Chapter 13 Methods of Payment in Import Trade

Introduction

There is no predefined definition of personal import. In general a personal import is a direct purchase of foreign goods from overseas mail order companies, retailers, manufacturers or by an individual for the purpose of personal use.

The most common terms of purchase are as follows:

- Consignment Purchase
- Cash-in-Advance (Pre-Payment)
- Down Payment
- Open Account
- Documentary Collections
- Letters of Credit

Consignment Purchase
Consignment purchase terms can be the most beneficial method of payment for the importer. In this method of purchase, importer makes the payment only once the goods or imported items are sold to the end user. In case of no selling, the same item is returned to the foreign supplier. Consignment purchase is considered the most risky and time taking method of payment for the exporter.

Cash-in-Advance (Pre-Payment)
Cash in Advance is a pre-payment method in which, an importer the payment for the items to be imported in advance prior to the shipment of goods. The importer must trust that the supplier will ship the product on time and that the goods will be as advertised. Cash-in-Advance method of payment creates a lot of risk factors for the importers. However, this method of payment is inexpensive as it involves direct importer-exporter contact without commercial bank involvement.

In international trade, Cash in Advance methods of payment is usually done when-

- The Importer has not been long established.
- The Importer's credit status is doubtful or unsatisfactory.
- The country or political risks are very high in the importer's country.
- The product is in heavy demand and the seller does not have to accommodate an Importer's financing request in order to sell the merchandise.

Down Payment
In the method of down payment, an importer pays a fraction of the total amount of the items to be imported in advance. The down payment methods have both advantages and disadvantages. The advantage is that it induces the exporter or seller to begin performance without the importer or buyer paying the full agreed price in advance and the disadvantage is that there is a possibility the Seller or exporter may never deliver the goods even though it has the Buyer's down payment.

Open Account
In case of an open account, an importer takes the delivery of good and ensures the supplier to make the payment at some specific date in the future. Importer is also not required to issue any negotiable instrument evidencing his legal commitment to pay at the appointed time. This type of payment

methods are mostly seen where when the importer/buyer has a strong credit history and is well-known to the seller. Open Account method of payment offers no protection in case of non-payment to the seller.
There are many merits and demerits of open account terms. Under an open account payment method, title to the goods usually passes from the seller to the buyer prior to payment and subjects the seller to risk of default by the Buyer. Furthermore, there may be a time delay in payment, depending on how quickly documents are exchanged between Seller and Buyer. While this payment term involves the fewest restrictions and the lowest cost for the Buyer, it also presents the Seller with the highest degree of payment risk and is employed only between a Buyer and a Seller who have a long-term relationship involving a great level of mutual trust.

Documentary Collections

Documentary Collection is an important bank payment method under, which the sale transaction is settled by the bank through an exchange of documents. In this process the seller's instructs his bank to forwards documents related to the export of goods to the buyer's bank with a request to present these documents to the buyer for payment, indicating when and on what conditions these documents can be released to the buyer.
The buyer may obtain possession of goods and clear them through customs, if the buyer has the shipping documents such as original bill of lading, certificate of origin, etc. However, the documents are only given to the buyer after payment has been made ("Documents against Payment") or payment undertaking has been given - the buyer has accepted a bill of exchange issued by the seller and payable at a certain date in the future (maturity date) ("Documents against Acceptance").
Documentary Collections make easy import-export operations within low cost. But it does not provide same level of protection as the letter of credit as it does not involve any kind of bank guarantee like letter of credit.

Letter of Credit

A letter of credit is the most well known method of payment in international trade. Under an import letter of credit, importer's bank guarantees to the supplier that the bank will pay mentioned amount in the agreement, once supplier or exporter meet the terms and conditions of the letter of credit. In this method of payment, plays an intermediary role to help complete the trade transaction. The bank deals only in documents and does not inspect the goods themselves. Letters of Credit are issued subject to the Uniforms Customs & Practice for Documentary Credits (UCPDC)(UCP). This set of rules is produced by the International Chamber of Commerce and Industries (CII).
Documents Against Acceptance: Instructions given by an exporter to a bank that the documents attached to the draft for collection are deliverable to the drawee only against his or her acceptance of the draft.