Getting Paid For Exports

SPECIAL REPORT 239

JUNE 1967

Cooperative Extension Service
Oregon State University
Corvallis, Oregon

GETTING PAID FOR EXPORTS

Donald M. Taylor
International Marketing Specialist
Cooperative Extension Service-Oregon State University

Getting paid for exports need not be any more uncertain than getting paid for domestic sales. There are well-defined procedures for making sure you get your money, even though your customer may be halfway around the world.

Credit checks

There are two primary sources of credit information on a prospective foreign customer. These are the international banking department of your own bank and the credit reporting facilities of the U. S. Department of Commerce.

Your international banking department will request a correspondent bank in the prospective customer's country to provide an appraisal of the customer's credit reliability. Usually this will be in relation to a specific purchase--in other words, is this firm good for a $10,000 purchase? The reply is prompt and specific.

For a fee of $2, the U. S. Department of Commerce will make a more general credit check for a U. S. exporter. If the firm has a report on file in Washington, D. C., the information will be back in a week or less. Reply will take about six weeks if a new report must be developed. It will consist primarily of information compiled by the commercial attache stationed in the customer's area.

The Department of Commerce has field offices in principal U. S. cities. The Portland office is at 520 S. W. Morrison Street.

Payment instruments

Once a satisfactory credit rating is established for the prospective customer, the exporter must decide what type of payment instrument he will use to ensure collection.

Letter of credit: An irrevocable, confirmed letter of credit is the safest and one of the most commonly used payment instruments in international trade. An irrevocable letter of credit is issued by a foreign bank to the importer. It substitutes the credit of the bank for that of the importer. If the letter of credit is confirmed by a U. S. bank, this means the bank in this country also backs the letter of credit with its own credit. Both banks thus guarantee payment.

An irrevocable, unconfirmed letter of credit is backed only by the foreign bank, but in almost all cases this is sufficient guarantee of payment. Before the letter of credit is drawn up, the buyer and seller should agree on terms and methods of payment, method of shipment, number and type of documents that must accompany the letter of credit, shipping date, and other provisions of the sale. A *pro forma* invoice (a skeleton invoice made up in advance of a sale to show details of the sale, used in international trade to satisfy customs and other requirements, but not a binding document) may be drawn up showing these terms. This is important, because unless the documents and terms of sale correspond exactly to those specified in the letter of credit, the importer has grounds for refusing to accept the shipment and the bank's guarantee of payment may not be valid. Your international banking department will check all documents to make sure they conform to the specifications of the letter of credit. Documents in an international transaction include a bill of lading, insurance certificate, commercial invoice, and, where required, consular invoices, certificates of origin, inspection certificates, and others.

Documentary compliance is one of the most important yet least observed requirements for successful dealing on a letter of credit basis. One Oregon banker estimates that in at least half of the international transactions involving letters of credit handled by his bank, the documents vary from conditions or terms specified in the credit. The only way these terms can be changed is through an amendment to the letter of credit, and this can be done only by mutual consent of both buyer and seller.

The letter of credit holds several advantages for the exporter. If the draft is drawn on his own bank or the letter of credit is payable at his bank, the bank will pay him as soon as he delivers the necessary documents showing that the goods have been shipped. The exporter is assured of receiving payment regardless of financial default on the part of the buyer, or possible exchange restrictions or other factors that might interrupt payment.

In many countries, however, well-established importers may refuse to do business through a letter of credit because they must pay a fee to the bank issuing the credit. The competitive situation may be such that the importer can buy a similar product from other sources who will not demand a letter of credit.

Instead of a letter of credit, a collection instrument such as a documentary draft may be used to obtain payment.

Sight and time drafts: Use of a sight or time draft, i.e., bill of exchange, ranks next to the letter of credit as a minimum-risk means of obtaining payment for exports.

A documentary draft is an order to pay, sent from the exporter to the importer through the exporter's U. S. bank and the foreign bank for collection. The foreign bank is responsible for making the collection.

In the case of a sight draft accompanied by shipping documents, the importer cannot obtain the documents until he pays the bank as specified in the draft. Without the shipping documents, the buyer cannot pick up his merchandise. As soon as payment is made, the buyer is given the documents and the foreign bank makes payment to the exporter through the U. S. bank. This means the exporter does not receive payment until the payment is received from the foreign bank.

If it is necessary to allow the buyer 30 to 180 days to make payment, a time documentary draft may be used. The exporter agrees to make payment within the specified time by signing his name and "accepted" across the face of the draft.

