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electronic marketplaces for international business

EMARKETPLACE TRADE AND INTERNATIONAL PAYMENT METHODS

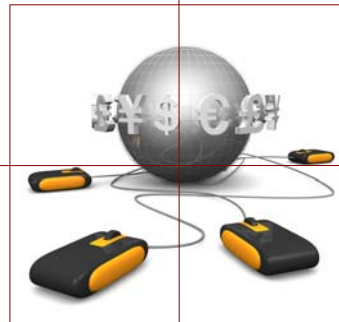
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Report



Abstract

Generally, reports on international trade and payment methods tend to highlight one important aspect in relation to payments: both the buyer and seller are subjected to a certain degree of financial risk – particularly when engaging in a first-time international transaction via an emarketplace. The degree of risk that your company is willing to be responsible for is determined when you negotiate your preferred payment method with a prospective trading partner.

This report will focus firstly by analyzing some of the more traditional payment methods available to small and medium-sized enterprise (SME) exporters and importers before looking at some of the contemporary e-payment methods as used by emarketplaces such as credit cards and online escrow services.

The paper will also look at the risk involved within these various payment methods as each method carries a varying degree of risk for both the buyer and seller.

Keywords: International payments, payment methods, Financial risk.

The Author

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Currently, he continues to work in an advisory capacity for emarketservices.com as well as operate his own e-consultancy business. If readers wish to comment, question or highlight any issues raised by this report, Peter can be contacted at peter.saint@emarketservices.com

Credit Worthiness

As highlighted in previous eMarket Services reports due diligence on a prospective trading partner is extremely important in relation to determining whether or not you are dealing with a legitimate company. Furthermore, and linked to that process, an experienced SME will be cautiously reviewing the credit worthiness of their prospective business partner determining the best payment method to be used for the transaction of goods or services.

Emarketplaces that have the functionality to include payment methods within their negotiation system normally allow the initial user (buyer or seller) to determine their preferred payment method firstly. However, an experienced company may wish to decline the initial user's payment method, particular if it is an unknown buyer suggesting a high risk method such as an open credit account to a seller. Of course, the antithesis applies, if the buyer is a highly-respected, creditworthy client then either a 45-day grace period to pay or an open account may be an acceptable payment method to a seller.

Therefore, negotiating the payment method is equally as important as negotiating the additional aspects of a transaction such as quantity, price, shipping method or whether or not it is a recurring transaction.

Methods of International Payment

In this section we will explore some of the well-known international payment methods and their varying degrees of risk to both the buyer and the seller. The following table gives a visual indication of the varying degrees of risk for both parties using specific payment method where: 1 = "High Risk" down to 5 = "Low Risk"

Buyer/Importer	Payment Method	Seller/Exporter
5	<i>Open Account: Buyer pays for goods/services after delivery</i>	1
4	<i>Documentary term bill: documents against acceptance</i>	2
3	<i>Documentary sight bill: documents against payment</i>	3
2	<i>Documentary credit: letter of credit</i>	4
1	<i>Cash in Advance: Buyer pays for good/services before shipment</i>	5

In the next few paragraphs is some basic information outlining some of the principles involved in the various payment methods used in international trade. For more detailed information, please reference some of the articles at the end of this report:

Open Account: The open account payment method is ideally used when the buyer has an excellent past-payment record, a well-established positive business reputation and their credit rating deems the organization highly creditworthy. From a seller's perspective this method of payment should only be utilized if a detailed analysis of the many potential risks involved has been fully undertaken.

Documentary Term Bill: The documentary term bill payment method is used if the seller allows credit to the buyer. In essence, the buyer has to pay after a certain time period has elapsed on receipt of the goods or service. Therefore, the parties could agree that the buyer must pay 45 days after acceptance of the goods from the seller. By allowing credit to the buyer the risk with this payment method is weighted against the seller.

Documentary Sight Bill: The documentary sight bill payment method is used when ownership of the goods or services is retained by the seller until they arrive at their destination and payment is received. The risk involved with this payment method relates to the buyer not accepting the goods, for whatever reason. It then becomes the responsibility of the seller to pay the various charges to have the goods returned to them.

Letter of Credit: The letter of credit payment method involves a reputable banking institute agreeing to pay the seller; and is determined on the seller meeting the conditions set-out in the letter of credit. The buyer requests the letter of credit from their bank and it is issued to the seller's bank. Irrevocable letters of credit cannot be changed whereas a revocable letters of credit can be changed, but increases the risk for the seller. Letters of credit are expensive, therefore, not an economically viable payment method for transactions of a smaller value.

