

INTERNATIONAL TRADE AND FINANCE MASTERCLASS

PART 05 OF 25 · SECTION II: PAYMENT METHODS AND TRADE FINANCE

PART 5

INTERNATIONAL PAYMENT METHODS

From cash in advance to open account — the complete spectrum of how money moves across borders, who bears the risk at each point, and how to choose the right payment method for every trade relationship.

IN THIS PART

- The payment risk spectrum — visualized and explained
- SWIFT wire transfers and how correspondent banking works
- The correspondent banking crisis and what to do about it
- Documentary Collections — D/P and D/A in full depth
- The Letter of Credit — the most important instrument in trade
- All seven types of LC explained with practical examples

CASE STUDIES

Each part includes fully worked case studies with detailed calculations, real-world context, and practical lessons for CFOs and finance leaders.

■ THE PAYMENT PROBLEM IN INTERNATIONAL TRADE

The Fundamental Trust Problem Between Strangers

International trade would be much simpler if every buyer and seller could trust each other completely. The seller would ship the goods and the buyer would pay when they arrived. But in reality, an exporter in South Korea has no legal system to rely on if a buyer in Brazil refuses to pay. A buyer in Germany has no way to inspect goods before they leave a factory in Vietnam. Both parties face genuine risk, and the payment mechanism chosen for each transaction must allocate that risk in a way that both parties can accept.

The payment risk spectrum in international trade runs from one extreme to the other. At the maximum-risk-to-seller end is open account trading — the seller ships the goods and then waits to be paid, perhaps thirty, sixty, or ninety days later, with no security whatsoever. At the maximum-risk-to-buyer end is cash in advance — the buyer pays before the goods are shipped, and then waits and hopes the seller delivers what was ordered. Between these extremes are several mechanisms — documentary collections and letters of credit — that use banks and documents to provide security to both parties without requiring either one to bear all the risk.

SWIFT Wire Transfers: How Money Actually Moves

Before we discuss the various payment instruments, it is essential to understand the physical infrastructure through which international payments flow. When a company in the United States wires money to a supplier in Thailand, the payment does not travel directly from the US bank to the Thai bank. It travels through a network of correspondent banking relationships — a chain of banks that have accounts with each other and can move money on each other's behalf.

The Society for Worldwide Interbank Financial Telecommunication — SWIFT — is the secure messaging network that banks use to communicate payment instructions to each other. Every bank that is a SWIFT member has a unique identifier called a BIC code — Bank Identifier Code — sometimes called a SWIFT code. When your bank receives instructions to send money to a Thai bank, it looks up that bank's BIC code and sends a SWIFT message instructing the payment through the correspondent chain.

◆ CORRESPONDENT BANKING PAYMENT FLOW

HOW A WIRE TRANSFER ACTUALLY MOVES

SCENARIO: US company pays Thai supplier \$180,000

Step 1: US Company instructs its bank (Bank of America) to wire \$180,000 to Thai supplier's account at Kasikorn Bank, Bangkok

Step 2: Bank of America checks if it has a direct correspondent relationship with Kasikorn Bank.

If yes: direct payment

If no: find intermediary (correspondent) bank

Step 3: Payment route (typical):

Bank of America (US) -> Citibank NY (correspondent)

-> Citibank Bangkok (Citibank's Thai branch)

-> Kasikorn Bank (beneficiary bank)

-> Thai Supplier's account

TIMELINE AND COSTS:

Day 1: BofA sends SWIFT message; debits your account

Day 2: Citibank NY processes; sends onward

Day 3: Kasikorn Bank receives; credits supplier

Total time: 1-3 business days

COSTS (typical, OUR instructions = sender pays all fees):

