TRADE LOGISTICS

YOUR KEY TO INTERNATIONAL TRADE

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International Payment Methods

As the globe is becoming smaller and international trade is becoming easily accessible, the issue of moving money safely and cost effectively across borders now affects most businesses and individuals at some time. Being knowledgeable in the different payment methods available can alleviate risk and reduce money transfer costs. Below is a summary of the most common and trusted payment methods as well as what to consider when making or receiving payments.

Considerations when choosing a Payment Method:

When choosing the payment method the following criteria must be taken into account: security, acceptability by buyer/seller, cost and ease of use. As with all trade, there are some risks associated with international trade that need to be considered. These risks are summarised below:

Commercial risks: Exporters run the risk of non-payment for merchandise after it has been exported. Importers run the risk of making payment and then not receiving the merchandise, or receiving faulty merchandise.

Political risks: If the country supplying or purchasing merchandise undergoes political instability or war, trade with that country may no longer be possible.

Transfer risks: When currencies are exchanged, the bank in the local country needs to have a sufficient amount of each currency to make the exchange. It occasionally happens that banks in third world countries run out of foreign currency. Should this happen payment will be delayed by the bank until the foreign currency is available.

To meet the various needs of the buyer and the seller a number of payment methods are available and are discussed below. In addition to choosing a suitable payment method a valid contract between buyer and seller is required. In trade law two agreeing documents, such as the purchase order and invoice, is deemed a valid contract. Alternatively, for large transactions, a sales contact may be drawn up by an international trade lawyer.

Payment Methods used in International Trade:

Cash before or after delivery of merchandise

Importers favour cash on delivery for merchandise to eliminate risks and improve their cash flow. For the same reason Exporters prefer merchandise to be paid in full before it leaves their premises. When considering payment before or on delivery of goods, carefully evaluate reliability of the supplier or buyer. This is a convenient method of payment and is often used when there is a strong trust relationship between buyer and seller.

Typically, buyers use bank transfers or credit cards to facilitate payment. Information on how to do this is under the Tools for Transferring Money Internationally section.

Open account

If the buyer is well established, has a long and favourable payment record, or has been thoroughly checked for creditworthiness an open account may be a simple and convenient way to conduct payment. In this method the buyer orders the merchandise as required and makes payment after an agreed time period.

In this method the seller carries all the cash flow pressure and the risk. It is generally only used when the business of the buyer is significant enough to outweigh these downsides. Open account payments are typically made by bank transfer.

Letter of Credit (LC)

Letters of credit are often used to protect the interests of both buyer and seller and are defined as:

"A definite undertaking of the opening bank to honour a complying presentation".

In layman's terms; a letter of credit is a guarantee of payment issued from the buyer's bank upon receipt of all documents required by the terms and conditions stipulated in the letter of credit. Typical documents required by a letter of credit include the

- shipping documents
- insurance documents and/or
- inspection documents.

The seller is protected as he is guaranteed payment after providing the required documents. The buyer is protected as the bank will only pay after proof that the terms and conditions in the LC (the documents required to be submitted) have been met.

This is how a Letter of Credit works in practice:

- The buyer arranges with his bank that a letter of credit be issued.
- The LC lists the terms and conditions of payment.
- The LC is given to the seller.
- The seller chooses to accept the LC and sends the merchandise to the buyer.
- The seller then takes the shipping documents and other document required in the LC to his bank.
- The seller's bank checks that the documents comply with the LC and sends the documents to the buyer's bank. Upon receipt of the documents the buyer's bank checks that the documents comply with the LC and pays the seller.

When working with letters of credit check the following:

- Letters of credit are governed by an international body called the UCP (Uniform Customs and Practice for Documentary Credits). This must be stated on the letter of credit.

- LCs normally have an expiry date, ensure that the date stated on the LC gives the seller enough time to have the required documents sent to the buyers bank.
- If the documents presented to the buyer's bank are incorrect the bank is under no obligation to pay.
- If you are not experienced in working with LCs it is recommended that you use a company/ freight agent/ banking consultant/ legal consultant that is experienced in letter of credit terms and conditions to avoid any problems with making/receiving payments.
- If seller is concerned about the inability of the buyer's bank to pay due to political instability or lack of foreign exchange in the buyer's country, then the seller can request that the LC be confirmed by a second bank. This is called a confirmed letter of credit. The second bank guarantees payment should the first bank not be able to make payment. The second bank is typically a bank in the seller's country or in a first world country.
- When choosing this method of payment, take into consideration the fees charged by the banks for letters of credit. . The fees as well as the entity responsible for payment of the administration fees should be stated on the LC and/or agreed upon by the buyer and seller.

Documentary Bank Collections

Documentary collections are similar to Letters of Credit in that the banks collect payment from the buyer on behalf of the seller against the delivery of the documents. The major difference between the letter of credit and documentary collections is that, for documentary collections, the buyer's bank does not guarantee payment.

