

MITIGATING RISKS AGAINST PAYMENT SYSTEMS



Learning Outcomes.

At the end of this paper, participants will be able to

- Understand Export Payment Risks.
- Evaluate Secure Payment Methods
- Conduct Buyer's Due Diligence
- Ensure Proper Documentation and Compliance.
- Implement Risk Mitigation Strategies

Introduction



In international trade, ensuring secure payment systems is one of the most critical challenges exporters face. Small and Medium Enterprises (SMEs) often struggle with non-payment, currency fluctuations, and fraudulent buyers, which can significantly impact business sustainability.

Introduction

The Importance of Secure Payment Systems in International Trade

- Secure payment systems play a crucial role in facilitating international trade by ensuring smooth transactions, reducing risks, and fostering trust between trading partners.
- Given the complexities of cross-border transactions, having a reliable and secure payment system is essential for exporters and importers to minimize financial losses and maintain business continuity.

KEY POINTS



- ✓ International trade presents a spectrum of risk, which causes uncertainty over the timing of payments between the exporter (seller) and importer (foreign buyer).
- ✓ For exporters, any sale is a gift until payment is received.
- ✓ Therefore, exporters want to receive payment as soon as possible, preferably as soon as an order is placed or before the goods are sent to the importer.
- ✓ For importers, any payment is a donation until the goods are received.
- ✓ Therefore, importers want to receive the goods as soon as possible but to delay payment as long as possible, preferably until after the goods are resold to generate enough income to pay the exporter.

UNDERSTANDING PAYMENT RISKS.



Whatever form the export contract takes, the exporter needs to be careful in formulating this document as they are drawn up between companies from countries that may have very different legal systems, regulations, and attitudes to doing business.

These differences may cause disputes even when trading with other developed nations. The challenge is to make the export contracts as clear, precise, and comprehensive as possible.

The exporter should be aware of and attentive to details of the export contract documents agreed by both parties.

International contracts can be complex. It is advised to seek advice on the legal implications from a professional.

TYPES OF RISKS.



- Commercial Risk (Contract Disputes)
- Payments Risk (Importer may be concerned that about the Exporter to perform according to the contract.)
- Foreign Exchange Risk (Currency Fluctuations)
- Political Risk (Government Restrictions, Instability)
- Operational risk (Delays, Documentation Errors)



