the draft. A date draft can prevent this delay in payment but still must be accepted.

When a bank accepts a draft, it becomes an obligation of the bank and creates a negotiable investment known as a *banker's acceptance*. This can also be sold to a bank at a discount for immediate payment.

Credit cards. Many U.S. exporters of consumer and other products (generally of low dollar value) that are sold directly to the end user accept Visa and MasterCard in payment for export sales. In international credit card transactions, merchants are normally required to deposit drafts in the currency of their country; for example, a U.S. exporter would deposit a draft in U.S. dollars. U.S. merchants may find that domestic rules and international rules governing credit card transactions differ somewhat and should contact their credit card processor for more specific information. International credit card transactions are typically placed by telephone or fax, methods that facilitate fraudulent transactions. Merchants should determine the validity of transactions and obtain proper authorizations.

Open account. Under open account, you would simply bill the buyer, who's expected to pay under agreed terms at a future date. Open account sales are risky. The absence of documents and banking channels may make it difficult to pursue claims, particularly in

the buyer's turf. Also, receivables may be harder to finance, since drafts or other evidence of indebtedness are unavailable. However, open account can be considered if the buyers are well established, have solid payment records, or have been thoroughly checked for creditworthiness. Some of the largest firms abroad make purchases only on open account.

Consignment sales. In international consignment sales, the same basic procedure is followed as in the United States. The material is shipped to a foreign distributor to be sold on your behalf. You retain title to the goods until they're sold. You get paid at that point. This method poses the greatest risk. You have the least control over the goods, and you may have to wait quite a while to get paid.

Factoring and forfaiting: Factoring is the discounting of a foreign account receivable that does not involve a draft. The exporter transfers title to its foreign accounts receivable to a factoring house (an organization that specializes in the financing of accounts receivable) for cash at a discount from the face value. Although factoring is often done without recourse to the exporter, the specific arrangements should be verified by the exporter. Factoring of foreign accounts receivable is less common than factoring of domestic receivables. Forfaiting is the selling, at a discount, of longer term accounts receivable or promissory notes of the foreign buyer. These instruments may also carry the guarantee of the foreign government. Both U.S. and European forfeiting houses, which purchase the instruments at a discount from the exporter, are active in the U.S. market. Because forfeiting may be done either with or without recourse to the exporter, the specific arrangements should be verified by the exporter.

Countertrade and barter. International countertrade is a trade practice whereby a supplier commits contractually, as a condition of sale, to undertake specified initiatives that compensate and benefit the other party. The resulting linked trade fulfills financial (e.g., lack of foreign exchange), marketing, or public policy objectives of the trading parties. Not all suppliers consider countertrade an objectionable imposition; many U.S. exporters consider countertrade a necessary cost of doing business in markets where U.S. exports would otherwise not occur.

Simple barter is the direct exchange of goods or services between two parties; no money changes hands. Pure barter arrangements in international commerce are rare, because the parties' needs for the goods of the other seldom coincide and because valuation of the goods may pose problems. The most common form of compensatory trade practiced today involves contractually linked, parallel trade transactions each of which involves a separate financial settlement. For example, a countertrade contract may provide that the U.S. exporter will be paid in a convertible currency as long as the U.S. exporter (or another entity designated by the exporter) agrees to export a related quantity of goods from the importing country. U.S. exporters can take advantage of countertrade opportunities by trading through an intermediary with countertrade expertise, such as an international broker, an international bank, or an export management company. Some export management companies offer specialized countertrade services. Exporters should bear in mind that countertrade often involves higher transaction costs and greater risks than simple export transactions