BofA outgoing wire fee: \$45

Citibank NY correspondent fee: \$15

Citibank Bangkok fee: \$20

Kasikorn incoming fee: \$12

Total fees: \$92

FX spread (if converting USD to THB): 0.5-2.0% of amount

On \$180,000 at 1% spread: \$1,800

The Correspondent Banking De-Risking Crisis

One of the most serious operational challenges facing companies doing business in developing markets is the ongoing collapse of correspondent banking relationships. Since 2015, major US and European banks have been systematically terminating their correspondent relationships with smaller banks in high-risk jurisdictions — including much of Sub-Saharan Africa, the Caribbean, parts of Central Asia, and several Pacific Island nations. The reason is

compliance costs: the cost of conducting anti-money-laundering due diligence on transactions from these banks has exceeded the revenue those transactions generate.

The practical consequence for a company with a supplier or customer in an affected country is that a payment that should take one to three days can take two to three weeks and may fail entirely if no correspondent route can be found. The solution is to work with your bank's correspondent banking team to identify the specific payment route before you need to make the payment, to build payment lead time into your trade terms, and to consider alternative payment mechanisms such as mobile money platforms — which dominate in East Africa — or regional payment networks.

Documentary Collections: The Middle Ground

A Documentary Collection is a payment mechanism that uses banks as intermediaries to control the exchange of shipping documents for payment or a payment commitment. It sits in the middle of the risk spectrum — it provides more security to the exporter than open account trading, but less security than a Letter of Credit, and it is cheaper and simpler to administer than an LC. Documentary Collections are governed by the ICC's Uniform Rules for Collections — publication URC 522.

There are two types of Documentary Collection. The first — Documents Against Payment, abbreviated D/P, also called a sight collection — requires the buyer to pay the face value of the collection immediately in order to receive the documents. The second — Documents Against Acceptance, abbreviated D/A, also called a term collection — allows the buyer to accept a time draft (a formal promise to pay at a specified future date) and receive the documents immediately. The buyer then pays on the maturity date of the draft.

◆ D/P COLLECTION PROCESS

DOCUMENTARY COLLECTION – STEP BY STEP PROCESS

PARTIES:

Principal (Exporter): Textile manufacturer in Pakistan

Remitting Bank: Standard Chartered, Karachi

Collecting/Presenting Bank: Deutsche Bank, Hamburg

Drawee (Importer): German fashion retailer

STEP 1: Exporter ships goods to Hamburg, obtains:

- Commercial Invoice
- Bill of Lading (consigned 'to order')
- Packing List
- Certificate of Origin

STEP 2: Exporter presents documents to Remitting Bank

with Collection Instruction specifying:

- D/P: release documents only against payment
- Amount: EUR 240,000

STEP 3: Remitting Bank sends documents to Collecting Bank

STEP 4: Collecting Bank notifies German buyer
that documents have arrived and payment is due

STEP 5 (D/P): German buyer PAYS EUR 240,000

Collecting Bank releases original B/L to buyer

Buyer presents B/L to carrier, collects goods

Collecting Bank remits EUR 240,000 to Remitting Bank

Remitting Bank credits Exporter's account

KEY RISK: If buyer refuses to pay (DISHONOR):

Documents remain with Collecting Bank

Goods are on the ship or in port – nobody claimed them

Exporter must arrange storage, find new buyer, or return

Cost of dishonor: freight + storage + resale loss

The Letter of Credit: The Most Powerful Payment Instrument

The Letter of Credit is the most important and most sophisticated payment instrument in international trade. It has been used in various forms for over eight hundred years — Florentine merchants used early forms of it to finance

trade across medieval Europe — and today it underpins trillions of dollars of trade transactions annually. The Letter of Credit solves the fundamental trust problem in international trade by substituting the bank's creditworthiness for the buyer's creditworthiness.

Here is the core principle, explained as simply as possible. The buyer's bank makes an irrevocable promise to the seller: 'If you present us with the specific documents described in this Letter of Credit, in exactly the form described, within the time limits specified, we will pay you the amount stated — regardless of any dispute between the buyer and the seller.' The seller no longer needs to trust the buyer. The seller only needs to trust the buyer's bank. And the buyer's bank — by definition — has paid very careful attention to its own creditworthiness.

