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bill of exchange, short-term negotiable financial instrument consisting of an order in writing addressed by one person (the seller of goods) to another (the buyer) requiring the latter to pay on demand (a sight draft) or at a fixed or determinable future time (a time draft) a certain sum of money to a specified person or to the bearer of the bill. The bill of exchange originated as a method of settling accounts in international trade. Arab merchants used a similar instrument as early as the 8th century ad, and the bill in its present form attained wide use during the 13th century among the Lombards of northern Italy, who carried on considerable foreign commerce. Because merchants (the buyers) usually retained their assets in banks in a number of trading cities, a shipper of goods (the seller) could obtain immediate payment from a banker by presenting a bill of exchange signed by the buyer (who, in so doing, had accepted liability for payment when due). The banker would purchase the bill at a discount from its full amount because payment was due at a future date; the purchasing merchant's account would be debited when the bill became due. Bills could also be drawn directly on the banks themselves. After the seller received his payment, the bill of exchange continued to function as a credit instrument until its maturity, independent of the original transaction. Bills of exchange are sometimes called drafts, but that term usually applies to domestic transactions only. The term bill of exchange may also be applied more broadly to other instruments of foreign exchange, including cable and mail transfers, traveler's checks, letters of credit, postal money orders, and express orders. Published : April 15, 2024, Updated : July 16, 2024

When businesses engage in international trade, a major concern revolves around receiving timely payments. While offering goods and services on credit can spur business growth, the risk of non-payment often deters companies. To address this challenge and facilitate smoother transactions for exporters, negotiable instruments have become indispensable. These instruments serve as guarantees to sellers that payments, even when extended, will be honored on time. Among these instruments, one notable example is the bill of exchange, a tool for resolving disputes in case of non-payment. They offer a clear record of the transaction terms and obligations, facilitating legal recourse if necessary. Global Acceptance: Due to their widespread use and recognition in international trade, bills of exchange are accepted across borders, currencies, and legal jurisdictions. This universality makes them a versatile and reliable tool for conducting business globally. Format of Bill of Exchange A bill of exchange typically contains the following essential information: Parties Involved: The names and addresses of the parties involved in the transaction, namely the drawer (seller/exporter), the drawee (buyer/importer), and the payee (to whom the payment is to be made). These details establish the contractual relationship between the parties. Amount: The specific amount of money that the drawee is obligated to pay to the payee. This amount is typically stated in both numerical and written formats to prevent discrepancies or misunderstandings. Date and Place of Issue: The date on which the bill of exchange is issued, as well as the place where it is issued. This information is crucial for determining the validity and timeline of the bill. Date of Payment: The date on which the payment is due or the bill matures. This date indicates when the drawee is required to make the payment to the payee. Payment Terms: Any specific terms or conditions related to the payment, such as whether it is payable upon sight (on demand) or at a specific future date, and any applicable interest rates or discounts. Reference Number or Invoice Details: A reference number or other identifying information that links the bill of exchange to the underlying transaction, such as an invoice number or purchase order reference. Signatures: The signatures of the drawer and the drawee, indicating their agreement to the terms and conditions of the bill of exchange. Additionally, there may be endorsements by subsequent holders of the bill, if it has been transferred or negotiated. Legal Clauses: Any additional legal clauses or provisions that may be relevant to the transaction, such as jurisdictional clauses, dispute resolution mechanisms, or special instructions regarding acceptance and payment. These details collectively establish the obligations and rights of the parties involved in the bill of exchange transaction, ensuring clarity, enforceability, and legal validity. Role of the Issuer in a Bill of Exchange A bill of exchange is initiated by the creditor or beneficiary, mandating the debtor or buyer to remit a predetermined sum within a stipulated time frame. As the issuer, the creditor establishes the terms and conditions of the payment obligation, including the amount owed and the due date. This financial instrument serves as a directive from the issuer to the debtor, facilitating secure transactions and ensuring timely payment. Through the bill of exchange, the issuer asserts their right to receive payment, providing a structured framework for commercial dealings while mitigating the risk of non-payment. Key Parties in a Bill of Exchange Three essential parties play distinct roles in facilitating smooth and secure exchanges: Drawer The drawer, often the seller or creditor, initiates the bill of exchange by drafting or authorizing its creation. By doing so, the drawer issues an order directing the drawee to