PAYMENT TERMS AND EXPORT FINANCE RESOURCES

**GENERAL INFORMATION**
A successful export transaction starts with the negotiation of a sales contract and ends with a timely payment. The buyer/importer gets the product they want and pays the seller/exporter a profitable amount as soon as possible. Depending on the parties’ comfort with the degree of risk, there are four methods of payment and other issues to consider, as explained below.

**CASH IN ADVANCE**
With Cash In Advance, the buyer pays the exporter before the shipment/export is made. This method benefits the seller, provided all costs were taken into consideration and calculated correctly. Ignoring actual cash and the barter system, there are three forms of payment that qualify as cash in advance:

- A wire transfer is the best method of paying, although banks charge ($25-$35) for this service.
- Paying by check is another good option, but payment could be delayed for up to six weeks waiting for clearance from a foreign account. A bank draft is more appropriate for trade.
- A credit card is a viable choice for low dollar amounts, mostly for the convenience of speed and the automatic currency conversion, but the decision will depend on the exporter’s product and in-house collections process.

Cash In Advance payment terms may be considered the most “credit-risky” for the importer/buyer, however the terms may allow for a “savings” to the importer if offered with a discount. Often, Cash In Advance payment terms can be less expensive for the importer when viewing the overall process of the sale and compared to the costs for opening a Letter of Credit at their bank. Depending on a product’s lead time and the investment required to produce goods for a specific buyer, Cash In Advance terms by “progress payments” can be an attractive payment method. For example, the terms could be 10% at start of production, 50% at midpoint, and the remainder due at shipment or offered at Open Account terms (see page 4). Based on the importer’s country and background, U.S. exporters sometimes offer a mix of Cash In Advance payment terms and Open Account terms. This means one portion is paid in advance (which is helpful to the exporter in covering whatever costs of the sale they may have incurred) and the remaining portion is paid at 30/60/90 days after shipment (which is helpful to the importer).

**LETTERS OF CREDIT / DOCUMENTARY CREDITS**
Letters of Credit (L/C) are often called Documentary Credits by some banks to avoid confusion with “Stand-by” L/C, which are used as a “back up” when services are not provided per a sales agreement. Documentary Credits help to remind the parties involved that banks deal strictly in documents; they do not see or handle the actual goods, so attention to detail on the shipping documents is a must. This method of payment involves strict adherence to bank instructions on the types of documents, terms, conditions, and specific wording required. See flow chart page 5.

- Letters of Credit are produced by commercial banks. The importer’s bank “opens” a L/C in favor of the exporter, which is based on the importer’s credit and the export sale involved.
- The format for Letters of Credit has been standardized by the International Chamber of Commerce (ICC). For instance, uniform codes are used for each line item so that, as an example, line item 45A will always be where the description of goods will be found, and line...
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item code 44C will always be where the latest shipment date is designated.
- The best type of L/C for the seller is one that is based on their proforma invoice and is non-transferrable and irrevocable. All L/Cs, unless specified, are considered irrevocable – meaning the buyer/seller cannot back out of the deal after the L/C has been opened and accepted.
- A “confirmed” L/C ensures the exporter will be paid by his or her own bank, even if the importer’s bank fails to pay, provided all of the L/C instructions and document requirements are followed. Although additional fees apply, exporters should request importers to open a confirmed, irrevocable and non-transferable commercial L/C. The importer’s bank must have a corresponding relationship with a U.S. bank or be creditworthy since the exporter’s bank will not confirm the L/C of an unknown bank. Note that in some countries, a confirmed L/C is not always available due to risk factors.
- A disadvantage to an importer (relative to the size of their business) is that their bank charges fees to open a L/C and usually will hold a percentage of collateral during the “validity” of the L/C (it “ties up” their cash).