The Parties to a Letter of Credit

An LC transaction involves multiple parties, each with a specific role and specific legal obligations. The Applicant is the buyer — the party who asks their bank to issue the LC and who ultimately bears the cost. The Issuing Bank is the buyer's bank — the institution that issues the LC and makes the irrevocable payment commitment. The Beneficiary is the seller — the party in whose favor the LC is issued and who will receive payment if the documents comply. The Advising Bank is a bank in the seller's country that receives the LC from the issuing bank and forwards it to the beneficiary, authenticating it in the process. The Confirming Bank — which is only present when the beneficiary requests confirmation — adds its own independent payment undertaking to that of the issuing bank, providing additional security if the beneficiary does not trust the issuing bank. The Negotiating Bank is the bank that examines the documents and pays the beneficiary against them.

The UCP 600: The Rules That Govern Every LC

The Uniform Customs and Practice for Documentary Credits — publication UCP 600 — is a set of thirty-nine articles published by the International Chamber of Commerce that govern the operation of Letters of Credit in virtually every country in the world. The UCP 600 has no legal force in the sense of a law passed by a parliament, but it achieves something close to universal application because virtually every LC in the world states that it is subject to UCP 600. This means that a dispute over an LC between a bank in Singapore and a company in Brazil is resolved by the same set of rules as a dispute between a bank in Germany and a company in the United States.

One of the most important principles in UCP 600 is the principle of strict compliance. This principle states that banks deal in documents — not in goods or services or performance of contracts. When a bank examines documents presented under an LC, it must determine whether those documents strictly comply with the terms and conditions of the LC. If the LC says the Bill of Lading must be made out to a specific party, and the presented B/L is made out to a slightly different name, that is a discrepancy. If the LC specifies that the goods must be described as 'frozen Atlantic salmon' and the invoice describes them as 'frozen salmon, Atlantic variety', that is a discrepancy. A discrepancy gives the issuing bank the right to refuse payment.

01

CASE STUDY 1

Sunrise Textiles Ltd.

Unconfirmed LC — When the Issuing Bank Cannot Pay

Background

Sunrise Textiles Ltd. is an Indian manufacturer of cotton yarn that exports primarily to buyers in West Africa and the Middle East. In January 2023, Sunrise received a large order from a Nigerian buyer for five hundred metric tons of cotton yarn worth approximately eight hundred and forty thousand US dollars. The buyer provided an irrevocable Letter of Credit issued by Heritage Bank Nigeria. Sunrise's sales team, eager to close the deal, accepted the LC without requesting confirmation from an international bank. They shipped the goods.

◆ UNCONFIRMED LC RISK AND COST

SUNRISE TEXTILES — UNCONFIRMED LC RISK ANALYSIS

LC amount: \$840,000

Issuing bank: Heritage Bank Nigeria (not rated)

LC type: Irrevocable, unconfirmed

WHAT HAPPENED:

Goods shipped; documents presented — fully compliant

Heritage Bank received documents; confirmed compliance

Heritage Bank requested payment from buyer

Buyer delayed — cash flow problems

Heritage Bank itself entered CBN conservatorship

Payment suspended indefinitely

Sunrise unable to collect under LC for 14 months

FINANCIAL IMPACT ON SUNRISE:

Lost use of \$840,000 for 14 months:

Opportunity cost at 12% annually:

$\$840,000 \times 12\% \times 14/12 = \$117,600$

Legal and collection costs: \$42,000

Eventually recovered (18 months after shipment): \$756,000

Permanent loss (haircut in bank resolution): \$84,000

TOTAL COST OF UNCONFIRMED LC: \$243,600

COST OF CONFIRMATION (what should have been done):

Confirmation fee from Standard Chartered India:

