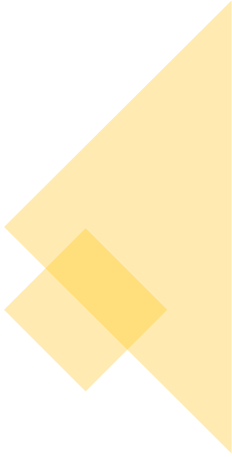


International Payment Methods

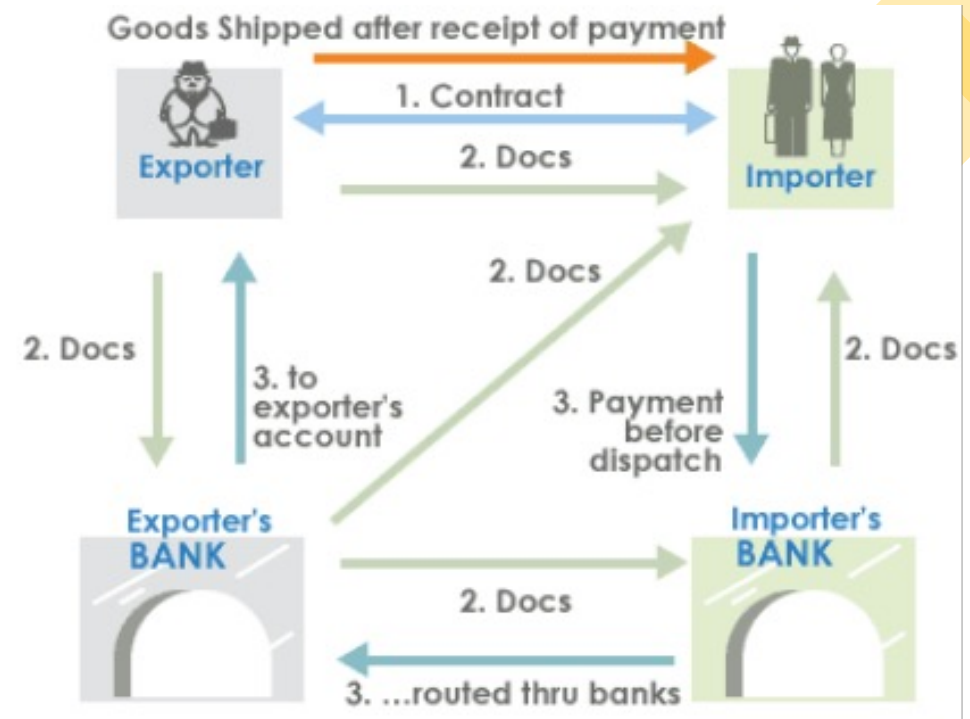
Features

- Cross-Border Transactions
 - Export
 - Import
- Involvement of Foreign Currencies
- Transactions facilitated through Banks
 - Authorized Dealers
 - Exporters (Importers) to have a relation with designated AD(s)
- At times bundled with Risk Mitigation mechanisms
 - Forex Risk, Credit Risk, Interest Rate Risk



