

International trade payment and finance with special reference to bangladesh



**ASSIGN
BUSTER**

This report explains the different methods of getting paid and the different levels of risks involved in international trade payment.

At first it will examine the different types of payment and finance method from the seller's and buyer's point of view. Secondly this report will investigate how these payment methods are practiced for international trade in Bangladesh. Getting paid for providing goods or services is critical for any business. However, getting paid for an international transaction can be a very different experience from securing payment on business with other domestic entities, due to the number of extra factors that can influence the process. None of the methods mentioned in this essay will completely eliminate the payment risks associated with international trade. That is why it is very important to understand how these payment methods work very well and consider the preferred payment option with care and hedges the risks along with appropriate credit insurance and credit check on the customers.

Popular Payment Methods in International Business There are many ways to make and receive payment in international trade. Due to the physical distances between buyer and seller, and the fact that the transaction may have taken place without the two parties actually meeting, minimizing exposure to risk is on the minds of both parties. The buyer wants to make sure they receive their order in acceptable condition and on time, and the seller needs to know they will get paid for it. The most popular methods for international trade and finance are: Advance Payment • Open Account • Bills for Collection • Letters of Credit (L/Cs) Advance Payment: This is the most secure method of trading for exporters and, consequently the least attractive

<https://assignbuster.com/international-trade-payment-and-finance-with-special-reference-to-bangladesh/>

for buyers. Payment is expected by the exporter, in full, prior to goods being shipped. It is the easiest and cheapest form of trade payment method.

Documents like airway bills, commercial invoices and packing lists are normally being sent to the importer along with the shipment so that the importer can clear the customs and pick up the goods. Shipping happens only after money is safely in exporter's bank account. With cash-in-advance payment terms, the exporter can avoid credit risk because payment is received before the ownership of the goods is transferred. Wire transfers and credit cards are the most commonly used cash-in-advance options available to exporters. However, requiring payment in advance is the least attractive option for the importer, because it creates cash-flow problems. Importers are also concerned that the goods may not be sent if payment is made in advance.

For this reason it is very popular between buyers and sellers who have already established a mutual trust, as this negates the associated risks and let them enjoy this hassle-free and very low transaction costs since no financial intermediaries are involved in this process. There are no universally accepted regulations to guide cash-in-advance and the basis of guidance of this method is normally the purchase/sale agreement or the mutual trust between the exporter and the importer. Open Account: The least secure method of trading for the exporter, but the most attractive to buyers. Goods are shipped and documents are remitted directly to the buyer, with a request for payment at the appropriate time (immediately, or at an agreed future date) which is usually 30 to 90 days.

An exporter has little or no control over the process, except for imposing future trading terms and conditions on the buyer. Clearly, this payment method is the most advantageous for the importer, in cash flow and cost terms. The main drawback of open account method is that exporter assumes all the risks while the importer gets the advantage over the delay use of company's cash resources and is also not responsible for the risk associated with goods. However, the financial risk can often be mitigated by obtaining a credit insurance policy to cover the potential insolvency of a customer, that provides reimbursement up to an agreed financial limit.

Banks are used only to transfer money in this method as well. This is why it is the most popular method of international trade payment worldwide since the buyer has more power over the seller through bargaining and it resembles the common business tradition of supplier's credit. No universally accepted regulations are practiced for this method of international trade payment whereby the purchase/sale agreement works as the guidance for this too. Bills for Collection: This method is also known as Documentary Collection (D/C) which is a transaction whereby the exporter entrusts the collection of a payment to the remitting bank (exporter's bank), which sends documents to a collecting bank (importer's bank), along with instructions for payment.

Funds are received from the importer and remitted to the exporter through the banks involved in the collection in exchange for those documents. More secure for an exporter than Open Account trading, as the exporter's documentation is sent from exporter's bank to the buyer's bank. This

invariably occurs after shipment and contains specific instructions that must
<https://assignbuster.com/international-trade-payment-and-finance-with-special-reference-to-bangladesh/>

be obeyed. Should the buyer fail to comply, the exporter does, in certain circumstances, retain title to the goods, which may be recoverable.

The buyer's bank will act on instructions provided by the exporter, via their own bank, and often provides a useful communication route through which disputes are resolved. There are two types of Bill for Collection, which are usually determined by the payment terms agreed within a commercial contract. Different benefits are afforded to exporters by each and they are covered separately below. Documents against Payment (D/P): Usually used where payment is expected from the buyer immediately. This process is often referred to as "Cash against Documents".

The buyer's bank is instructed to release the exporter's documents 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. Unfortunately, for airfreight items, unless the goods are consigned to the buyer's bank no such control is available under an Air Waybill or Air Consignment Note, as these documents are merely "movement certificates" rather than "documents of title" (N. B. Under URC522, goods should not be consigned to a bank without prior approval).

Similarly there is no such control available for road or rail transport.

Documents against Acceptance (D/A): 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 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.

