CHAPTER - 6
There are several basic methods of receiving payment for products sold abroad. As with domestic sales, a major factor that determines the method of payment is the amount of trust in the buyer's ability and willingness to pay. For sales within a country, if the buyer has good credit, sales are usually made on open account; if not, cash in advance is required. For export sales, these same methods may be used; however, other methods are also often used in international trade. Ranked in order from most secure for the exporter to least secure, the basic methods of payment are:

1. Cash in advance,
2. Letter of credit,
3. Bills for collection (D/P, D/A),
4. Documentary collection or draft,
5. Open account, and
6. Other payment mechanisms, such as consignment sales.

Since getting paid in full and on time is of utmost concern to exporters, risk is a major consideration. Many factors make exporting riskier than domestic sales. However, there are also several methods of reducing risks. One of the most important factors in reducing risks is to know what risks actually exist. For that reason, exporters are advised to consult an international banker to determine an acceptable method of payment for each specific transaction.

6.1 Cash in advance (Jain, 2003)

Cash in advance before shipment may seem to be the most desirable method of all, since the shipper is relieved of collection problems and has immediate use of the money if a wire transfer is used. Payment by cheque, even before shipment, may result in a collection delay of four to six weeks and therefore, frustrate the original intention of payment before shipment. On the other hand, advance payment creates cash flow problems and increases risks for the buyer. Thus, cash in advance lacks competitiveness; the buyer may refuse to pay until the merchandise is received.
6.2 Documentary letter of credit and drafts

The buyer may be concerned that the goods may not be sent if the payment is made in advance. To protect the interests of both buyer and seller, documentary letters of credit or drafts are often used. Under these two methods, documents are required to be presented before payment is made. Both letters of credit and drafts may be paid immediately, at sight, or at a later date. Drafts that are to be paid when presented for payment are called sight drafts. Drafts that are to be paid at a later date, which is often after the buyer receives the goods, are called time drafts or date drafts.

6.2.1 Letters of Credit

A letter of credit adds a bank's promise of paying the exporter to that of the foreign buyer when the exporter has complied with all the terms and conditions of the letter of credit. The foreign buyer applies for issuance of a letter of credit to the exporter and therefore is called the applicant; the exporter is called the beneficiary. Often a letter of credit issued by a foreign bank is confirmed by a local bank. This means that the local bank, which is the confirming bank, adds its promise to pay to that of the foreign, or issuing, bank. Letters of credit that are not confirmed are advised through a local bank and are called advised letters of credit. Exporters may wish to confirm letters of credit issued by foreign banks not only because they are unfamiliar with the credit risk of the foreign bank but also because there may be concern about the political or economic risk associated with the country in which the bank is located. An international banker can help exporters evaluate these risks to determine what might be appropriate for each specific export transaction.

Merits of Letter of Credit (SITPRO, 2008).

1. The beneficiary is assured of payment as long as it complies with the terms and conditions of the letter of credit. The letter of credit identifies which documents must be presented and the data content of those documents. The credit risk is transferred from the applicant to the issuing bank.
2. The beneficiary can enjoy the advantage of mitigating the issuing bank’s country risk by requiring that a bank in its own country confirm the letter of credit. That bank then takes on the country and commercial risk of the issuing bank and protects the beneficiary.

3. The beneficiary minimizes collection time as the letter of credit accelerates payment of the receivables.

4. The beneficiary’s foreign exchange risk is eliminated with a letter of credit issued in the currency of the beneficiary’s country.

**Risks involved in letter of credit** (SITPRO, 2008):

1. Since all the parties involved in Letter of Credit deal with the documents and not with the goods, the risk of Beneficiary not shipping goods as mentioned in the LC is still persists.

2. The Letter of Credit as a payment method is costlier than other methods of payment such as Open Account or Collection.

3. The Beneficiary’s documents must comply with the terms and conditions of the Letter of Credit for Issuing Bank to make the payment.

4. The Beneficiary is exposed to the Commercial risk on Issuing Bank, Political risk on the Issuing Bank’s country and Foreign Exchange Risk in case of Usance Letter of Credits.

In Appendix 6 some banks are being mentioned which are considered safe while doing business using L/C with CIS. The banks name is given by the respondents of the survey.

**6.3 Bills of collection**

There are two types of Bill for Collection, which are usually determined by the payment terms agreed within a commercial contract.
6.3.1 Documents against Payment (D/P)

Documents against payment used where payment is expected from the buyer immediately, otherwise known as "at sight". This process is often referred to as "Cash against Documents".

The buyer's bank is instructed to release the exporter's goods only when payment has been made. Where goods have been shipped by sea freight, covered by a full set of Bills of Lading, title is retained by the exporter until these documents are properly released to the buyer.

