ABSTRACT

Financing is one of the most important aspects of trade. International trade, although seemingly not different from local trade, differs from local trade because shipment/delivery takes longer, and different documentation and legislation is due to different countries involved in international trade. Financing also differs compared to local trade, and there are some specific methods used in international trade like documentary credit, although there is no limitation for documentary credits to be used in local trade. Documentary credit is a well-known method generally used in international trade. This chapter aims to define the role of documentary credits in international trade finance. In this chapter along with other finance methods, documentary credits, types, process will be explained. It is aimed to help importers and exporters how to mitigate the potential risks by using documentary credit. Furthermore, which type of documentary credit is to be used depending on the situation is clarified.

INTRODUCTION

The most important issue in international trade financing is that how the payment or financing will be made and from which sources (Dinçer, Yüksel & Şenel, 2019). As the international trade covers too many parties involved like importer, exporter, importer’s bank, exporter’s bank etc, it is important for all parties to contribute in solving the finance issue (Yüksel, 2017). In other words how and when the exporter will be paid is main issue. As financing is the payment of the value of the goods exported, the main finance method can be defined as the payment methods, namely payment of the value of the goods by the importer (Dinçer, Hacıoğlu & Yüksel, 2018a,b). Payment methods can be defined as advance payment, payment against goods/open account, where there are no intermediary institutions settled between importer and exporter (Dinçer et al., 2019). How-
ever, there are other methods like letter of guarantees and documentary credits, where banks have to be involved in the transaction between importer and exporter (Foley, Johnson & Lane, 2010). Although the payment and delivery in a purchasing transaction seem the same in local trade and international trade, international trade transactions are different from local trade transactions because transportation takes longer and different rules apply in cross border transactions in international trade (Antras & Foley, 2015). There are also finance methods from external sources like factoring, forfaiting, export credit agencies, IFC, Worldbank etc.

**INTERNATIONAL TRADE FINANCE**

**International Trade Payment Methods**

**Advance Payment**

If the exporter requests payment before the goods are shipped, the name is self explanatory, it is called advance payment. The transaction starts with exporter’s advance payment of the goods to the importer (Li et al., 2018). Importer ships the goods after receiving the value of the goods from importer (Dinçer, Yüksel, Adali and Aydın, 2019). In this payment exporter is financed by the importer, by the advance payment. It is an advantageous payment and finance method for the exporter. In this form of payment, the importer pays the price of the goods in advance before loading more exporter goods. In the form of this payment, contrary to the goods, the exporter makes a loan to the exporter (Tunay et al., 2019). Before accepting such a form of payment, the buyer must fully trust the seller and believe that he will fulfill his commitment (Giovannucci, 2001).

**Open Account/Payment Against Goods**

The importer pays the goods after clearing the goods. In this system, the importer is advantageous because it will withdraw the goods from the customs without any payment and will have the opportunity to control. The exporter is faced with the risk that the importer will not pay the cost of the goods. In a way it is the opposite of advance payment method as in open account method, the exporter ships the goods before the payment where importer receives the goods before making payment and pays after receiving the goods (Karadag, 2015).

**Consignment**

Consignment is one step further than open account. It can be defined as international version of open account (Export.gov, 2018). In this method, payment is effected only after the goods are sold by the importer. It is usually used between parties which know each other well and trust each other, i.e. distributer of the production company. It is also usually used for very expensive or heavy machinery and equipment where the importer has to display it before selling like new cars etc. The payment is effected after selling the goods, by deducting their profit, commission and charges are transferred to the exporter as per the sales contract. If the importer can not sell it can return it back to exporter depending on the contract (Khezr & MacKenzie, 2018). Although it is risky for the exporter to send the goods on consignment it has some advantages as well. It helps the exporter to compete with others with faster delivery and avail-

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*Strategic Management of Finance and Role of Documentary Credit*