Bills for Collection are used in certain markets (particularly Asian) to fulfil Exchange Control Regulations. They are a cost-effective method of evidencing a transaction for buyers, where documents are handled (and reported) via the banking system. The Bills for Collection process is governed by a set of rules, published by the International Chamber of Commerce (ICC) called "Uniform Rules for Collections" document number 522(URC522). Over 90% of the world's banks adhere to this document. Letters of Credit (L/Cs): The most secure instruments available to international traders. A Letter of Credit (also known as a Documentary Credit) is a bank-to-bank commitment of payment in favour of an exporter (the Beneficiary), guaranteeing that payment will be made against certain documents that, on presentation, are found to be in compliance with terms set by the buyer (the Applicant).

An L/C is useful when reliable credit information about a foreign buyer is difficult to obtain, but the exporter is satisfied with the creditworthiness of the buyer's foreign bank. An L/C also protects the buyer because no payment

obligation arises until the goods have been shipped or delivered as promised. It deals in documents rather than goods. Thus, the process works in favour of both the exporter and importer. Like Bills for Collections, Letters of Credit are governed by a set of rules from the ICC.

In this case, the document is called; “ Uniform Customs and Practice” and the latest version is document number 600. In short, it is known as UCP600 and, again, over 90% of the world’s banks adhere to this document. Broadly there are two types of L/Cs which are: revocable & irrevocable. A Revocable Letter of Credit can be cancelled or changed without the consent of the exporter. But under UCP600, revocable L/Cs are no longer acceptable under any circumstances. Whereas the terms and conditions within a L/C cannot be changed without the express agreement of the beneficiary for an irrevocable L/C which has practically become a key characteristic of all types of L/Cs since UCP600 does not recognize irrevocable L/Cs anymore.

There are various types of L/Cs among them which are: Confirmed L/C: If an exporter has any concerns about the circumstances which may prevent payment being made from either the Issuing Bank or buyer’s Country, the adding of “ Confirmation” moves the bank/country risk issues to the bank which adds its confirmation (the confirming or advising bank) and notifies the DC to the exporter. The price of such a confirmation will obviously depend upon the level of perceived risks to be covered. Banks can often provide indicative pricing for confirmations prior to the arrival of the DC, so that costs can be estimated. Unconfirmed L/C: The payment commitment within the L/C is provided by the Applicant’s issuing bank. This type of letter of credit, does not acquire the other bank’s confirmation.

<https://assignbuster.com/international-trade-payment-and-finance-with-special-reference-to-bangladesh/>

Transferable L/C: A Transferable Credit is the one under which the exporter has the right to make the credit available to one or more subsequent beneficiaries. Credits are made transferable when the original beneficiary is a middleman and does not supply the merchandise himself but procures goods from the suppliers and arrange them to be sent to the buyer and does not want the buyer and supplier know each other. The middleman is entitled to substitute its own invoice for the one of the supplier and acquire the difference as his profit in transferable letter of credit mechanism. A letter of credit can be transferred to the second beneficiary at the request of the first beneficiary only if it expressly states that the letter of credit is “transferable”.

A bank is not obligated to transfer a credit. A transferable letter of credit can be transferred to more than one second beneficiary as long as credit allows partial shipments. Non-transferable L/C: It is said to the credit that seller cannot give a part or completely right of assigned credit to somebody or to the persons he wants. In international commerce, it is required that the credit will be nontransferable.

Usance L/C: It is kind of credit that won't be paid and assigned immediately after checking the valid documents but paying and assigning it requires an indicated duration which is accepted by both of the buyer and seller. In reality, seller will give an opportunity to the buyer to pay the required money after taking the related goods and selling them. At sight L/C: It is a kind of credit that the announcer bank after observing the carriage documents from the seller and checking all the documents immediately pays the required money. Red Clause L/C: In this kind of credit assignment, the seller before <https://assignbuster.com/international-trade-payment-and-finance-with-special-reference-to-bangladesh/>

sending the products, can take the pre-paid or part of the money from the bank. The first part of the credit is to attract the attention of the acceptor bank. The reasoning behind this is the first time this credit is established by the assigner bank, it is to gain the attention of the offered bank.

The terms and conditions were written by red ink, going forward it became famous with that name. Back to Back L/C: This type of LC consists of two separated and different types of LC. First one is established in the benefit of the seller that is not able to provide the corresponding goods for any reasons. Because of that reason according to the credit which is opened for him, neither credit will be opened for another seller to provide the desired goods and sends it. Back-to-back L/C is a type of L/C issued in case of intermediary trade. Intermediate companies such as trading houses are sometimes required to open L/Cs by supplier and receive Export L/Cs from buyer.