pay a specified amount to the designated payee. Essentially, the drawer functions as the initiator of the financial instrument, setting forth the terms of payment and initiating the transaction. Drawee The drawee, typically the buyer or debtor, is the party upon whom the bill of exchange is drawn. They are obligated to honor the payment directive outlined by the drawer. Upon presentation of the bill, the drawee is legally bound to settle the specified amount to the payee either upon sight (on demand) or at a predetermined future date. The drawee's acceptance signifies their agreement to the payment terms. Payee The payee is the beneficiary designated to receive the payment specified in the bill of exchange. They are entitled to collect the funds owed by the drawee according to the terms of the instrument. In some cases, the payee may also be the drawer, particularly if the bill remains in the possession of the original creditor. However, if the bill is transferred or negotiated to a third party, that individual or entity becomes the payee entitled to receive the payment. Bill of Exchange Types Bills of exchange serve as essential instruments in commercial transactions, offering flexibility and security to traders. Understanding the diverse types of bills is crucial for navigating international trade effectively. Inland Bill An inland bill is drawn and settled within the same country. For instance, if a bill is drafted and paid in India, it qualifies as an inland bill, simplifying transactions within national borders. Demand Bill Demand bills necessitate immediate payment upon presentation without specifying a particular date. Payment is made promptly upon demand, ensuring flexibility for the buyer or drawee to the payee. This documentation strengthens the legal validity of the transaction and facilitates dispute resolution if necessary. Bill of Exchange With a Practical Example Imagine a company based in Germany, called XYZ GmbH, specializes in manufacturing machinery. They have recently supplied a shipment of industrial equipment to a company in Japan, called ABC Corporation. The total value of the machinery is €100,000. Creation of the Bill of Exchange: XYZ GmbH, acting as the seller (drawer), decides to extend credit terms to ABC Corporation, the buyer (drawee). Instead of demanding immediate payment, XYZ GmbH opts to create a bill of exchange to formalize the payment agreement. They drafted a bill instructing ABC Corporation to pay €100,000 to XYZ GmbH within 90 days from the date of the bill. Acceptance by the Drawee: ABC Corporation, upon receiving the machinery and the bill of exchange, reviews the terms and agrees to the payment conditions. They accept the bill, signifying their commitment to paying the specified amount within the agreed timeframe. Negotiation or Discounting: XYZ GmbH may choose to negotiate or discount the bill of exchange to obtain immediate liquidity. They can approach a bank or financial institution and present the bill for discounting. The bank assesses the creditworthiness of ABC Corporation and XYZ GmbH before agreeing to discount the bill. Assuming the bank agrees, XYZ GmbH receives a discounted amount, slightly less than the face value of the bill, providing them with immediate funds to support their operations. Payment and Settlement: As the due date approaches, ABC Corporation prepares to settle the bill. On the maturity date specified in the bill of exchange, they transfer €100,000 to the bank or financial institution, which then remits the funds to XYZ GmbH. This completes the transaction, and XYZ GmbH receives the full payment owed for the machinery they supplied. In this example, the bill of exchange facilitated a smooth and secure transaction between XYZ GmbH and ABC Corporation, allowing XYZ GmbH to extend credit terms while ensuring timely payment. It provided flexibility, liquidity, and assurance to both parties, demonstrating the practical utility of bills of exchange in international trade. Also Read: Documents Required for Import-Export Customs Clearance Difference Between a Bill of Exchange and a Promissory Note This table highlights the key differences between a bill of exchange and a promissory note in terms of parties involved, payment direction, legal standing, commercial use, and other important aspects. In conclusion, the bill of exchange stands as a cornerstone of international trade, providing a reliable framework for secure transactions and mitigating the risks associated with credit sales. Its versatility and legal enforceability make it an invaluable tool for businesses navigating the complexities of global commerce. Whether facilitating payments, accessing funds, or providing evidence of transactions, the bill of exchange plays a pivotal role in fostering trust and reliability among trading partners. With its enduring importance and practical utility, the bill of exchange remains a vital instrument in facilitating seamless trade relationships and driving economic growth on a global scale. Also Read: 9 Documents Generated in Post Export Shipment Banking Activities Today, most trade happens on a credit basis - cash rarely exchanges hands without a bill of exchange. Most, if not all trade in the world balances on promises - the buyer promising to pay the seller at a later date. A bill of exchange is the written form of this promise - and one of the most important instruments in both international and domestic trade. Let's understand how a bill of exchange works, and more. What is a Bill of Exchange? A bill of exchange is a written order from a drawer instructing a drawee to pay a specified amount of money at a specific date. Simply put, a bill of exchange is a note that