**Chapter 7: Terms of Payment**

TRUE/FALSE

1. The greater the exposure, the more secure terms of payment should be.

ANS: T DIF: Easy REF: page 243

1. In a letter of credit, the creditworthiness of the exporter is substituted for the creditworthiness of the importer.

ANS: F DIF: Moderate REF: page 246

1. A letter of credit is more secure than cash in advance.

ANS: F DIF: Moderate REF: page 246

1. Because some of their cash must be frozen at the issuing bank to guarantee payment, importers often prefer terms other than those of a letter of credit.

ANS: T DIF: Hard REF: page 247

1. An irrevocable letter of credit cannot be canceled by the issuing bank unless the applicant agrees to it.

ANS: F DIF: Hard REF: page 254

1. In most cases, it is wise to have a letter of credit confirmed by the advising bank.

ANS: F DIF: Hard REF: page 251

1. In those few cases in which the letter of credit does not reflect exactly the *pro-forma* invoice (misspellings for example), it is wiser to attempt to obtain an amendment rather than to issue an invoice that matches the letter of credit.

ANS: F DIF: Hard REF: page 255

1. It is possible to add a draft to a letter of credit.

ANS: T DIF: Moderate REF: page 256

1. It is often a disadvantage to request a letter of credit because of the costs (and the cumbersome process) associated with it.

ANS: T DIF: Easy REF: page 257

1. A date draft transaction solves one of the problems of documentary collection in general: the date at which the importer will have to make payment.

ANS: T DIF: Moderate REF: page 261

1. In a documentary collection transaction, the responsibilities of the presenting bank in the importing country generally stop at notifying the importer that the documents have arrived and at requesting that the importer endorse the draft or pay before releasing the documents.

ANS: T DIF: Easy REF: page 262

1. Documentary collections are more cumbersome and expensive than letters of credit.

ANS: F DIF: Easy REF: page 263

1. Usually a bank guarantee is offered by a single bank, rather than multiple banks.

ANS: F DIF: Easy REF: page 268

1. A bank guarantee payable at first request is one in which the beneficiary does not have to provide any evidence that the terms of the underlying contract between the contractor and the beneficiary have not been met.

ANS: T DIF: Moderate REF: page 268

1. United States law prohibits bank guarantees.

ANS: T DIF: Easy REF: 7-11d

1. A payment guarantee is the most commonly used type of guarantee and is used to ensure that the contractor finishes the project.

ANS: F DIF: Moderate REF: page 268

1. Since a draft (or a bill of exchange) is a legal document in the importing country, the courts in the importing country would consider non-payment by an importer as a domestic issue.

ANS: T DIF: Moderate REF: page 260

1. A date draft goes into effect at the time the draft is endorsed (signed).

ANS: F DIF: Moderate REF: page 261

1. A procurement card is conceptually similar to a consumer credit card.

ANS: T DIF: Easy REF: page 264

1. A problem with TradeCard is that it is an extremely expensive alternative.

ANS: F DIF: Moderate REF: page 265

1. The exporter that offers “open account” terms is less likely to clinch a sale than one that offers more secure terms, such as “letter of credit” terms.

ANS: F DIF: Moderate REF: page 269

1. The majority of transactions issued in the European Union are conducted on a “documentary credit” basis.

ANS: F DIF: Hard REF: page 270

1. There are insurance policies that pay the exporter if the importer does not pay.

ANS: T DIF: Moderate REF: page 244

1. When a factor offers its services “without recourse,” it means that the importer has to pay regardless of the exporter’s performance.

ANS: F DIF: Hard REF: page 245

1. SWIFT is the international central bank, with which all national central bank have to deal when making an international fund transfer.

ANS: F DIF: Hard REF: page 243

MULTIPLE CHOICE

1. Among other reasons, international transactions are perceived to have more risk of non-payment because of

|  |  |  |  |
| --- | --- | --- | --- |
| a. | a lack of credit information. | d. | higher cost of collection. |
| b. | a lack of personal contact. | e. | all answers in this list are reasons for the perception of risk of non-payment. |
| c. | no easy legal recourse. |

ANS: E

Each of these reasons makes international transactions more complex than domestic transactions.

