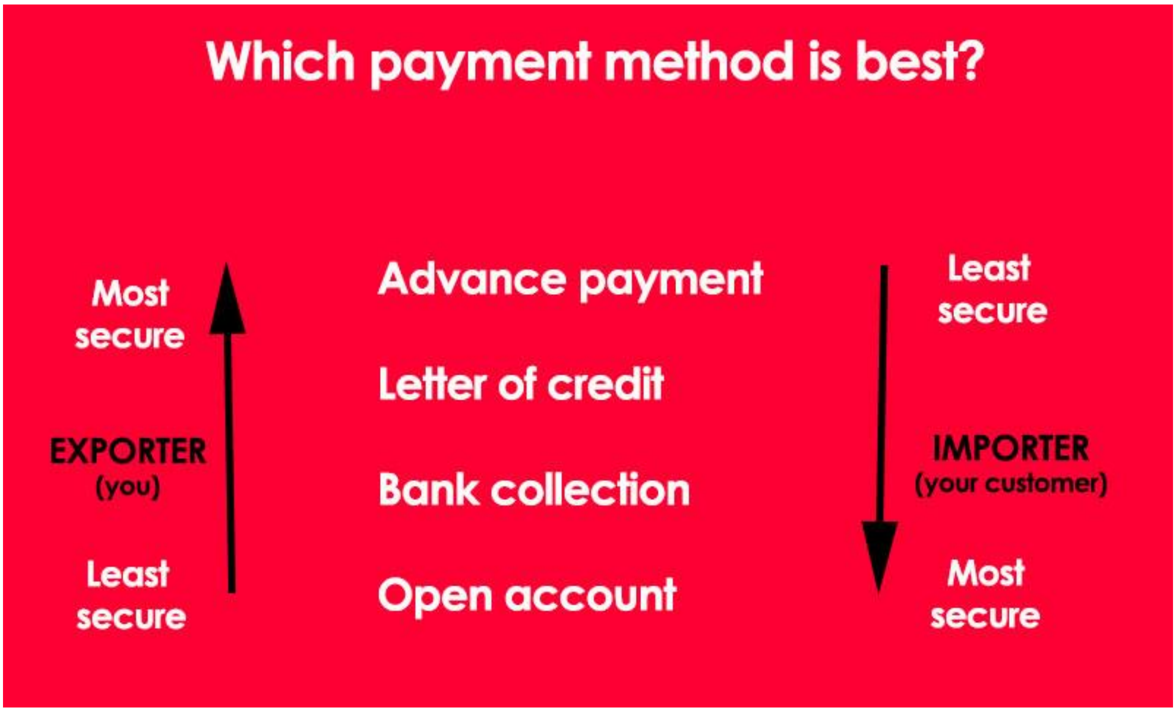
Understanding Method of Payment



To select the best payment method, it can be helpful to think about it in terms of the above risk ladder. The nature of the relationship with your buyer may also determine the settlement method used.

Payment Method 1: Open account

This is probably the least secure payment method for you as the exporter. Your buyer receives the goods and then pays for them, usually with a credit period attached (30, 60 or 90 days).

This payment method extends the period before which your business receives cash –and your working capital position will be impacted further if a period of credit applies.

You might consider offering this option under the following circumstances:

- You have an established relationship with the buyer
- The buyer is a multinational business with strong buying power and strong buyer credit rating
- Smaller value exports.

Payment method 2: Bank collection

This is a more secure option than an open account, whereby, as the name suggests, your bank collects the money on your behalf. It is also known as a documentary collection.

An instruction document is forwarded by your bank to your buyer's bank for release against either Payment (Documents against Payment) or Acceptance – of a Bill of Exchange (Documents against Acceptance).

This can be a good way of "meeting in the middle" with your buyer, wherein the risk is reduced (but not eliminated) for you both.

It is also not as time consuming or costly as a letter of credit, and doesn't take up any credit facilities.

Payment method 3: Letter of credit

A letter of credit is essentially a bank's promise to another bank that you they know you and (hold your overdraft facility) will act as a guarantor for your transaction. You need both banks' party to the transaction to agree to act in this way.

Once it is agreed, in the event that your buyer is unable to make payment, the bank will cover and pay the outstanding amount, provided that certain delivery conditions have been met.

One of the important things to note from a payment method perspective is that, if ever you receive a letter of credit, ensure you give it your immediate attention and check it in detail.

Remember, it is a document that should lead to your business being paid on time. Lack of attention to detail could delay payment and cost you money.

Payment method 4: Advance payment

This is the most advantageous method for you as the exporter as, where the buyer has to pay for the goods before they receive them. Consumers essentially do this every day when purchasing online, being charged either at the time of order or when the goods dispatch.

This method is advisable in the following circumstances:

- You have a new relationship with the buyer, where there is a 'lack of trust' between buyer and seller
- The buyer does not have a strong credit rating
- You sell a unique/rare product of high value.

So, once you have selected the appropriate method of payment, allow sufficient time to get everything in place and make sure you ask questions – of your buyer, if need be, and especially of your bank, who are there to help.