6.3.2 Documents against Acceptance (D/A)

Documents against acceptance used where a credit period (e.g. 30/60/90 days - 'sight of document' or from 'date of shipment') has been agreed between the exporter and buyer. The buyer is able to collect the documents against their undertaking to pay on an agreed date in the future, rather than immediate payment. The exporter's documents are usually accompanied by a "Draft" or "Bill of Exchange" which looks something like a cheque, but is payable by (drawn on) the buyer. When a buyer (drawee) agrees to pay on a certain date, they sign (accept) the draft. It is against this acceptance that documents are released to the buyer. Up until the point of acceptance, the exporter may retain control of the goods, as in the D/P scenario above. However, after acceptance, the exporter is financially exposed until the buyer actually initiates payment through their bank (SITPRO, 2008).

6.4 Drafts

A draft, sometimes also called a bill of exchange, is analogous to a foreign buyer's check. Like checks used in domestic commerce, drafts sometimes carry the risk that they will be dishonored.

6.4.1 Sight Draft (Edward et al., 1993)

A sight draft is used when the seller wishes to retain title to the shipment until it reaches its destination and is paid for. Before the cargo can be released, the original
ocean bill of lading must be properly endorsed by the buyer and surrendered to the carrier, since it is a document that evidences title.

Airway bill or bills 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 airway bill 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.

When a sight draft is used to control the transfer of title of a shipment, some risk remains 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 cannot or will not pay for and claim the goods, then returning or disposing of them becomes the problem of the exporter.

Exporters 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, thereby putting the exporter at a disadvantage. Exporters should consult their international bankers to determine an appropriate strategy for negotiating drafts.

6.4.2 Time Drafts and Date Drafts

If the exporter wants to extend credit to the buyer, a time draft can be used to state that payment is due within a certain time after the buyer accepts the draft and receives the goods, for example, 30 days after acceptance. By signing and writing "accepted" on the draft, the buyer is formally obligated to pay within the stated time.
When this is done the draft is called a trade acceptance and can be either kept by the exporter 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, XXXX, 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 a negotiable investment known as a banker's acceptance is created. A banker's acceptance can also be sold to a bank at a discount for immediate payment.

6.5 Credit cards

Many exporters of consumer and other products (generally of low value) that are sold directly to the end user accept Visa and MasterCard in payment for export sales.

International credit card transactions are typically placed by telephone or fax, methods that has inherent threat of facilitating has an inherent threat of fraudulent transactions. Merchants should determine the validity of transactions and obtain proper authorizations. Use of credit cards in international business is rather a new phenomenon, which can be discussed in great detail. But it is not done so, as it is beyond the scope of this study.

6.6 Open account (Commonwealth Bank, 2006)

In a foreign transaction, an open account is a convenient method of payment and may be satisfactory if the buyer is well established, has demonstrated a long and favorable payment record, or has been thoroughly checked for creditworthiness. Under open account, the exporter simply bills the customer, who is expected to pay under agreed terms at a future date. Some of the largest firms abroad make purchases only on open account.
Open account sales do pose risks, however. The absence of documents and banking channels may make legal enforcement of claims difficult to pursue. The exporter may have to pursue collection abroad, which can be difficult and costly. Also, receivables may be harder to finance, since drafts or other evidence of indebtedness are unavailable.

Before issuing a pro forma invoice to a buyer, exporters contemplating a sale on open account terms should thoroughly examine the political, economic, and commercial risks and consult with their bankers if financing will be needed for the transaction.

6.7 Other payment mechanisms

6.7.1 Consignment sales

In international consignment sales, the same basic procedure is followed as in the local market. The material is shipped to a foreign distributor to be sold on behalf of the exporter. The exporter retains title to the goods until they are sold by the distributor. Once the goods are sold, payment is sent to the exporter. With this method, the exporter has the greatest risk and least control over the goods and may have to wait quite a while to get paid.

When this type of sale is contemplated, it may be wise to consider some form of risk insurance. In addition, it may be necessary to conduct a credit check on the foreign distributor. Furthermore, the contract should establish who is responsible for property risk insurance covering merchandise until it is sold and payment received.

6.7.2 Foreign currency

One of the uncertainties of foreign trade is the uncertainty of the future exchange rates between currencies. The relative value between the local currency and the buyer's currency may change between the time the deal is made and the time payment is received. If the exporter is not properly protected, devaluation in the foreign currency could cause the exporter to lose money in the transaction. One of the simplest ways for an exporter to avoid this type of risk is to quote prices and...
require payment in local currency. Then the burden and risk are placed on the buyer to make the currency exchange. Exporters should also be aware of problems of currency convertibility; not all currencies are freely or quickly convertible into local currency.

Russia is the largest trading partner of India. It accounts for more than 60% of total trade between India and CIS countries. Before the disintegration, the currency of trade was Indian Rupee and Russian Rouble. At present, most of the trade takes place in US dollar denominated value. So the currency risk for the traders is due to the movement of US dollar with respect to Indian Rupee and Russian Rouble (Bhattacaharya. 2004).