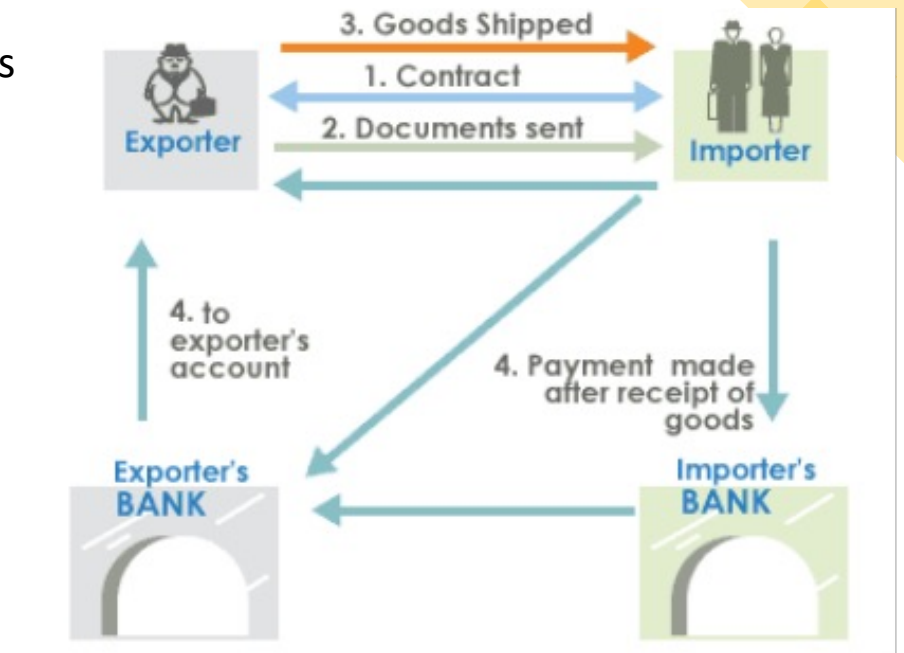
Advance Payment

- Context
 - Seller has much higher bargaining power over the buyer
 - Buyer is not able to open LC through its Bank(s)
 - Buyer is a cash rich company and wants to avail a cash discount
 - Established trustworthiness of the seller
- Risks are borne by Buyers
 - Performance risk of the exporter
 - Country risks
- Bank Guarantee from Seller covering performance risk may be obtained
- Documents routed through Banks (AD)



Open Account

- Importer pays only after taking possession of the goods
- The importer may ask for a credit period – 30, 60, 90 days
- Risk is entirely borne by the Seller
 - Risk of Non-Payment
 - Risk of Delayed Payment
 - Pressure on Cashflows
 - Stress on Working Capital
- Money is routed through AD
- Beneficial for the Importer
 - Improved cashflows



Collection: DA/DP

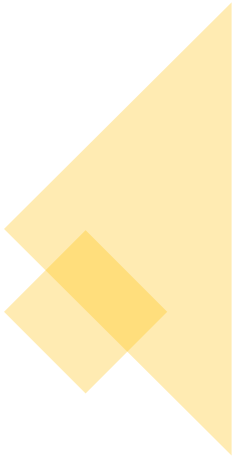
- Seller (German) and Buyer (Indian) agree to conduct business
 - Agree that payment be made based on a documentary collection
- Seller ships the goods and tenders the documents to its bank (**Remitting Bank**)
 - Documents are tendered with a **Collection Order**.
- Seller's bank forwards the documents along with its collection instructions to the Buyer's Bank in India
 - Axis Bank is the Buyer's bank (**Collecting Bank**)
- Collecting Bank notifies the Indian buyer of arrival of documents
 - Indian Buyer needs to agree on payment or acceptance.
- Documents against Payment (DP)
 - Buyer pays the amount due to the Collecting Bank
- Documents against Acceptance (DA)
 - Buyer accepts the documents and gives an undertaking to pay on a later date (maturity date)
- After Payment or Acceptance, the buyer receives the documents using which he takes possession of goods
- Collecting Bank remits the amount to the Remitting Bank which further credits the amount to the seller's account

DP and DA

- Delivery against Payment (DA)
 - Buyer gets the Title of the Goods only after it pays for the Goods
 - Payment is made to the Collecting Bank
- Delivery against Acceptance
 - Buyer gets the Title of the Goods after it accepts the Documents
 - Buyer also must sign a Bill of Exchange (drawn by the Seller on the Buyer) in order to get the Title of the Goods
 - Bill of Exchange stipulates a Credit Period extended by the Seller to the Buyer (Usance Period)
 - At the end of the maturity period, the Buyer makes payment to the Collecting Bank

Collections - Risks

- Risk is entirely borne by the Seller
 - There is no promise of payment by the Remitting Bank and/or Collecting Bank
- Collection mechanisms exist when
 - Buyer has higher bargaining power vis-à-vis Seller
 - Seller is sure that the Buyer will not refuse accepting the documents
- All money are routed through AD

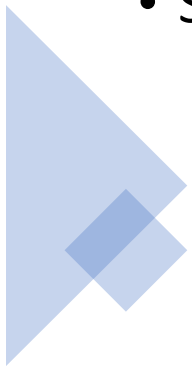
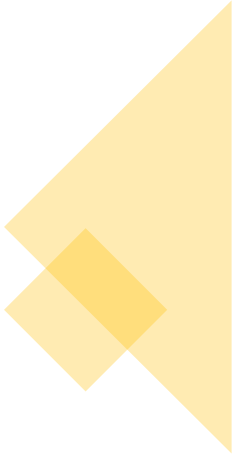




