- With this information, you can evaluate the creditworthiness of a prospective customer and decide which terms of payment to offer.

METHODS OF PAYMENT AND THEIR CREDIT SIGNIFICANCE

In order of increasing risk, the methods of payment you can request are:

1. cash in advance
2. letters of credit
3. bills of exchange
4. open account
5. consignment

1. Cash in Advance

Although this is risk free and ideal for an exporter, an importer is seldom prepared to pay cash in advance. Exceptions are found where there is a shortage of merchandise or the importer must finance the exporter to manufacture the goods.

2. Letter of Credit (Documentary Credit)

This is an engagement in writing by a bank on behalf of a customer (the applicant) addressed to a person (the beneficiary) undertaking that drafts by the beneficiary, up to a total of the stated amount on the "issuing bank" or other named bank, will be honoured provided they are accompanied by specific documents usually relative to the shipment of specified goods. The letter of credit protects both the buyer and the seller. In exporting, where credit information may be unreliable, a seller is concerned about receiving payment and a buyer about receiving the proper goods. The letter of credit is a guarantee that the importer's bank will make the required payments provided the seller has fulfilled the obligations in the letter of credit. The procedure for a letter of credit (L/C) is as follows:

- The exporter and foreign buyer agree on a contract with payment by Letter of Credit.
- The issuing bank is instructed by the foreign buyer to provide credit in favour of the exporter.
- The issuing bank asks the exporter's bank to advise and/or confirm credit.
- The exporter's bank sends the letter of credit to the exporter.
- The exporter dispatches the goods to the foreign buyer.
- The exporter presents the shipping documents to its own bank.
- The exporter's bank checks, pays and/or accepts under the terms of credit.
- The bank then forwards these documents to the issuing bank.
- The issuing bank checks the documents and reimburses the exporter's bank.
- The foreign buyer is debited by the issuing bank in the pre-agreed manner.
- The issuing bank then releases the documents to the foreign buyer.
- The foreign buyer uses the documents to receive delivery of the goods.

There are several types of letters of credit and you should be aware of the differences between them. A letter of credit may be "revocable or irrevocable." An irrevocable letter of credit obliges the issuing bank to honour drafts complying with the letter of credit and can neither be cancelled nor modified without the consent of *all* parties, including you, the exporter. A revocable letter of credit can be cancelled or amended at any time and is no guarantee of payment. You should insist on an irrevocable letter of credit. Another distinction between letters of credit is "confirmed" versus "unconfirmed." A letter of credit issued by a foreign bank can be confirmed by the Canadian bank, thereby guaranteeing payment. When you are uncertain about the foreign bank or its government, you should insist upon a confirmed, irrevocable letter of credit.

The advantages of the letter of credit over other payment terms are numerous. You have the promise of a bank rather than that of a business, which could go bankrupt. Banks tend to be more reliable and stable than other businesses. The letter of credit also ensures the availability of foreign exchange in countries with currency restrictions. The letter of credit, is a legal document, must be honoured, whereas trade obligations such as drafts may receive lower priority in foreign exchange allocation.

The main disadvantage of the letter of credit is its cost to the buyer. It can be an expensive process because of bank fees and, sometimes, government requirements for a large up-front deposit.