0.8% per quarter = $\$840,000 \times 0.8\% = \$6,720$

Confirmation provides Standard Chartered's guarantee

If issuing bank fails, Standard Chartered pays

Saving from confirmation: $\$243,600 - \$6,720 = \$236,880$

02

CASE STUDY 2

Meridian Engineering GmbH

LC Discrepancy Management — Saving a \$2.4M Payment

Background

Meridian Engineering GmbH is a German manufacturer of industrial pumping equipment that had just completed its largest ever export contract — a two million four hundred thousand euro supply of pumping stations to a Saudi Arabian water authority. The payment was secured by an irrevocable LC issued by a Saudi bank. When Meridian's export team presented the documents to their bank, the bank's documentary credit examiner identified four discrepancies. Payment was at risk.

◆ LC DISCREPANCY RESOLUTION

MERIDIAN — LC DISCREPANCY ANALYSIS

LC amount: EUR 2,400,000

DISCREPANCY 1: Late presentation

LC required: documents presented within 21 days of B/L date

B/L date: March 14

Presentation date: April 6 (23 days after B/L — 2 days late)

SEVERITY: High — issuing bank can refuse payment

DISCREPANCY 2: Bill of Lading description mismatch

LC says: 'Industrial centrifugal pumping stations'

B/L says: 'Industrial centrifugal pump stations'

('pumping' vs 'pump' — one word difference)

SEVERITY: Medium — technicality but valid under strict compliance

DISCREPANCY 3: Weight discrepancy

Invoice shows: 48,200 kg gross weight

Packing list shows: 48,350 kg gross weight

SEVERITY: Medium — amounts must agree across documents

DISCREPANCY 4: Missing inspection certificate

LC required a third-party inspection certificate

Certificate was in the shipment file but not presented

SEVERITY: Critical — missing required document

RESOLUTION:

Inspection certificate located and presented immediately

Weight discrepancy: new packing list issued (minor amendment)

B/L description: buyer agreed to waive discrepancy

Late presentation: issuing bank accepted buyer's waiver

Payment received 8 days later

Cost of discrepancy management: 8 days of interest +

bank amendment fees = approximately EUR 14,800

03

CASE STUDY 3

NovaTech Components

*Transferable LC — Financing a Supply Chain as a Trading Intermediary***Background**

NovaTech Components is a Hong Kong-based trading company that sources electronic components from manufacturers in China and Taiwan and sells them to buyers in Europe and North America. In a typical transaction, NovaTech's margin is fourteen percent — which it earns by adding value through quality inspection, consolidation, customs clearance, and supply chain management. The challenge is financing: NovaTech must pay its suppliers before it receives payment from its buyers. A transferable LC solved this problem without requiring NovaTech to use its own balance sheet.

◆ TRANSFERABLE LC MECHANICS

NOVATECH — TRANSFERABLE LC MECHANISM

TRANSACTION:

European buyer purchases \$1,400,000 of components
 NovaTech's cost from Chinese manufacturers: \$1,204,000
 NovaTech's margin: \$196,000 (14%)

STEP 1: European buyer opens LC for \$1,400,000

LC is marked 'transferable'

NovaTech is the first beneficiary

STEP 2: NovaTech transfers the LC to Chinese manufacturers

Transfer amount: \$1,204,000 (not \$1,400,000 — NovaTech substitutes its own lower price)

Chinese manufacturers ship goods directly to buyer

STEP 3: Chinese manufacturers present documents under transferred LC — receive \$1,204,000

STEP 4: NovaTech substitutes its own commercial invoice for \$1,400,000 in place of manufacturer's \$1,204,000 invoice

NovaTech presents substituted documents to issuing bank

NovaTech receives \$1,400,000; retains \$196,000 margin

BENEFIT: NovaTech financed \$1.2M of purchases without

using any of its own cash or bank facilities

The buyer's creditworthiness financed the supply chain