Letter of Credit

Uncertainties in International Business

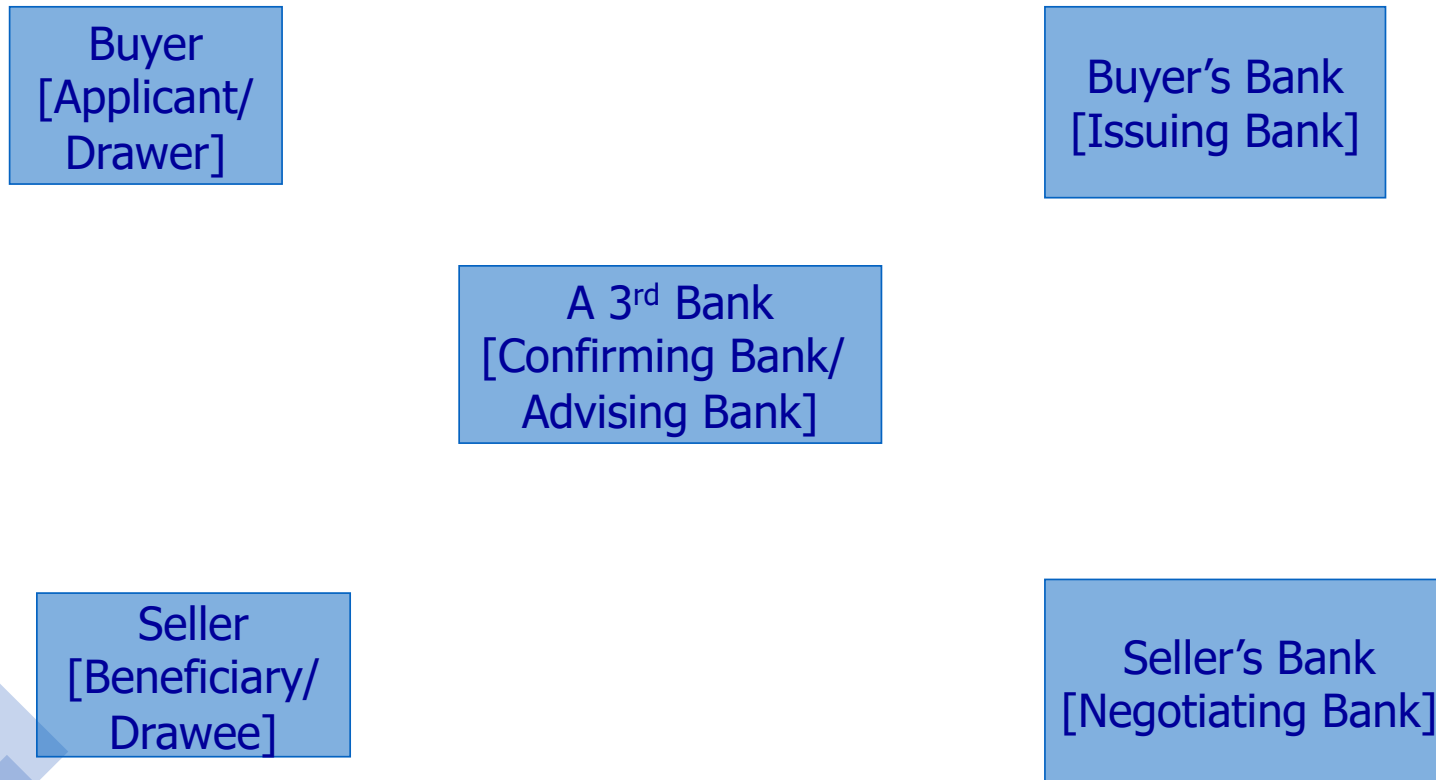
- Buyer may not keep his commitment of Paying the Seller
- Buyer may delay payments
 - Credit Risk
- Seller may take Advance and not ship the goods
 - Performance Risk
- Seller may ship Sub-Standard Goods
 - Performance Risk



What is LC?

- LC is a Commitment of Payment by the Buyer's Bank
 - Commitment is made to the Seller
 - Commitment is made by the Buyer's Bank on behalf of the Buyer
- The Commitment is conveyed to the Seller's Bank
- The Commitment will be honoured, subject to the fulfillment of certain conditions by the Seller
- LC reduces the ANXIETY of the Trading Partners
- Credit risk is mainly borne by the Buyer's Bank

LC: Semantics



LC: Mechanism

Step	Activity
1	Buyer and Seller finalizes the Terms of Sale [Price + Quantity + Mode of Shipment + Credit Period, LC Terms, etc.]
2	Buyer sends the Purchase Order to the Seller
3	Seller Accepts the Terms of the PO and Conveys the Acceptance to the Buyer
4	Seller Sends the Pro-forma Invoice to the Buyer
5	Buyer approaches the Issuing Bank for opening the LC
6	Issuing Bank opens the LC and sends the LC to the Negotiating Bank (and Confirming Bank, if any)
7	Negotiating Bank authenticates the LC and advises the LC to the Seller
8	Seller Ships the Goods to the Buyer
9	Seller submits the required documents to the Negotiating Bank