There are several variations of Letters of Credit, including Export, Sight, Time, Performance, and Stand-By. Before the exporter accepts the Letter of Credit from the importer, it is extremely important for them to review every detail of the L/C. For example, the exporter should consider if the latest ship date referenced in the L/C is acceptable, or if the amount/value of the L/C is correct (a “+” or “−” prefix to the value on the amount stated can actually help prevent delays when the total ends up being different than the exact amount indicated on the L/C). Ensuring the amounts and figures referenced in the L/C are correct and will match what is used in the shipping documents is important. A frequent problem for U.S. exporters is overlooking weights and dimensions that differ slightly from one document to another. This can happen when the preparers (in-house or the freight forwarder) use different digit levels in converting to and from the metric system. The Commercial Invoice and shipping documents must match precisely as stipulated in the L/C. If the Commercial Invoice describes the products differently, even if spellings are different from the L/C, then the bank will charge added fees for handling/amending the documents due to the discrepancies, unless the buyer accepts the discrepancies.

The exporter must ensure that they are listed as the beneficiary on the letter of credit and that the product listed is the product they are selling. They must also check that the pre-sale terms haven’t been changed (banks make errors, too, and sometimes misspell the beneficiary’s name or address). If so, it is not uncommon for the beneficiary/exporter to use the same misspelling on all their documents presented to the bank rather than ask for an amendment to the L/C. Either way, this takes more time, delays, and communication management. If changes are needed, the exporter can ask for an amendment via the U.S. bank that is backing the transaction, which will then relay the request to the buyer’s bank. This takes time and banks charge fees for amendments and extra handling, in some cases $20, $50, or $150 fees. Multiple or itemized discrepancies can significantly add to the cost and stress of a sale. To avoid problems, exporters need to have constant communication with buyers, and may want to consider sending an outline to the buyer with the criteria the L/C should address. Usually the exporter sends a Proforma Invoice to be used by the buyer/importer at their bank when opening the L/C.

See VEDP Export Issues FastFact - Responding to Inquiries
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With technological advances, some Letters of Credit are increasingly being managed through an electronic format. The benefits include saving time in fixing simple errors on the documents, such as typos, and saving financial costs. The faster process means cash is tied up for less time in a collateral status. Some companies, like TradeCard Inc., allow a buyer to connect the flow of physical goods with the flow of electronic funds by handling both through the same electronic document. UPS Capital, a subsidiary of United Parcel Service Inc., is developing a similar product that allows it to transport both the hard goods of its clients and the money to pay for them.

**Letter of Credit Flow Chart**

Documents may include: Shipping Instructions, Commercial Invoice, Packing List, Bills of Lading—Air, Ocean, Truck; Customs Declaration, Insurance Policy, Certificate of Origin, Inspection Certificates, and the Letter of Credit.

**DOCUMENTARY DRAFT**

Documentary drafts [Cash Against Documents (CAD) or Documents Against Payment (D/P)] are a standardized document available to the exporter by their bank and used to execute the payment terms for a sale. Drafts are filled out by the exporter/seller and sent with the shipping documents to the presenting bank – the bank in the buyer’s country (which could be a corresponding bank to
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the seller’s bank or the buyer’s same bank). Copies are sent to the exporter’s bank and the two banks become “witnesses” to the transaction.

The original shipping documents (needed for customs clearance) are released by the presenting bank as the importer/buyer “accepts” the draft with a payment schedule of 30/60/90 days "tenor" or pays the draft “at sight.” Then, the presenting/buyer’s bank sends the payment to the seller’s bank.

In the hierarchy of security for payments, CAD is considered third, with Cash In Advance first, followed by Letters of Credit. Using the documentary drafts process requires coordination and proper due diligence as to the customer’s ability to pay, the country’s economic conditions and international transaction laws, as well as communication with the freight forwarder. Assuring the freight forwarder involved (preferably selected by the exporter) that the goods are not to be released to the buyer or their customs broker until there is confirmation from the presenting bank that the draft has been accepted will help avoid miscommunication and make the CAD or DP payment terms work for both parties. The exporter’s bank is a good place to start for reviewing the process and viability of this payment term.