Payment security is provided to the seller in one of two ways:

1. As per the LC the required documents (such as shipping documents etc.) are sent to the buyer's bank. The buyer's bank agrees to give the documents to the buyer only after the buyer has authorised payment. Without these documents the buyer cannot clear the merchandise at customs.

2. The bank agrees to give the buyer the required documents upon the buyer signing a Bill of Exchange. A Bill of Exchange is an unconditional order to pay. It is acceptable in the international court and enforcement upon non-payment is immediate. A bill of exchange is often used to ensure payment after an agreed period such as 30, 60 or 90 days.

When working with documentary collections check the following:

- Documentary collections are governed by an international body called the URC (Uniform Rules for Collection). This must be stated on the contract of sale.
- The terms and conditions on the documentary collections need to be agreed upon in the contact of sale.
- If you are not experienced in working with documentary collections it is recommended that you use a company/ freight agent/ banking consultant/ legal consultant that is experienced in letter of credit terms and conditions to avoid any problems with making/receiving payments.

Escrow

An escrow is often used in conjunction with trade originating from internet-based business-to-business trading platforms such as those listed in our '*Guide to Source or Sell Products Globally*'.

Internet escrow places money in the control of an independent and licensed third party in order to protect both buyer and seller in a transaction. When both parties verify that the transaction has been completed per the set terms, the money is released. If, at any point, there is a dispute between the parties in the transaction, the process moves along to dispute resolution governed by the third party. The outcome of the dispute resolution process will decide what happens to money in escrow. Payment to the third party is typically made by bank transfer.

Tools for transferring Money Internationally:

The most common, efficient and cost effective tools for making or receiving international payments are bank transfers and credit card payments. The ins and outs on how these payments work are discussed below.

Bank Transfers

1. Transfers through a local bank:

International payments or receipts can be facilitated by the foreign exchange section of your local bank. Some banks now have international payment facilities as part of their internet banking offering. Alternatively you can contact your private banker, business banker or visit your closest bank branch with a foreign exchange division. Not all bank branches have a foreign exchange division, be sure to find out which bank branches in your area have a foreign exchange division before making the trip.

Your bank will require the following information from you:

- your FICA information. If you are using your local bank they should already have these documents.
- the reason for the international transfer.
- for importing or exporting the bank will need your import or export registration code as well as the commercial invoice.
- for payments; the bank will need the banking details, SWIFT code and address of the receiving bank.
- the bank's international transfer forms need to be completed and signed.

Once submitted, the bank will process all the relevant information and book the exchange rate. The bank may contact the applicant to confirm that the exchange rate has been booked. Exchange rates fluctuate constantly and there is little control in regards to exactly when the rate is booked. This results in a small exchange rate exposure risk for the duration of the process. After the exchange rate is booked the bank will arrange payment. This whole process usually takes 2-5 days.

The banks have a set fee structure for foreign exchange transactions. Clients are charged as follows:

- An administration fee is charged for the transaction. This fee varies depending on the amount that is exchanged. Both the buyer's bank and the seller's bank charge a fee. The buyer can choose whether or not he will pay the seller's bank's fee.
- The bank's add a margin or mark-up on the foreign exchange. The exchange rate quoted by the bank is usually the SPOT exchange rate plus 1.5% - 2%

A better fee structure can be negotiated with a bank only if the volume and frequency of foreign exchange is sufficient to attract a better fee. The more money transferred, the better the fee structure.

2. **Transfers through a local bank with Trade Logistics:**

As Trade Logistics works with many importers and exporters who transfer large volumes of foreign exchange we have been able to negotiate favourable exchange fees with South African banks. We pass these favourable rates onto our clients. This results in a saving of between R800 – R1 500 for every USD 10 000 exchanged and similar savings for the other currencies.

Transferring money with Trade Logistics therefore works the same as transferring money through a bank, but with the following advantages:

- Guaranteed maximum 0.5% margin on the exchange rate. – Save up to 75% on your exchange costs or an average of R1 200 per USD 10 000 exchanged.
- Banking fees are capped at R195 – Avoid excessive and hidden banking fees.
- All transactions processed from your desk - Never leave your office.

- You decide on the time and date to book the spot exchange rate – Avoid paying higher exchange rates due to the timing when the bank books your rate.
- Avoid bank exchange rate hikes after 3:30pm when the interbank trade hours end.

Credit Card Payments

Using a credit card for international payments is a popular payment method for smaller transactions. Credit Card payments are quick and convenient. Payment is typically made using an online, secured payment portal. For South Africans the maximum transaction size is R20 000 per payment and there is no limit to the amount of transactions allowed per year. Payment typically takes between 1-2 days.

Credit card foreign exchange administration fees are charged according to the standard fee structure from your credit card supplier and cannot be negotiated.

Due to fraudulent activities associated with credit card transactions, should you choose to make use of this method of payment please make sure that your merchant and the portal you are using are valid and secure.

By weighing up the risks and benefits around security, acceptability by buyer/seller, cost and ease of use for each of the above payment methods you can make a calculated decision on the payment method best suited to your business or transaction.

Need further assistance or advice?

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