LC: Mechanism

Step	Activity
10	Negotiating Bank checks the documents and disburses payment to the seller [immediately or on Collection Basis]
11	Negotiating Bank sends the documents to the Issuing Bank
12	Issuing Bank check the Documents and informs the Buyer about Arrival of Documents and seeks his Acceptance (DA/DP)
13	On Acceptance of the Document by the Buyer, the Issuing Banks Pays to the Negotiating Bank
14	Issuing Bank also Releases the Transport Documents to the Buyer so that he can take Delivery of the Goods
15	Buyer pays to the Issuing Bank

Some Important Points

- Seller must be paid if its has complied with the Terms and Conditions of LC
- LC Deals with Documents and NOT the Goods
- Opening LC is a Skill – Stipulations should ensure that the Seller Ships the CORRECT Goods
- To Avoid confusion [among Banks] for accepting/rejecting documents, a Uniform Code has been adopted: Uniform Conduct and Procedure for Documentary Credit [UCPDC 600]
- UCPDC 600 is published by International Chamber of Commerce

LC Limit

- Importer [Buyer] files Application to the Issuing Bank for LC Limit
- Bank Checks the Credit-worthiness of the Buyer
- Sanctions LC Limit
- Limit is secured by First Charge on the Current assets and Collateral Security
- Bank Charges a Commission on the LC Amount

Sight LC & Usance LC

SIGHT LC

- Applicant is required to pay the amount at Sight of the Documents
- A Maximum of 7 banking days is allowed for making the payment
- There is no effective Credit Period for the Applicant

USANCE LC

- Applicant enjoys a Credit Period with his Banker
- The usance period is a mutually agreed period between the Applicant and the Issuing Bank
- Usance period could be 30 days, 60 days, 90 days, 120 days

Types of LC

- Irrevocable LC
 - Cannot be modified and/or cancelled by the Issuing Bank without the consent of the Beneficiary
- Revocable LC
 - Can be modified and/or cancelled by the Issuing Bank at the request of the Applicant
 - Issuing Bank has no liabilities after the LC has been cancelled
- Standby LC
 - Very similar to a Bank Guarantee
 - The Issuing Bank undertakes to pay the seller if the buyer fails to perform his duties

Types of LC

- Confirmed LC
 - Confirmed by a third Bank
 - A safer document – as the Payment Commitment by the issuing Bank is guaranteed by the Confirming Bank
- Unconfirmed LC
 - When LCs are not confirmed
- Transferable LC
 - The Beneficiary (Seller) has the right to assign part of payments against the LC to one or more third parties (vendors of the seller)
 - Eliminates the requirement of opening of several LCs by the Beneficiary

Types of LC

- Back-to-Back LC
 - Beneficiary of the First LC can open a Second LC in favour of its supplier on the basis of the First LC
 - Beneficiary of the First LC becomes the Applicant in the case of Second LC
- Red Clause LC
 - Beneficiary is entitled to an advance payment (a part of the LC amount) before dispatch of goods and submission of documents to the advising Bank
 - This clause is printed in Red, hence the name