• Documentary drafts are also standardized by Uniform Customs and Practices (UPC 600).
• Documentary drafts involve a slight risk for the exporter compared to a confirmed L/C since there is no guarantee of a payment.
• Payments by documentary drafts are less costly than documentary drafts to process for the importer. For the exporter, they have the advantage of allowing the shipment to be without the stipulations of a L/C. For example, a L/C may have a “latest ship date” that is impossible to meet because of product availability or production delay requiring an amendment to the L/C which, if accepted, will add a fee to the cost of the sale.
• With this payment term, the exporter need not wait for a L/C to be opened from the importer’s bank - if the goods are ready to ship, the exporter just needs the buyer’s bank information to send the Documentary Draft.
• Using Documentary Drafts for collections is a good step in building a long-term relationship with a client. The documentary draft process signals more trust, less costs to the importer, and may be used as a gauge for the exporter to decide when to offer Open Account terms.

OPEN ACCOUNT

Open account means the exporter is extending credit to the buyer as a contractual relationship.

• The importer agrees to pay at a later time. Terms offered by the exporter may be 30/60/90 and sometimes 120 days after the date of the Commercial Invoice or Bill of Lading.
• The exporter’s credit and collections/finance department monitors the customer’s account in their billing/accounting system designating the transaction involved and payment due date.
• Open Account payment terms may be considered the most “credit-risky” for the exporter and should not be offered until they have determined that the importer has a good reputation for making payments.
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EXPORT FINANCING RESOURCES
Organizations that have programs that assist exporters include the Export Import (Ex-Im) Bank, the U.S. Department of Agriculture (USDA) Foreign Agricultural Service (FAS), the Overseas Private Investment Corporation, and the Small Business Administration. See “Ag Exporter Assistance” at http://www.fas.usda.gov/ageexport/oldsitefiles/exporter.html, the Overseas Private Investment Corporation at http://www.opic.gov, and the Small Business Administration at: http://www.sba.gov/services/financialassistance/sbaloantopics/SpecialPurposeLoans/ewcp/index.html.

The U.S. Export-Import Bank
Ex-Im is an independent agency of the U.S. federal government that helps finance overseas sales of U.S. goods and services. Ex-Im does not compete with commercial lenders, which actually provide loans, but rather guarantees loans. Local commercial banks are the gateway to accessing Ex-Im benefits. For Ex-Im to determine if they can help, they need to know: a) What country is involved; b) the sale value; c) the buyer’s bank and d) if the buyer is a public organization or private company. Ex-Im can issue a Letter of Interest indicating their willingness to assist in a transaction. This is not a commitment to the transaction, but rather a pre-export tool to use when negotiating with a prospective customer.

Credit Insurance
Ex-Im also provides credit insurance at very reasonable prices which protects U.S. exporters against the risks of non-payment by foreign buyers for political or commercial reasons. Ex-Im assumes the risks banks will not accept—as long as there is reasonable assurance of repayment.

Pre-Export Financing
Ex-Im’s working capital financing can help U.S. exporters obtain loans to produce or buy goods or services for export. These working capital loans are made by commercial lenders and backed by an Ex-Im guarantee. Exporters may use the guaranteed financing to:

• Purchase finished products for export;
• Pay for raw materials, equipment, supplies, labor and overhead to produce goods and/or provide services for export;
• Cover Standby L/C serving as bid bonds, performance bonds, or payment guarantees;
• Finance foreign receivables.

To be eligible for working capital loans:

• Exporters must be located in the U.S., have at least a one-year operating history, and a positive net worth;
• Exports must be shipped from the U.S.;
• Products must have at least 50% U.S. content. If less than 50%, then Ex-Im can only support the export up to the percent of the U.S. content;
• Services must be performed by U.S.-based personnel;
• Military or defense items are generally not eligible, nor are sales to military buyers (with certain exceptions).
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VEDP TRADE EVENTS
The VEDP participates in numerous trade events around the world that are open to all Virginia exporters. For a complete listing of VEDP’s international trade events, please visit the “Events” tab on our website: www.ExportVirginia.org

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ADDITIONAL RESOURCES
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  Lawrence Blackburn - Business Development Officer for Virginia
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- International Chamber of Commerce: http://www.iccwbo.org
- National Association of Credit Managers (NACM): http://www.nacm.org
- SunTrust Bank: www.Suntrust.com
  Contact: Marsha Sompayrac, VP International Division
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- U.S. Small Business Administration: http://www.sba.gov
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WORKS CITED

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