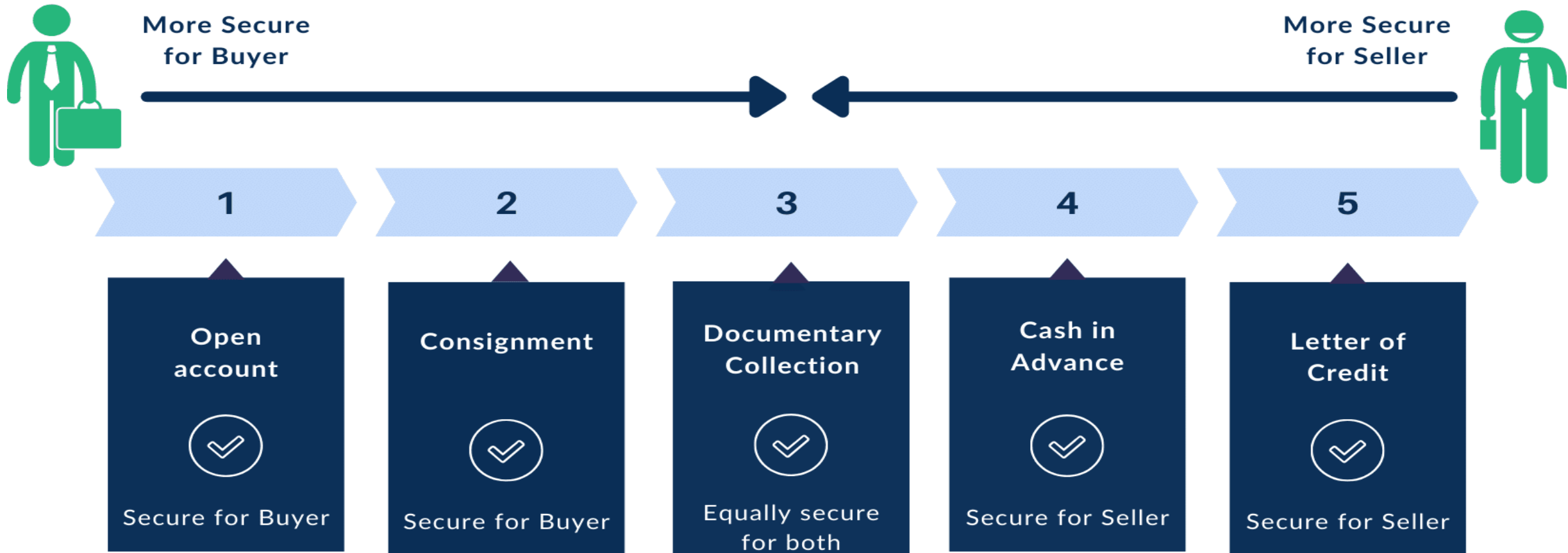
Types of International Payment Methods

EXPORT RISK ON PAYMENT TERMS



METHODS OF PAYMENT IN INTERNATIONAL TRADE

Five Types of Export Payment Terms



Advance Payment

- ❖ Advance payment is a method where the buyer pays the seller before goods are shipped.
- ❖ It benefits exporters by ensuring upfront payment, which can be made upon order confirmation or before shipment.
- ❖ The exporter must ship the goods within one year of receiving payment.

How It Works:

- The importer (buyer) pays the exporter (seller) in full before goods are shipped or services are rendered.

When to Use:

- When dealing with new or high-risk buyers.
- For customized products or small-value transactions.
- In politically or economically unstable markets.

Risks & Considerations:

- **For Buyers:** High risk since payment is made without assurance of product quality or delivery.
- **For Sellers:** Low risk as they receive payment upfront.
- May discourage buyers from doing business due to lack of trust.

Open Account

- ❖ An open account is a payment arrangement between a business and customer .
- ❖ Under this arrangement, the customer can buy goods and services on deferred payment basis and then pay the business at later date .
- ❖ The buyer promises to pay the seller within a predetermined number of days and the sellers doesn't restrict the availability.

How They Work:

- The exporter ships goods and extends credit terms (e.g., payment in 30, 60, or 90 days).
- The importer pays after receiving and selling the goods.

Risks for SMEs:

- **For Sellers:** High risk—payment may be delayed or defaulted.
- **For Buyers:** Low risk—they receive goods before payment.
- Difficult to enforce payment collection in foreign jurisdictions.

When to Use:

- With trusted, long-term customers.
- When competitive market conditions demand flexible payment terms.

Mitigation Strategies:

- Use trade credit insurance to protect against defaults.
- Conduct background checks and secure strong contracts.

Documentary Collection

- ❖ An open account is a payment arrangement between a business and customer .
- ❖ Under this arrangement, the customer can buy goods and services on deferred payment basis and then pay the business at later date .
- ❖ The buyer promises to pay the seller within a predetermined number of days and the sellers doesn't restrict the availability.

Process

- The exporter ships the goods and submits shipping documents to their bank.
- The importer's bank releases documents upon payment or acceptance of a time draft.

Risk Factors:

- **For Sellers:** No payment guarantee—importers can refuse to pay.
- **For Buyers:** Less risky than advance payment, but they must pay to obtain goods.
- Bank involvement provides some security but does not guarantee payment.

When to Use:

- When there is an existing relationship between buyer and seller.
- When LCs are too costly or complex.

Letter of Credit

- ❖ A letter of credit is an assurance or guarantee to sellers that they will be paid for a large transaction.
- ❖ Letter of Credits are particularly common in international or foreign exchanges .

How They Work:

- A bank guarantees payment to the seller once all contractual terms are met.
- The buyer's bank issues the LC, and the seller's bank confirms payment upon document verification.

Why LCs Are Secure:

- Banks act as intermediaries, reducing non-payment risk.
- Funds are released only when specific conditions are met.
- Particularly useful in new trade relationships or for high-value shipments.

Risks & Considerations:

- Costly due to bank fees and documentation requirements.
- Strict compliance with terms is necessary—any discrepancies may cause delays or non-payment.

STRATEGIES TO MITIGATE PAYMENT RISKS.

Choosing the Right Payment Method

- Negotiate favorable payment terms (prefer LC or advance payment).
- Use Documentary Collection (D/P or D/A) for safer transactions.

Due Diligence on Buyers

- Conduct a background check on the buyer's creditworthiness.
- Request a bank reference or trade history.
- Use trade intelligence services to check buyer reputation and solvency.

Legal Protections and Contracts

- Draft a clear sales contract specifying:
 - Payment terms
 - Currency and exchange rates
 - Dispute resolution mechanism
 - Delivery terms (Incoterms)
- Work with a trade lawyer to ensure contract enforceability.

STRATEGIES CONT'D...

