

An Introduction to Getting Paid by Overseas Trade Customers

Business Information Factsheet
BIF225 · November 2017

Introduction

This factsheet introduces the four most common methods of getting paid by overseas trade customers: cash in advance, open account payments, letters of credit and documentary collection. It also outlines the main features and risks involved in each one, and provides sources of further information and support for exporters.

Cash in advance

For most exporters, cash in advance is the ideal payment method, particularly when dealing with new trade customers.

Under this arrangement, the goods ordered must be paid for in full before they are shipped to the customer. Payment is generally made in response to a commercial or pro forma invoice and may take several forms:

- **Electronic transfer.** There are several options for transferring money electronically:
 - International money transfers using SWIFT (Society for Worldwide Interbank Financial Telecommunications). SWIFT is the main system used by banks for international financial payments and transactions.
 - SEPA (Single Euro Payments Area) transfers can be used to make payments in euros between banks and firms in over 30 European countries.
 - If the amounts in question are relatively small, it may be easier to use a simple online payment service such as PayPal (www.paypal.com/uk/home) or HiFX (www.hifx.co.uk).
- **Banker's draft.** A banker's draft is a cheque that is prepaid and guaranteed by the overseas customer's bank. This is preferable to payment by a normal cheque, but there is still a delay before currency items are cleared, making the value of the payment subject to fluctuations in the exchange rate. This is known as exchange rate risk.
- **Cheque.** Exporters should wait until the cheque has cleared before dispatching the goods. Unless the cheque is in US dollars or sterling (possibly from a UK account that the buyer may hold) this method may incur a long delay before money is cleared, increasing the risk of adverse fluctuations in the exchange rate.

All transfers of currency, cheques in particular, are subject to handling time. These will depend on the efficiency of the banking chain and on all parties meeting the agreed requirements and presenting the correct documents. Banks can provide advice on what is involved in transfers of currency.

Although payment in advance is an attractive option for exporters, customers may need some encouragement, such as discounts for prompt payment or for payment in sterling.

Exporters should avoid entering agreements where overseas customers pay a deposit and offer to complete the balance on receipt of the goods, unless they have an effective procedure for dealing with non-payment (such as withholding future shipments in long-term agreements).

Cash in advance may be prohibited under local exchange controls in some countries.

Open account payments

For established customers, exporters may wish to offer an 'open account' arrangement. In this case, goods are supplied directly to the customer, who agrees to pay by a specified date, according to the instructions given on the delivery bill.

This arrangement has advantages and disadvantages for both parties and - despite the obvious risk that the customer may not pay at all - is widely used. It is inexpensive and, in theory, straightforward.

However, it is essential that all the sales and payment terms are clearly understood and accepted by all parties concerned from the outset. Provision should be made in the sales agreement or contract regarding the expected currency, payment date and penalties for late payment.

The International Chamber of Commerce (ICC) has developed an internationally recognised series of terms ('Incoterms') that are used worldwide in contracts for the sale of goods. Go to <https://iccwbo.org/resources-for-business/incoterms-rules/incoterms-rules-2010/> for more information.

Insurance can be taken out against non-payment, but claims will not recover the full value of the goods. Exporters should always obtain credit references and make it absolutely clear to the buyer:

- How much money is due.
- When it is due.
- Which currency it should be paid in.

A robust non-payment action plan is particularly important in the case of an open account payment. Exchange rate risks are high in open account payments, as the money will be received at a future date.

Letter of credit (also known as documentary credit)

A letter of credit is an agreement under which a trade customer arranges with their bank for the seller to be paid, provided the seller can demonstrate that they have shipped the goods within a specified time and complied with all the conditions set out in the letter of credit. Payment depends on the seller presenting all the documents required by the letter of credit.

Letters of credit are generally considered to be lower risk than open account payments, as the promise to pay is moved from the customer to their bank.

It is important to understand that there are different types of letters of credit, including:

- **Revocable and irrevocable.** A revocable letter of credit can be cancelled after issue. An irrevocable letter of credit cannot be cancelled or altered in any way without the consent of

all four parties involved: the buyer, the seller, the overseas bank and the UK bank. The issuing bank will pay provided that the exporter fulfils the conditions set out in the letter. All letters of credit are irrevocable unless explicitly stated to be revocable.

- **Confirmed and unconfirmed.** A confirmed letter of credit is guaranteed by a UK bank as well as the customer's bank. An unconfirmed letter of credit is guaranteed by the customer's bank only. Confirmed credit ensures that the money is credited to the UK bank before being paid to the exporter, rather than being held in the bank abroad.
- **With and without recourse.** With recourse, if a buyer fails to pay in accordance with the agreement, the bank that has already paid and failed to recover the payments from the buyer can reclaim the payments from the exporter. Without recourse, once the exporter fulfils their part of the contract and receives payment from their bank, they are not liable to pay back the money to the bank if the buyer fails to pay their bank.
- **Transferable.** This type of letter of credit may be transferred, in whole or in part, to a third party; for example, the exporter may use the money to pay a supplier. All letters of credit are non-transferable unless explicitly stated to be transferable.