Arriving at LC Limit

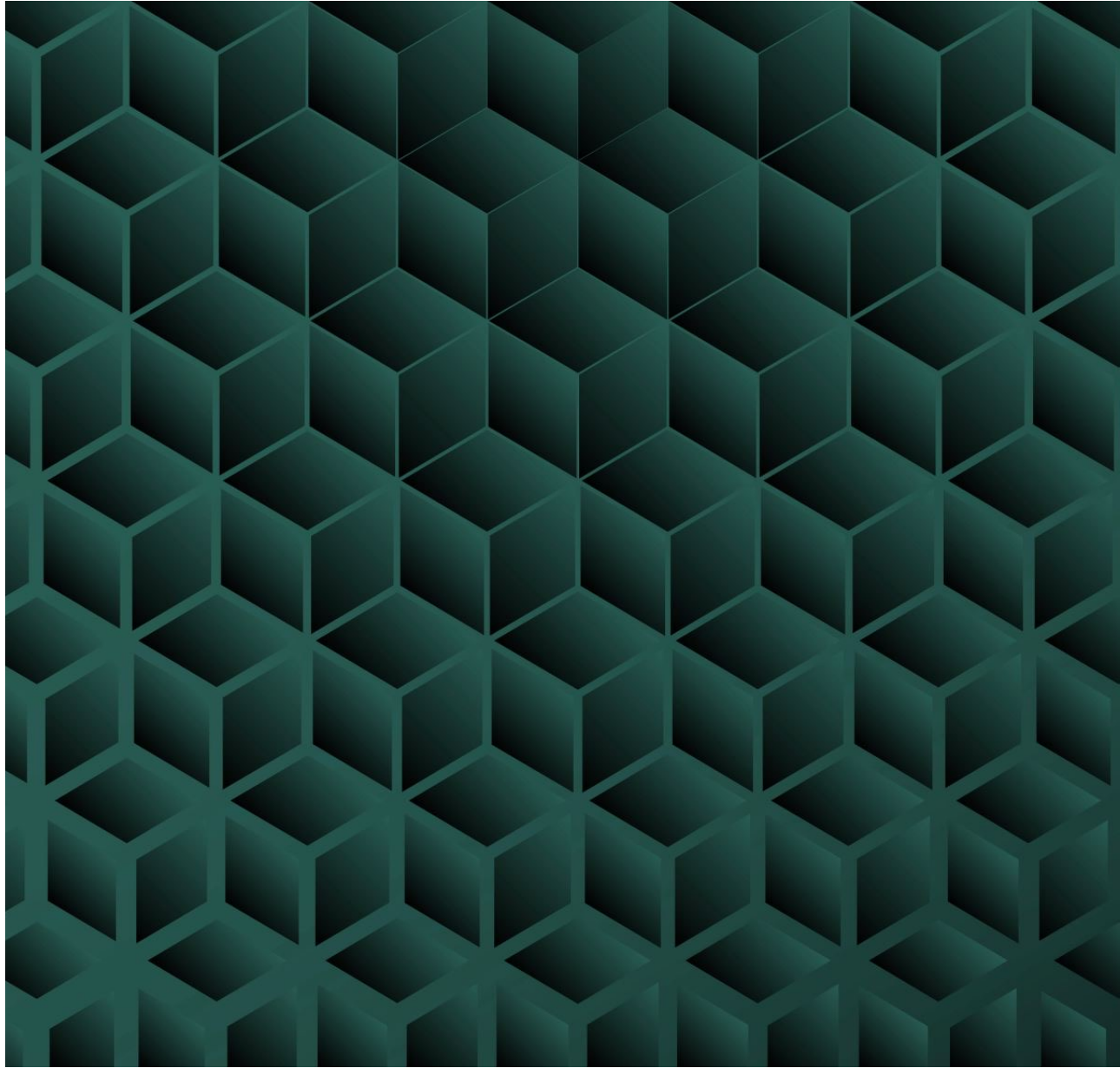
- Alpha Limited has estimated the Materials Purchase worth Rs. 3200 million in FY 2023-24
 - 50% of the planned purchased will be procured from domestic suppliers
 - 50% of the planned purchase will be imported from overseas suppliers
- Alpha further plans:
 - 30% of the imports will be procured through sight LCs
 - 70% of the imports will be procured through usance LCs
- We have the following details:
 - Total purchase under LC = $50\% * 3200 \text{ million} = 1600 \text{ million}$
 - Purchase under Sight LC = $30\% * 1600 \text{ million} = 480 \text{ million}$
 - Purchase under Usance LC = $70\% * 1600 \text{ million} = 1120 \text{ million}$

Arriving at LC Limit

- Lead Time (L) is the time period between date of opening of LC to the date of shipment by the overseas seller
- Transit Time (T) is the time between date of shipment and date of retiring documents (by the applicant from the issuing Bank)
 - Retirement charges are payable at this time
- Usance Period (U) is the credit period enjoyed by the applicant to pay its obligations to the Issuing Bank
- For Alpha,
 - $L = 1$ month
 - $T = 0.5$ months
 - $U = 2$ months (average usance period)
 - Purchase Cycle for Usance LC = $L+T+U = 3.5$ months

Arriving at LC Limit

- For Alpha,
 - Annual purchase under Usance LC = 1120 million
 - Average monthly purchase under Usance LC = $(1120/12)$ million = 93.33 million
 - Annual Usance LC Requirement = 93.33 million * 3.5 = 326.67 million
 - Annual Usance LC requirement = Avg. monthly purchase under usance LC * Purchase cycle for Usance LC
 - Annual purchase under sight LC = 480 million
 - Average monthly purchase under sight LC = $(480/12)$ million = 40 million
 - Purchase Cycle for Sight LC = $L+T = (1+0.5)$ months = 1.5 months
 - Annual Sight LC requirement = 40 million * 1.5 = 60 million
 - Annual Sight LC requirement = Avg. monthly purchase under Sight LC * Purchase cycle for Sight LC
- Total LC requirement = 327 million + 60 million = 387 million



Thank you!