Cash in Advance: The cash in advance payment method weighs the least risk for the seller and all the risk with the buyer as payment is made before the goods or services are shipped. Payment methods can involve wire transfers, credit cards or cash if the buyer decides to visit a seller's premises to view the merchandise and purchase.

The above list is not exhaustive; there are other payment methods which can be explored with further research. Buyers and sellers using an emarketplace may decide to use any of the above outlined payment methods once they have concluded their initial negotiations online. From my experience, as Globalrecycle.net manager, the majority of companies would tend to negotiate their payment methods offline rather than online; although the preferred payment method was always indicated by the initial user (buyer or seller) within the emarketplace negotiation system.

e-Payments and Online Methods of Payment

Since the advent of the internet, and in particular, the increase of emarketplaces since the start of 21st century there have been a number of methods adopted in relation to payment methods using online marketplaces. As in the previous section, all payment methods carry a certain degree of risk, and it is only by carrying out accurate due diligence on a potential business partner do you alleviate some of that risk to your company.

One of the most widely available payment methods for participants in emarketplaces is that of escrow services. Escrow services such as www.escrow.com , and Alibaba's China-based escrow service, Alipay, are available to companies for a fee which is normally based as a percentage cost of the overall transaction value.

An escrow service, in relation to an emarketplace, operates essentially as follows. The buyer and seller participate in online negotiations over a particular material or service. After negotiation the participants finalize the transaction online: normally agreeing on a purchase order which would detail fields such as price, quantity, shipping method, buyer's inspection period. These finalized details would be passed to the Escrow service. The buyer issues payment for the merchandise to the escrow service – once payment is confirmed by the escrow service, it is the escrow service who notifies the seller to ship the goods or services to the buyer. On arrival, the buyer then has a set number of days to inspect the merchandise as was previously set-out in the purchase order. The buyer can accept or reject the goods or services during this period. If they accept the seller is paid by the escrow service and the transaction is concluded. If the buyer rejects the merchandise, the buyer returns the goods to the seller and payment is returned to the buyer by the escrow service. The risk to participants is lessened in comparison to using a method such as a wire transfer, for example. Currently, the main risk in relation to escrow services is the proliferation of fake

escrow websites. More information can be referenced on this topic by reading the following links:

<https://www.escrow.com/support/faq/index.asp?sid=27&qid=136>

<http://news.alibaba.com/article/detail/safe-trading/100069489-1-how-spot-fraud-escrow-site.html>

From experience, one of the reasons why some SMEs do not engage in escrow services is the additional fee charged by the escrow provider. Once the fee is factored-in to the profit on the transaction, unless it's a particularly large transaction, the transaction itself becomes economically unviable. Therefore, SMEs may engage in more high risk payment methods in order to sustain a potential higher profit.

Paypal, and other online payment sites such as 2checkout.com, are prominent alternatives used for making online payments. However, in relation to emarketplaces, currently, it would appear that SMEs prefer to meet, negotiate and conclude business using the more traditional payment methods that were outlined. This trend may change in future years, however, as the next generation of business leaders will be much more comfortable in using the various ebusiness solutions offered on the Internet.

Additional payment methods such as wire transfer, and payment using credit cards are also available to SMEs, however, they also include a high degree of risk, particularly from a buyer's perspective. Additional information can be referenced on the subject matter by following some of the links at the end of this report.

Finally, payments to unknown sellers on emarketplaces via institutions such as Western Union should be discouraged; as can be referenced in this article by Western Union: <http://www.westernunion.com/info/fraudIndex.asp?country=global>

In conclusion

At the time of writing this report there is no payment method which does not encounter a certain degree of risk to either the buyer, or the seller, or both. As all payment methods carry a degree of risk the conclusion of this report is that it is imperative that appropriate due diligence is carried out on any prospective trading partner with particular focus on that trading partner's credit worthiness. After due diligence has been successfully finalized, selection of an appropriate payment method whilst using an emarketplace will be an easier task.

Reference material and further research on the topics addressed previously can be viewed on the following links:

- Managing Risk in International Trade :
<http://www.sitpro.org.uk/trade/managingrisk.html>
- Online Payment Systems:
<http://www.e-bc.ca/pages/resources/ecommerce/online-payment-systems.php>
- Basic Trade Finance Tools: Payment Methods in International Trade:
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=996765

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