tells someone to pay a certain amount of money at a later date. Bill of exchange in India is defined by the Negotiable Instruments Act of 1881. Under this act, bill of exchange is defined as "an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument." How does a Bill of Exchange work? A bill of exchange can be drawn between two or three parties. Drawee: the party required to pay the money Drawer: the maker of the bill of exchange Payee: the party that receives the money Why is there a distinction between the party making the bill of exchange and the party receiving the money? In some cases, the party that drew up the bill might transfer the bill of exchange to a third party, in a transaction called an endorsement. Otherwise, the drawer and the payee are the same party - the party that drew up the bill of exchange and stands to receive the money from the drawee. Sample Bill of Exchange Here's a sample bill of exchange drawn up for the sum of Rs 20 lakhs on the 15th of August. This bill of exchange matures three months after the 15th of August - on the 15th of November, 2023. Format of Bill of Exchange Here is the information that a bill of exchange should have: Name and address of drawer Name and address of drawee Amount of money to be paid Date of transaction Date of maturity Signatures of both parties to authorize the transaction Features of Bill of Exchange Bill of exchange must be in writing and is legally binding It can be drawn in any currency and is usually settled in the currency of the country in which it was issued. It is transferable and can be endorsed to another party. It also serves as a guarantee of payment and is usually accompanied by a promissory note. If it is not paid on the due date, the holder can take legal action to enforce the payment. The bill must be signed by both drawee and drawer. Bill of Exchange in International Trade The terms of transactions in international trade can be quite complicated since there are multiple currencies and multiple parties involved - not to mention differences in legal regulations and time zones. In these cases, a bill of exchange becomes very important. The exporter or the seller writes a bill of exchange to the importer, or the buyer. The bill can then be guaranteed by a bank, which becomes a third-party payee. If the importer dishonours the bill and fails to make the payment on the due date, the payee is then liable to make the payment to the exporter. Learn more: How to bring foreign capital to India with RazorpayX Forex Endorsement of Bill of Exchange Bills of exchange are transferable between parties. This process is called endorsement and helps reduce risk to both parties in case of failure of payment. Endorsement of a bill of exchange is the process by which the drawer of the bill transfers their rights to receive payment under the bill to another party. This endorsement is a critical aspect of negotiability for bills of exchange, allowing them to function as a form of payment and credit instrument in business transactions. Promissory Note vs Letter of Credit vs Bill of Exchange Feature Promissory Note Letter of Credit Bill of Exchange Issued by a seller (drawer) to a buyer (drawee) to pay a specified amount to a payee (seller) on a future date or on demand. Parties Involved Maker (borrower) and Payee (lender) Buyer, Seller, and Issuing Bank Drawer (seller), Drawee (buyer), and Payee (seller) Payment Assurance Based on trust and relationship between parties. Ensures payment to seller if terms met; minimizes buyer's risk. Payment may or may not be assured depending on acceptance and financial standing. Payment Date Specified maturity date or on-demand. Payment due upon meeting conditions. Specified due date or on-demand. Usage Often used in informal lending situations. Commonly used in international trade to facilitate secure transactions. Widely used in domestic and international trade for payment. Negotiability Can be negotiable or non-negotiable, depending on terms. Non-negotiable, only parties involved can use it. Can be negotiable or non-negotiable, depending on terms. Types of Bill of Exchange Sight Bill of Exchange Payable on demand or on a set date after the bill is presented. Time Bill of Exchange Payable on a set date and not on demand. Usance Bill of Exchange Payable after a set period of time, typically several months. Trade Acceptance Bill of Exchange Used in international trade and is generally accepted by the seller of goods to the purchaser. Accommodation Bill of Exchange Created for the purpose of providing financial accommodation to a third party such as a family member or friend. Bill of Exchange Terms Let's have a look at the important bill of exchange terms. Drawer: The person who issues or creates the bill of exchange. Drawee: The person or entity who is ordered to pay the amount specified in the bill of exchange. Payee: The person or entity to whom the payment is to be made. Acceptance: The act by the drawee of agreeing to pay the amount specified in the bill of exchange. Endorsement: The act of transferring the ownership of the bill of exchange to another person or entity. Due date: The date on which the payment is due to the payee. Maturity date: The date on which the payment becomes due and payable. Discounting: The process of selling the bill of exchange to a bank or financial institution at a discounted price. Bill of exchange amount: The amount of money specified in the bill of exchange. Noting: The act of recording any protest or dishonour of the bill of exchange by the drawee or payee. Exploring bill of exchange for trade transactions? You might need an escrow account. Click below to speak with an escrow expert to get started with