“

**Ways To Reduce Payment
Risk In Foreign Trade**

Currency Risk Management

- ❖ Use forward contracts to lock in exchange rates.
- ❖ Price products in stable currencies (e.g., USD, EUR).
- ❖ Open a foreign currency account to manage fluctuations

Trade Finance and Insurance

- ❖ Use export credit insurance to protect against buyer default.
- ❖ Work with export financing banks (e.g., NEXIM Bank, Afreximbank).

CHECKLIST FOR SECURE EXPORT PAYMENT



1. Buyer Verification & Due Diligence

- Conduct a background check on the buyer (business registration, financial stability).
- Request trade references from previous suppliers.
- Verify the buyer's creditworthiness using trade intelligence services.
- Confirm buyer details through export advisory services or chambers of commerce.

2. Payment Security & Terms

- Choose a secure payment method (Letter of Credit, Advance Payment, Documentary Collection).
- If using an Open Account, secure trade credit insurance.
- Define clear payment terms (currency, due dates, penalties for late payment).
- Work with a trusted bank to confirm the buyer's ability to pay.

CHECKLIST CONT'D



Foreign Exchange & Currency Risk Management

- Determine the currency of payment and assess forex risk.
- Use forward contracts to lock in exchange rates (if needed).
- Consider invoicing in a stable currency (USD, EUR, GBP).
- Open a foreign currency domiciliary account for transactions.

Shipping & Logistics Security

- Select a reliable freight forwarder or logistics partner.
- Ensure proper packaging and labeling to meet international standards.
- Obtain insurance to cover transportation risks.
- Use trackable shipping methods and obtain proof of delivery.

CHECKLIST CONT'D...

Documentation Compliance

Prepare and verify all export documents, including Proforma Invoice, Bill of Lading/Airway Bill.

Packing List, Certificate of Origin, Phytosanitary or Health Certificate (if applicable)

Export Declaration Form (from the Nigerian Customs Service)

Risk Management & Insurance

Secure export credit insurance to cover payment defaults.

Ensure trade agreements protect against political and economic risks.

Communication & Customer Relationship Management

Maintain open communication with the buyer throughout the transaction.

Provide tracking details and shipping updates.

Address any disputes or quality concerns promptly.

Build long-term trust by ensuring consistency in quality and service.

Common Payment Challenges in International Trade

Non-Payment Issues

- Buyers may default on payment due to financial difficulties or business closures.
- Some buyers may refuse to pay due to contract disputes, dissatisfaction with goods, or bad faith.
- Legal enforcement across borders can be difficult, leading to financial losses for exporters.

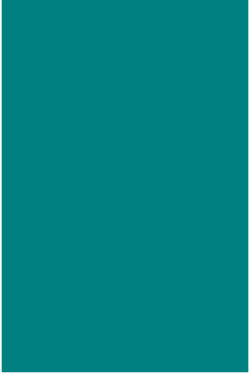
Currency Fluctuations and Forex Risks

- Exchange rate volatility can lead to financial losses if payments are received in a depreciated currency.
- Delayed payments can result in unfavorable exchange rates, affecting profitability.
- Exporters and importers may struggle to hedge against forex risks due to unpredictable market conditions.

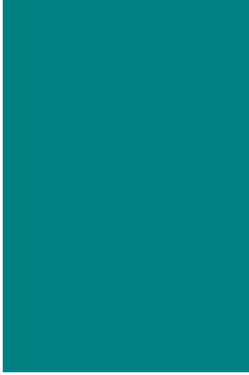
Fraudulent Buyers and Scams

- Some buyers may engage in fraudulent schemes, such as issuing fake payment confirmations or disappearing after receiving goods.
- Scams like phishing, identity theft, and cyber fraud pose significant risks to international transactions.
- Lack of stringent verification processes can make businesses vulnerable to fraudsters.


How Secure Payment Systems Help Address These Challenges



Use of Letters of Credit (LCs): Ensures that payment is made only when agreed conditions are met, providing security for both parties.



Escrow Services: Funds are held by a third party until trade obligations are fulfilled, preventing fraud.



Secure Digital Payment Platforms: Utilizing platforms like PayPal, SWIFT, and fintech solutions ensures encryption, authentication, and traceability.



Foreign Exchange Risk Management Tools: Hedging strategies, forward contracts, and multi-currency accounts help mitigate forex risks.

Conclusion



Mitigating payment risks in export business is essential for sustaining a profitable and secure international business. Exporters can minimize risks of non payment and fraud by conducting thorough due diligence on buyers, choosing secure payment methods and implementing strong contractual agreement.

Thank You