DIF: Easy REF: page 236

2. In attempting a credit check of a foreign firm, a basic problem is

|  |  |  |  |
| --- | --- | --- | --- |
| a. | deciphering the business’s organization and name. | d. | trusting the source providing the credit history. |
| b. | most international banks are corrupt. | e. | reading a credit report in a foreign language. |
| c. | most countries avoid international trade. |

ANS: A

There is generally much less information available on the creditworthiness of a creditor in a foreign market, coupled with a lack of familiarity with the diverse business organizations and with an inability to decipher businesses’ names.

DIF: Easy REF: page 236

3. The risk(s) that an exporter takes in requesting cash in advance as a means of payment is/are

|  |  |  |  |
| --- | --- | --- | --- |
| a. | fluctuations in the exchange rate. | d. | there is no risk associated with cash-in-advance payments. |
| b. | it puts the exporter at a competitive disadvantage. | e. | it increases shipping costs. |
| c. | it can increase inventory stockouts. |

ANS: B

While cash in advance might include fluctuations in the exchange rate and increases in inventory stockouts, they are not directly applicable. However, it is correct that it puts the exporter at a competitive disadvantage because competitors who offer some form of credit are more likely to get the business.

DIF: Moderate REF: page 243

4. Among country risks in international trade are labor issues. For instance, \_\_\_\_\_ has/have a strike almost every year at its/their ports.

|  |  |  |  |
| --- | --- | --- | --- |
| a. | Chad | d. | Mongolia |
| b. | Paraguay | e. | Bolivia |
| c. | Japan |

ANS: C

Chad, Mongolia, Bolivia, and Paraguay are landlocked and have no ports.

DIF: Moderate REF: page 240

5. International commercial risk can be evaluated by

|  |  |  |  |
| --- | --- | --- | --- |
| a. | credit report companies. | d. | banks. |
| b. | factoring houses. | e. | all parties listed in these responses analyze commercial risks. |
| c. | some accounting firms, insurance companies, and banks. |

ANS: E

All of these organizations can be sources of international commercial risk evaluation.

DIF: Moderate REF: 7-3b

6. SWIFT stands for

|  |  |  |  |
| --- | --- | --- | --- |
| a. | Southwestern International Fund Transfers. | d. | Society for Worldwide Institutional Transfers. |
| b. | Sales World Institutional Financial Telecommunications. | e. | Society for Worldwide Interbank Financial Telecommunication |
| c. | Serving-the-World Institutional Financial Transactions. |

ANS: E

SWIFT stands for Society for Worldwide Interbank Financial Telecommunication

DIF: Hard REF: page 243

7. An exporter can conduct its international business in a manner similar to the way it and most companies conduct domestic business by using

|  |  |  |  |
| --- | --- | --- | --- |
| a. | an open account. | d. | cash in advance. |
| b. | a letter of credit. | e. | Incoterms® rules. |
| c. | a documentary collection. |

ANS: A

While there may be instances of demanding cash in advance or even a letter of credit in domestic transactions, in most cases, businesses offer open account terms in their domestic transactions. Documentary collections are not necessary for domestic transactions.

DIF: Moderate REF: page 244

8. In the European Union, it has become difficult to conduct business on any payment terms other than

|  |  |  |  |
| --- | --- | --- | --- |
| a. | cash in advance. | d. | factoring. |
| b. | open accounts. | e. | documentary collection. |
| c. | letters of credit. |

ANS: B

While any of the payment terms may be used in specific cases in the European Union, competition there is so intense and the practice is so widespread that an exporter is essentially expected to offer open accounts.

DIF: Moderate REF: page 244

9. International factoring

|  |  |  |  |
| --- | --- | --- | --- |
| a. | is more complicated than domestic factoring. | d. | tends to be expensive. |
| b. | can be used to extend credit beyond what the exporter can normally afford. | e. | all points listed in these responses are associated with international factoring. |
| c. | frequently involves factoring firms in both the exporting and importing countries. |

ANS: E

All of these issues apply in international factoring.

DIF: Moderate REF: page 245

10. In a letter of credit, the most important aspect is

|  |  |  |  |
| --- | --- | --- | --- |
| a. | the creditworthiness of the importer. | d. | the promise of eventually changing to an open account. |
| b. | the documentation of the transaction. | e. | the currency of the transaction. |
| c. | the creditworthiness of the exporter. |

ANS: B

A letter of credit is being used because the creditworthiness of the importer is already in doubt. The creditworthiness of the exporter is not relevant, nor is any promise or hope of eventually switching to an open account. Rather, the most important aspect of a letter of credit is that all documents be precisely in order so banks in both the exporting and importing countries can properly process them and transfer the appropriate funds.