Payment and exchange rate risks can be reduced by making the credit both 'irrevocable and confirmed'. Insurance may be taken out against non-payment of an unconfirmed letter of credit, but exporters are unlikely to be able to redeem the full value if this occurs.

Letters of credit are used extensively and, in principle, are relatively secure. However, it is important to check that all details are correct and acceptable at every stage of the transaction. It is also essential to present the correct documentation to the bank. Errors may lead to lengthy delays in payment, increasing the exchange rate risk.

The procedures themselves can be complex and time-consuming. Exporters may find themselves out of pocket with regard to interest lost during the time taken to process payment.

The ICC's 'Uniform Customs and Practice for Documentary Credits' (UCP 600) govern the use of letters of credit worldwide. A letter of credit must show that it has been issued in accordance with the most recent 2007 revision. Exporters who use letters of credit regularly may need to train a member of staff in the terms and procedures of UCP 600.

The full UCP 600 rules are available from the ICC. Go to <http://store.iccwbo.org/icc-uniform-customs-and-practice-for-documentary-credits-ucp-600-leaflet-format-set-of-25>.

Documentary collection (also known as export bills for collection)

Under this arrangement, the exporter ships the products and asks their bank to forward the shipping documents (such as the certificate of origin and original bill of lading) and any collection instructions to the customer's bank. The products will not be released to the customer until they have paid, or at least undertaken to do so, by a mutually agreed date.

Documentary collection is a halfway house between an open account arrangement and a letter of credit. This arrangement offers the exporter some protection (goods are not released until paid for), but also means that customers do not have to pay in advance, which could be helpful for their cash flow.

There are three main types of documentary collection:

- **Clean collections.** All commercial documents, except the bill of exchange, which is sent via the banking system, go directly to the buyer. This avoids delays in clearance, but involves putting a higher degree of trust in the buyer to fulfil their obligations.
- **Documents against acceptance.** The buyer accepts and signs the bill of exchange, agreeing to pay on a future date, and is then given the shipping documents.
- **Documents against payment (also known as cash against documents).** The buyer must pay when they accept the bill of exchange, before they are given the documents.

Hints and tips

- Deal with potential overseas customers as if they were any prospective UK customers. Avoid committing to any deal or payment method until the foreign company has proven they are a reliable payer.
- Of the payment methods listed above, letters of credit are often considered to be one of the safest.
- An active and robust non-payment plan is essential. Not only will late payments affect cash flow, but a sudden slump in the exchange rate could mean losing money on the original deal.
- Insurance can be taken out against non-payment and while this may ensure that some of the balance is recovered (it is unlikely that the full amount will be recovered) the risk of non-payment should be minimised through the payment arrangement.
- The British Chambers of Commerce can help with information, training and advice about all aspects of export documentation. Go to <http://exportbritain.org.uk> for more information. Banks also provide support and international trade services specifically for exporters.

Further information

BIF184 A Guide to Incoterms

BIF208 A Guide to Export Documentation

BIF235 Government Support for Exporters

BIF238 A Guide to Methods of Entering Export Markets

Useful contacts

The Department for International Trade provides a wide range of assistance to UK companies trading internationally and encourages overseas firms to invest in the UK.

Tel: (020) 7215 5000

Website: www.gov.uk/government/organisations/department-for-international-trade

Business Wales helps exporters in Wales to establish themselves in overseas markets.

Tel: 03000 603000

Website: <http://businesswales.gov.wales/zones/export>

Scottish Development International works in partnership with other organisations to help firms in Scotland trade internationally.

Tel: 0300 013 2734

Website: www.sdi.co.uk

Invest NI can provide information and advice to exporters in Northern Ireland.

Tel: 0800 181 4422

Website: www.investni.com/support-for-business/thinking-about-exporting.html

Export Britain is an online resource for UK exporters produced by the British Chambers of Commerce.

Website: <http://exportbritain.org.uk>

Local chambers of commerce provide a wide range of business services in areas such as exporting, training, information and representation.

Website: www.britishchambers.org.uk

UK Export Finance is the export credit agency for the UK. It provides insurance for UK exporters and makes loans to overseas buyers of UK goods and services.

Tel: (020) 7271 8010

Website: www.gov.uk/government/organisations/uk-export-finance

The Institute of Export & International Trade (IOE&IT) provides a range of advice, information and training for potential and existing exporters.

Tel: (01733) 404400

Website: www.export.org.uk

The International Chamber of Commerce UK (ICC UK) publishes a range of information for exporters including the latest Incoterms and model contracts.

Tel: (020) 7838 9363

Website: www.international-chamber.co.uk

DISCLAIMER While all reasonable efforts have been made, the publisher makes no warranties that this information is accurate and up-to-date and will not be responsible for any errors or omissions in the information nor any consequences of any errors or omissions. Professional advice should be sought where appropriate.

Cobweb Information Ltd, Unit 9 Bankside, The Watermark, Gateshead, NE11 9SY.

Tel: 0191 461 8000 Website: www.cobwebinfo.com