

Whatever the terms, the exporter should always strive to ensure that the language of the L/C is consistent with the contract agreed upon between the exporter and the buyer. It should provide the simplest possible conditions for approval of payment. And it should set strict limits on the time allowed for approval or disapproval of the invoice.

Letters of credit can be used in financing both buyers and sellers. If the exporter agrees to receiving a term draft payable 90 days after the documents are received by the buyer's bank, the exporter is actually providing the buyer with short-term financing. At the same time, however, the term draft was accepted by the exporter's bank and is referred to as a Bankers' Acceptance. This is regarded as a short-term obligation by the bank. In effect, the exporter holds a financial instrument that matures in 90 days, plus a grace period, and that can be sold at a discount to receive immediate cash. Thus, both buyer and seller have short-term financing.

Letters of credit are highly flexible instruments. For example, if an exporter wants to receive partial early payments, it is possible to send partial shipments as long as the L/C provides for this and deadlines are met. L/Cs can also contain red clauses, often printed in red, authorizing the exporter's bank to make advances to the exporter against the guarantee of the importer's bank. Transferable L/Cs can be used to share the proceeds of a transaction between parties. Back-to-back L/Cs can be drawn up between exporter and buyer and between the exporter and a supplier of inputs as a way of financing more complex transactions. Standby L/Cs are used to guarantee performance under a commercial contract and serve as bid bonds or advance payment guarantees. Finally, revolving L/Cs are automatically renewable as to time or amount in order to cover a series of shipments occurring over a period of time.

There are four major parties to a transaction involving an L/C: the importer, the importer's bank, the exporter and the exporter's bank. Each of the four parties is responsible for performing a number of tasks when using an L/C to effect payment.

- First, the buyer and exporter agree on the terms of their contract.
- The buyer then applies to its bank for a L/C in favour of the exporter.
- The L/C specifies which documents have to be presented to secure payment. The buyer's bank accepts the application, prepares the L/C, and forwards it to the exporter's bank.