DIF: Moderate REF: page 246

11. The importer’s bank is called the

|  |  |  |  |
| --- | --- | --- | --- |
| a. | applicant. | d. | advising bank. |
| b. | beneficiary. | e. | correspondent bank. |
| c. | issuing bank. |

ANS: C

The *applicant* is the importer. The *beneficiary* is the exporter. The *advising bank* is the exporter’s bank.

DIF: Moderate REF: page 247

12. Following negotiations on a transaction which result in use of a letter of credit for payment, the next step is for the exporter to

|  |  |  |  |
| --- | --- | --- | --- |
| a. | ship the goods to the importer. | d. | send a pro-forma invoice to the importer. |
| b. | ask the advising bank to open a letter of credit. | e. | send a pro-forma invoice to the importer's bank. |
| c. | make a security deposit in the issuing bank. |

ANS: D

Following negotiations, the exporter needs to send a *pro-forma* invoice to the importer which estimates the terms of the transaction as closely as possible. The exporter does not want to ship the goods until the payment terms have been arranged. The *importer* (not the exporter) initiates the letter of credit by asking the *issuing bank* (not the advising bank) to open it. And there is no reason for the exporter to make a security deposit.

DIF: Hard REF: page 246

13. Sometimes a third bank, in addition to the issuing bank and the advising bank, becomes involved with a letter of credit. This bank is called a

|  |  |  |  |
| --- | --- | --- | --- |
| a. | primary bank. | d. | amending bank. |
| b. | secondary bank. | e. | correspondent bank. |
| c. | intermediary bank. |

ANS: E

The correct answer is correspondent bank (or confirming bank).

DIF: Hard REF: page 253

14. The UPC 600 is

|  |  |  |  |
| --- | --- | --- | --- |
| a. | used only in open accounts. | d. | a set of rules for documentary collections. |
| b. | normally not used when a letter of credit is issued through the SWIFT network. | e. | a set of rules for cash-in-advance transactions. |
| c. | the *Universal Customs and Practice for Documentary Credit*, 2007 revision, Publication 600 of the International Chamber of Commerce. |

ANS: C

The UPC 600 deals with letters of credit, and open accounts do not use letters of credit. The UPC 600 is normally used when a letter of credit is issued through the SWIFT network. UPC 600 stands for the *Universal Customs and Practice for Documentary Credit*, 2007 revision, Publication 600 of the International Chamber of Commerce.

DIF: Hard REF: page 254

15. A standby letter of credit is similar to a “simple” letter of credit except for

|  |  |  |  |
| --- | --- | --- | --- |
| a. | it generally has a much longer validity period. | d. | it secures the interests of the exporter in a long-term business relationship. |
| b. | it usually applies to more than one shipment from the exporter to the importer. | e. | all answers in this set of responses apply to standby letters of credit. |
| c. | it allows the exporter to extend an open account to the importer, using the letter of credit only if the importer doesn’t meet its obligations. |

ANS: E

All answers are applicable to the ways a standby letter of credit is different from a simple letter of credit.

DIF: Moderate REF: page 257

16. The bill of lading serves as

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| --- | --- | --- | --- |
| a. | a certificate of title to transported goods. | d. | an export certificate. |
| b. | a substitute for a letter of credit. | e. | a document used to clear customs in the importing country. |
| c. | a certificate of an open account. |

ANS: A

A bill of lading is not a substitute for a letter of credit, nor a certificate of an open account, but it is a certificate of title to the goods.

DIF: Moderate REF: page 250

17. The instruction letter is part of the documentary collection

|  |  |  |  |
| --- | --- | --- | --- |
| a. | that is not recognized in the United States. | d. | that dictates what the remitting bank's obligations are. |
| b. | in which the exporter, through the remitting bank, tells the presenting bank what it is expected to accomplish. | e. | that dictates what the confirming bank's obligations are. |
| c. | that is not recognized in the European Union. |

ANS: B

The instruction letter is a document in which the exporter, through the remitting bank, tells the presenting bank what is expected to accomplish and it is recognized in the United States and in the European Union.

DIF: Easy REF: page 261

18. An *aval*

|  |  |  |  |
| --- | --- | --- | --- |
| a. | is a used only in open accounts. | d. | is a guarantee by the remitting bank that the importer will pay. |
| b. | means funds are available. | e. | is a guarantee by the correspondent bank that the exporter will pay. |
| c. | makes the presenting bank a co-signer of a draft. |

ANS: C

An avail is a promise by the presenting bank that the importer will honor the draft and if the importer defaults, the bank will make the payment, acting as a co-signer.