SMBC will issue a L/C for the intermediary company which is secured by the Export L/C (Master L/C). Standby L/C: SBLCs are similar to Bank Guarantees, in that they sit behind a transaction and are only called upon if the buyer fails to pay in the normal course of business (which is often Open Account). They can be particularly useful to cover an underlying financial risk where multiple payments are to be made, possibly as part of an agreed schedule. However, they do not offer the documentary control of Letters of Credit to buyers and, as such they are an unconditional guarantee Scenario and regulations of International Trade Payments in Bangladesh In the context of Bangladesh, letter of Documentary Credit is the most popular and widely used for making import payments from Bangladesh.

<https://assignbuster.com/international-trade-payment-and-finance-with-special-reference-to-bangladesh/>

About 85% import payments from the country are made through letter of credit. The other two methods- cash in advance and documentary collection- the less used methods for international trade payment. In case of imports the open account is absent. On the other hand, in case of exports, about 60% of export payments are obtained through letters of credit and the other method, as documentary collection, accounted for about 35% and advance payments accounted for 2%. Another method of open account is used for export recently which comprises the remaining volumes of payment methods. So it can be said that most of the export and import transactions of Bangladesh are dominantly settled by documentary credit.

The result is that the businesses are paying high for their transaction settlement. As documentary credit has involvements of different parties namely the nominating bank, the reimbursing bank, the confirming bank etc. Some of them are involved only to ensure the creditworthiness of the issuing bank against a certain percentage of commission. Another reason could be that the sovereign rating is lower than that in some countries in LDC group.

Although there is specific guidelines published by the International Chamber of Commerce (Such as UCP-600, ISP98), documentary credit is an inefficient process in terms of time. As a result the businesses of our country are losing their advantage over those of some countries under the class of developing countries. ICC guidelines are not complete set of rules in regulating and guiding international trade payment transactions. Since the payment guidelines do not provide for comprehensive and complete rules for international trade payment transactions, national laws play an important role.

<https://assignbuster.com/international-trade-payment-and-finance-with-special-reference-to-bangladesh/>

This is particularly true for the issues that are not addressed by the UCP intentionally. For example the legal nature of the credit itself and legal nature of the relationship between different parties have not been addressed in the UCP. For effective international trade payment operation, it is required that national laws are capable of providing solutions to any issues of international trade payment procedure open to interpretation. In Bangladesh, Foreign Exchange Regulation Act, 1947 [FERA, 1947] is the most important domestic regulation in the area of international banking. FERA, 1947 has empowered Bangladesh Bank to regulate all kinds of foreign exchange dealings in Bangladesh.

Empowered by the act, Bangladesh Bank issues Authorized Dealers licenses to the selected bank branches for conducting trade payments and other international banking operation. Following the provisions of the act, Bangladesh Bank issues circulars/guidelines time to time to regulate trade payment and international banking activities to be followed by the banks. While dealing in international trade payment, other than FERA, 1947 and Bangladesh Bank circulars/ Guidelines, bank are required to follow trade policies issued from the Ministry of Commerce of the country empowered by Import and Exports { Control } Act, 1950. The export and import policies specifically prescribe the policies/ rules of the government in regard to the export and import transactions and procedure and operation of making and receiving trade payment. Importer, exporters and indenters are required to be registered in Bangladesh under Importers, Exporters and Indenters Registration Order 1981.

Moreover, Customs Act 1969 is also applicable to trade transactions that deal with levy and collection of customs duties and other allied matters. The new Import Policy Order, 2006-2009, has been formulated, keeping in mind the market economy ideology, to make available the commodities to the consumers at fair prices through removing the barriers to movement of goods internationally, to ensure availability of quality and health compliant goods, to create a congenial environment for Foreign Direct Investment through expansion and growth of export oriented industries, expansion and consolidation of domestic industrial base so as to make Bangladesh economy active and vibrant. At this moment the number of commodities kept under restricted list is only 25. The new import policy has allowed opening of L/C for importing capital machinery even without IRC. The limit of import without L/C has risen from \$5000 to \$35000. For enhancing easy availability of industrial raw materials and consumer goods at fair prices, some commodities have been declared importable as raw materials.

Conclusion This report has been investigated different methods of payments for international business and the international and domestic regulations which guide these processes, and their operations in the context of Bangladesh. In Bangladesh the payment process for international trading for both exports and imports are heavily depended on Letters of Credit which is more time consumable and costlier than the other methods which hinders smooth international trading operations and is responsible for losing many potential international business opportunities. However, the authorities are concerned about this fact and trying to change the practices for international

trading payments through reforming and making new regulations and policies. Reference List Mizan A. N. K.

, Factoring: a Better Alternative of International Trade Payment methods, 2011, retrieved from <http://www.asaub.edu.bd> SITPRO International Trade Guides, Methods of Payment in International Trade, 2007, retrieved from <http://www.iptu.co.uk>

co. uk Soykot, Letter of Credit Operation in Bangladesh, 2012, retrieved from <http://edupedia.educarnival.com> <http://www.wouxun.com>

<http://www.lawyersnjurists.com>