The documents are given to the importer so he can get his merchandise, and the accepted draft is returned to the exporter through his bank. The exporter holds the draft until several days before its due date. At this time the draft is returned to the bank so it may be presented to the buyer for payment on the due date. If the exporter wishes earlier payment, he may be able to obtain an advance from his bank against the draft, depending on his own credit standing. Interest will be charged for the number of days the advance is outstanding.

Unless the exporter borrows money against the time draft, he must wait for payment until the time specified in the draft has elapsed and the buyer has paid for the merchandise.

There is more risk involved with a sight draft than with a letter of credit, because the sight draft allows the customer to "revoke" his purchase without penalty by not paying the bank to obtain the documents. Also, if the customer is a marginal operator, he could go broke before the merchandise and documents arrive. This is another reason for obtaining credit information from your bank, Department of Commerce, and other sources before any transactions. The irrevocable letter of credit is the safest payment instrument for the beginning exporter, but obtaining payment through collection instruments such as the sight or time draft is becoming more and more common as a means of doing overseas business.

Open account or consignment sales: In some cases, documents will be sent directly to the buyer by the exporter and a draft will be sent through for collection without the documents. This so-called "clean" draft does not provide protection against possible default on the part of a buyer. The existence of an accepted draft can help provide grounds for legal action to recover payment, but actual collection of merchandise or money from an overseas customer could be a difficult process.

Shipping on open account, which means shipping the goods and billing the customer for later payment, or shipping on consignment, with payment to be made after the merchandise is sold, generally are not recommended for overseas transactions. In open-account or consignment transactions, the exporter has no protection against failure to pay by the buyer, nor any recourse if payment is blocked by the buyer's government because of exchange restrictions.

Exchange restrictions

Before making a shipment, the exporter should check to make certain there are no government restrictions in the buyer's country that might prevent the buyer from making payment.

Restrictions may prevent exchange of the buyer's currency for U. S. currency. In other cases, payment may be delayed because of dollar shortages. If the potential customer has an import license for the merchandise from his own government, however, this is a good indication that the necessary foreign exchange is available to complete the transaction.

The exporter can check with the U. S. Department of Commerce field office for current exchange restrictions. A good international banking department also will keep up-to-date on the economic and political climate in market countries and often can advise the exporter as to potential exchange difficulties.

Export insurance

Some governments now insure their own exporters against losses caused by failure of the foreign buyer to pay, or political conditions which make it impossible for him to pay.

In the United States, since February 1962, the Foreign Credit Insurance Association has made available to U. S. businessmen insurance against both commercial risks (failure of the buyer to pay for the merchandise) and political risks (action by a foreign government which interferes with payment). FCIA is an association of more than 65 stock and mutual insurance companies. Its function is to insure trade credits granted by U. S. suppliers of products to buyers abroad who qualify as normal risks. FCIA assumes liability for commercial risks and the Export-Import Bank of Washington (a U. S. government agency) covers political risks. The exporter applies for both types of coverage through FCIA.

There are four types of policies. These include short-term comprehensive, which covers both commercial credit and political risks on sales involving payment terms to 180 days; short-term political, the same as short-term comprehensive, except it covers only loss from political risk; medium-term comprehensive, which covers both commercial credit and political risks on sales involving payment terms from 181 days to five years; and medium-term political, same as medium comprehensive, except it covers political risks only.

Commercial risks are classified as (1) insolvency of the buyer; or, (2) failure of the buyer to pay the insured within six months after due date for products delivered to and accepted by the buyer.

Listed under the political-risks category are transfer risks (where the buyer may have made a deposit in his local currency but is unable to convert payment into dollars), war or civil disturbances, interference by a foreign government, and transport or insurance charges imposed after shipment because of political reasons.

The short-term comprehensive policy usually covers political risks to 95 percent of the sale and commercial risks to 90 percent. Short-term political coverage is 90 percent. Medium-term comprehensive coverage, political and commercial, is 90 percent. Medium-term political coverage is 90 percent. In some cases, the normal percentage of cover will be reduced because of unusually high risks with some products, or in certain countries.

There are no standard rates for export credit insurance--rates are based on a combination of payment terms or length of credit period and economic and political stability of the buyer's country. Rates have averaged about 48 cents per $100 of gross invoice value.

Applications for export credit insurance can be submitted through the exporter's insurance agent or broker or directly to FCIA. For more information, check with your bank or write to Federal Credit Insurance Association, 250 Broadway, New York, N. Y., 10007.

The Oregon exporter should have little difficulty in getting paid for his exports if he is familiar with payment methods and takes advantage of the excellent credit information and collection services available.