DIF: Easy REF: page 262

19. Credit terms can be considerably lengthened through

|  |  |  |  |
| --- | --- | --- | --- |
| a. | a letter of credit. | d. | international forfaiting. |
| b. | trade acceptance. | e. | a credit draft. |
| c. | banker’s acceptance. |

ANS: D

A letter of credit does not necessarily lengthen credit. Trade acceptance and banker’s acceptance are not related to credit issues. International forfaiting is used as a means to extend credit terms.

DIF: Easy REF: page 264

20. A bank guarantee that is requested by a beneficiary to ensure that the contractor is bidding in good faith and will enter the contract if awarded is called a(n)

|  |  |  |  |
| --- | --- | --- | --- |
| a. | tender guarantee or bid guarantee. | d. | advance payment guarantee or repayment guarantee. |
| b. | performance guarantee. | e. | seller guarantee. |
| c. | maintenance guarantee. |

ANS: A

A tender guarantee or bid guarantee ensures the contractor is bidding in good faith. The performance guarantee is used to insure that the contractor finishes the project. The maintenance guarantee is used to ensure that the contractor performs the services necessitated by the contract after the completion of the project. The advance payment guarantee or repayment guaranteeis used to ensure that payments made by the beneficiary in advance of the work would be reimbursed if the contractor fails to start the project.

DIF: Moderate REF: page 268

21. The most commonly used terms of payment for a customer located in the Middle East are

|  |  |  |  |
| --- | --- | --- | --- |
| a. | letters of credit. | d. | cash in advance terms. |
| b. | open accounts. | e. | open accounts with credit insurance. |
| c. | documentary collections. |

ANS: A

Letters of credit are most commonly used in the Middle East.

DIF: Hard REF: page 270

22. Among the following terms of payment, which is the one which is the most customer-friendly and still protects the exporter from the risk of non-payment?

|  |  |  |  |
| --- | --- | --- | --- |
| a. | a letter of credit | d. | international forfeiting |
| b. | open account | e. | documentary collection. |
| c. | open account with credit insurance |

ANS: C

An open account with credit insurance presents the most customer-friendly terms, since the importer does not have any cash-flow requirements prior to the transaction, and the exporter is covered against the risk of non-payment.

DIF: Easy REF: page 269

COMPLETION

1. In a cash-in-advance transaction, all risk is transferred to the \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_.

ANS: importer

DIF: Moderate REF: page 243

2. While a cash-in-advance transaction shows a lack of it, an open account demonstrates that the exporter has \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ toward the importer.

ANS: trust

DIF: Easy REF: page 244

3. Because of the risks associated with open-account transactions, when an exporter is forced for competitive reasons to offer an open account, the exporter should acquire credit \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ on those sales.

ANS: insurance

DIF: Moderate REF: page 244

4. In terms regarding letters of credit, the importer is called the \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_.

ANS: applicant

DIF: Easy REF: page 247

5. The issuing bank’s promise to pay is contingent upon the proper \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ being in order.

ANS: documents

DIF: Moderate REF: page 246

6. When a letter of credit and the required documents do not match perfectly, it is normally the role of the \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ bank to request an amendment to the letter of credit from the bank of the other party.

ANS: advising

DIF: Hard REF: page 256

7. A \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ is an instrument that legally binds the importer to pay within a certain period of time (and allows the exporter to grant commercial credit to the importer whenever it is deemed necessary).

ANS: draft

DIF: Moderate REF: page 256

8. The rules of the URR 725 of the International Chamber of Commerce apply to \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ rather than to exporters.

ANS: banks

DIF: Hard REF: page 253

9. In documentary collection activity, the exporter’s bank is called the \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ bank.

ANS: remitting

DIF: hard REF: page 259

10. In some cases, the exporter may want to grant some credit terms to the importer but still want some means to ensure it will be paid. In that case, it can request that the bank exchange documentation against a \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ draft in which the importer endorses to promise to pay within a certain time period.

ANS: time

DIF: Easy REF: page 261

11. The most commonly used term of payment in the European Union is \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_.

ANS: open account

DIF: Hard REF: page 270

12. The less developed an area of the world is, the more likely it is that an exporter will use a \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ term of payment.

ANS: letter of credit, secure

DIF: Moderate REF: page 241