the safest, most seamless escrow account on the market. Speak with our Escrow Experts Frequently Asked Questions A bill of exchange is a written order from one person (the drawer) to another person (the drawee) to pay a specified sum of money to a third person (the payee) at a specified date or on demand. The parties involved in a bill of exchange are the drawer (the issuer), the drawee (the person/entity to whom the bill is addressed), and the payee (the person/entity to whom the payment is to be made). The different types of bills of exchange are demand bills, sight bills, time bills, usance bills and acceptance bills. The legal implications of bills of exchange depend on the jurisdiction in which the bill is issued and the laws governing it. Generally, a bill of exchange creates a legally binding obligation between the parties involved, and the drawee is obligated to make the payment to the payee as specified in the bill. An acceptance bill is a type of bill of exchange in which the drawee acknowledges the payment obligation and agrees to pay the bill at a specified date. Definition A bill of exchange is similar to an invoice presented when goods or services are exchanged. A bill of exchange is a written order used primarily in international trade that binds one party to pay a fixed sum of money to another party on demand or at a predetermined date. Bills of exchange are similar to promissory notes; individuals or banks can draw them and are generally transferable by endorsements. A bill of exchange binds one party to pay a fixed sum of money to another party on demand or at some point. A bill of exchange is used in international trade to help importers and exporters fulfill transactions. While a bill of exchange is not a contract, the involved parties can use it to specify the terms of a transaction, such as the interest rate. Investopedia / Laura Porter A bill of exchange is used in international trade to pay for goods or services. While a bill of exchange is not a contract, the involved parties can use it and its format to fulfill a contract. It can specify that payment is due on demand or at a specified future date. The period between billing and payment is called the usance. It's often extended with credit terms, such as 90 days. A transaction can involve up to three parties. The drawee is the party that pays the sum specified by the bill of exchange. The payee is the one who receives that sum. The drawer is the party that obliges the drawee to pay the payee. The drawer and the payee are the same entity unless the drawer transfers the bill of exchange to a third-party payee. Bills of exchange generally do not pay interest, making them, in essence, post-dated checks. They may accrue interest if not paid within an agreed timeline, and the rate must be specified on the instrument. A bill of exchange must be accepted by the drawee to be valid. Bank Draft: A bill of exchange issued by a bank. The issuing bank guarantees payment on the transaction. Trade Draft: Bills of exchange issued by individuals. Sight Draft: Funds are paid immediately or on demand. In international trade, a sight draft allows an exporter to hold the title to the exported goods until the importer takes delivery and immediately pays for them. Time Draft: Funds are paid at a set date in the future. A time draft gives the importer a short amount of time to pay the exporter for the goods after receiving them. Suppose Company ABC purchases auto parts from Car Supply XYZ for \$25,000. Car Supply XYZ draws a bill of exchange, becoming the drawer and payee in this case. The bill of exchange stipulates that Company ABC will pay Car Supply XYZ \$25,000 in 90 days. Company ABC becomes the drawee and accepts the bill of exchange, and the goods are shipped. In 90 days, Car Supply XYZ will present the bill of exchange to Company ABC for payment. The bill of exchange was an acknowledgment created by Car Supply XYZ, the creditor, to show the indebtedness of Company ABC, the debtor. Checks are payable on demand, while a bill of exchange can specify that payment is due on demand or at a specified future date. Unlike a check, a bill of exchange is a written document outlining a debtor's indebtedness to a creditor. Bills of exchange are used in international trade because they help buyers and sellers deal with the risks associated with exchange rate fluctuations and differences in legal jurisdictions. The difference between a promissory note and a bill of exchange is that the latter is transferable and can bind one party to pay a third party not involved in its creation. Banknotes are common forms of promissory notes. A bill of exchange is issued by the creditor who orders a debtor to pay a particular amount within a given period. A debtor issues a promissory note with a promise to repay money. Bills of exchange help facilitate the process of international trade by stipulating payment from one party to another at a specified date. They are not a contract but can be used to fulfill the terms of a contract. Definition A bill of exchange is similar to an invoice presented when goods or services are exchanged. A bill of exchange is a written order used primarily in international trade that binds one party to pay a fixed sum of money to another party on demand or at a predetermined date. Bills of exchange are similar to promissory notes; individuals or banks can draw them and are generally transferable by endorsements. A bill of exchange binds one party to pay a fixed sum of money to another party on demand or at some point. A bill of exchange is used in international trade to help importers and exporters fulfill transactions. 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