6.7.3 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 exporters consider countertrade a necessary cost of doing business in markets where 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 exporter will be paid in a convertible currency as long as the exporter (or another entity designated by the exporter) agrees to export a related quantity of goods from the importing country.

According to Mr. Claude Lemberger (2006), “Indian exporters must 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 specially in CIS region.”

The primary survey conducted among the 57 has revealed the following facts regarding the issues related to payment procedures. The respondent traders etc. were asked to give their most favoured mode of payment. They were asked to point out from among ‘L/C’, ‘open account’, ‘documents against acceptance’, ‘documents against payment’ and ‘cash in advance’ and other method.

6.8 Modes of payment

As it can be seen from the graphs below, the trends in mode of payments is similar for both exports (Fig. 6.1) and imports (Fig. 6.2). Most common mode of payment is documents against acceptance followed by letter of credit and cash in advance. The least commonly used method is open account.

![Fig. 6.1: Mode of payment (in exports)](image)

All the respondents use documents against acceptance and 91% of the respondents use Letter of Credit as a mode of payment. Open account is not used by any of the respondents.
All the respondents use document against acceptance and 82% of them trust letter of credit. 59% of them also use cash in advance. Open account is not used by any of them.

6.9 Dispute settlement

The use of industrial tribunals which are made for the purpose of settling disputes between the two trading partners is very low (Fig. 6.3). There should be sincere effort put in this direction to improve the healthy trade practices.

As against the exporters approach in dispute settlement, importers use industrial tribunals for dispute settlements but still the % is very low (Fig. 6.4). There is need of serious efforts in the direction to enhance the healthy trade practices.
Freight Charges for different Mode of Transport for Delhi based exporter.

The norm that is followed in case of India-CIS trade through rail & road is that the Indian exporter is supposed to bear the cost of transportation till the land custom point in India. Therefore, the Table (6.1) shows the freight charges till the Mumbai port. Though the freight charges were reported in different units by the exporters, researcher has normalise them to equivalence of 20’ container by road, rail & sea transport to facilitate comparison across the modes.

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<th>Table 6.1: Freight charges for different transportation Mode.</th>
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<td>Distance (KM)</td>
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<td>Delhi-Mumbai</td>
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<td>Mumbai_Bandar Abbas</td>
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The above freight is based on a 20’ container of carrying capacity 19 MT from Delhi to Mumbai by road and rail. Though freight charges are less in railway compared to
Hawala is an alternative or parallel remittance system. It exists and operates outside of, or parallel to 'traditional' banking or financial channels. It was developed in India, before the introduction of western banking practices, and is currently a major remittance system used around the world. It is but one of several such systems; another well known example is the 'chop', 'chit' or 'flying money' system indigenous to China, and also, used around the world. These systems are often referred to as 'underground banking'; this term is not always correct, as they often operate in the open with complete legitimacy, and these services are often heavily and effectively advertised.

The components of hawala that distinguish it from other remittance systems are trust and the extensive use of connections such as family relationships or regional affiliations. Unlike traditional banking or even the 'chop' system, hawala makes minimal (often no) use of any sort of negotiable instrument. Transfers of money take place based on communications between members of a network of hawaladars, or hawala dealers (Passas. 2004).

6.10.1 Process of Hawala/Hundi

The process is simple; the client has a quantity of cash which he wants to send from his country of abode to his family in his country of origin. He gives this money to his hawala banker. The banker calls his contact, also a hawala banker, in the second country and asks him to release the cash to the family of the client. At the same time, the hawala banker provides the client with a remittance code which he, in turn, tells a member of his family. His family member visits the contact who releases the money on presentation of the correct remittance code. This whole process can take less than 24 hours (Flowchart 6.1).

The hawala banker and his counterpart in the customer's country of origin keep a tally of how much each owes the other and settle their accounts several times a year.
Hawala bankers often have import/export businesses and may use goods to settle accounts e.g. one may export a certain amount of goods to the other at a reduced rate to cover the amount he owes from hawala exchanges. The figure below shows the working of a Hawala system.

**Flowchart 6.1: Method of Hawala Transaction**

Basic method of payments used by the exporters and importers are cash in advance, letter of credit, documentary collection or draft, open account and other methods like consignment sales etc. But with every payment method there are some risks involved. In any transaction it is tried form each side that their risks are minimized. For example, in mechanism like cash in advance increases the risk conditions of buyer because the payment has already been made and the goods are not yet transported. Risk factors include that now if the goods are damaged then asking for replacement might not bear fruits. But since in these businesses only serious players are there chances of such happenings are very less. Also on the other hand the payment processes are modified like 50% of the cash is paid in advance and rest is paid after delivery.
Apart from these legal methods which are in practice there are some illegal payment systems like Hawala are also very much popular. Hawala is an alternative or parallel remittance system. It exists and operates outside of, or parallel to 'traditional' banking or financial channels. It was developed in India, before the introduction of western banking practices, and is currently a major remittance system used around the world.
References


