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Payment Methods and Finance for International Trade

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Preface

This book covers various methods of payment in international trade and trade finance schemes for international trade. In addition, this book also overviews the concepts, purposes, features, and risks of international trade.

Companies engage in international trade transactions for various purposes. Maximizing corporate value by increasing revenues and profits will be the ultimate goal for most companies. Companies engaging in international trade transactions are likely to gain more revenue and profits.

International trade transactions, however, bring various risks that originate from the features of international trade transactions. Exporters may not get paid even after the performance of a contract. The risk of non-payment is largely dependent on the method of payment.

In international trade, the number of documents required will vary depending on the individual transaction. Documents come in two types: financial documents and commercial documents. Financial documents mean bills of exchange, promissory notes, checks, or other similar instruments used for obtaining the payment of money, while commercial documents mean invoices, transport documents, documents of title, or other similar documents.

The basic methods of payment in international trade are "payment in advance" (cash in advance), "open account", "documentary collection", and "documentary credit" (letter of credit). Other types of method of payment, such as "consignment", "netting", and "bank payment obligation", are also used. Each of the methods of payment has advantages and disadvantages to the respective parties.

Some methods of payment might bring detrimental losses rather than profits, and also cause cash flow problems. In negotiating methods of payment, companies need to consider trade finance as well as non-payment risk. There are various types of trade finance normally used in international trade: pre-shipment finance, post-shipment finance, export working capital financing, negotiation of bills of exchange (or discounting invoices), export factoring, international forfaiting, export credit insurance (export credit guarantee), etc.

The understanding of various methods of payment in international trade together with the relevant trade finance scheme is a key factor for a successful international trade transaction. The understanding of the features and risks of international trade will help to understand the various methods of payment.

For the successful completion of an international trade transaction, depending on the terms of the transaction, both parties need access to funds. Small and Medium-Sized Enterprises (SMEs), compared to large companies, often face difficulties in raising capital or funds. Financing an international trade transaction is often key to successful completion. There are various financing mechanisms available for international trade transactions. Besides financing ability, the choice of a proper financing mechanism is also important for the successful completion of an international trade transaction.

For successful completion of an international trade in goods or services, depending on the payment terms and other conditions of a particular transaction, both exporters and importers need access to funds. Thus, it is important to understand the trade finance mechanisms for the successful completion of an international trade. The ability to allow longer payment terms has become a competitive factor in international trade. However, long payment terms bring cash flow shortage to an exporter. Thus, an exporter needs to obtain trade finance in order to make up the cash flow shortage arising out of an international trade transaction with long payment terms.

Exporters preparing the performance of export transactions are frequently in need of finance for the performance of the transactions (or for delivery of the goods). Such finance is called pre-shipment finance. Exporters are also in need of finance after the performance of the transactions (or after delivery of the goods) because they get paid long after transactions are completed. Such finance is called post-shipment finance. Post-shipment finance includes negotiation of bills of exchange and/or documents, forfaiting, and factoring.

Export credit insurance (or export credit guarantee) is very useful for the facilitation of pre-shipment finance and of post-shipment finance. Therefore, it is considered one of the financing mechanisms available in international trades.

Many countries have established export credit agencies to promote exports through various support mechanisms, including export credit insurance (or export credit guarantee). Its main aim is to promote exports by protecting exporters from commercial and political risks.

Export credit insurance (or export credit guarantee) promotes a country's exports by giving a variety of advantages to its exporters. The key functions of export credit insurance include reducing non-payment risks, offering competitive payment terms, increasing exports with reduced non-payment risk and competitive payment terms, creating easy and accessible trade financing solutions, etc. When an export credit insurance (or export credit guarantee) backs an exporter's foreign receivables, commercial banks are often willing to lend to an exporter with favorable terms against foreign receivables, otherwise excluded from the borrowing base.

This book provides a comprehensive treatment of methods of payment in international trade accessible to those less familiar with the subject matter. This book provides various examples and figures for trade documents, each method of payment, trade finance scheme, etc.

This book will be a valuable reference for experienced managers and bankers in international trade. This book can be used as a guide book or a manual for new employees in trading companies. It can also be used as a college textbook for a one-semester course for upper-level undergraduate or graduate students.

This book is based on the author's practices as a legal consultant and underwriter for export trades, and researches as a professor of international trade. The figures were created or modified by the author.

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