

In India, Bills of Exchange are governed by the Negotiable Instruments Act, 1881, specifically defined in Section 5 as a written, unconditional order by a drawer to a drawee to pay a certain sum to a specific person or bearer, with essential elements like writing, signatures, certainty of parties/amount, proper stamping, and an unconditional order. They function as legally binding financial instruments for credit transactions, especially in trade, ensuring payment assurance for sellers and credit for buyers, and can be transferred, with legal recourse available for non-payment.

Key Provisions under the Negotiable Instruments Act, 1881:

Definition (Section 5): A written, unconditional order, signed by the maker, directing a person to pay a certain sum of money to a specified person or bearer.

Essential Characteristics:

Must be in writing and signed by the drawer.

Drawer, drawee (payer), and payee must be certain.

Sum payable must be certain (can include interest/exchange rates).

Order must be unconditional (not dependent on future events, though time for payment can be specified).

Must be properly stamped.

Parties Involved: Drawer (creator), Drawee (ordered to pay), Payee (receives payment).

Acceptance: The drawee must "accept" the bill (usually by signing) to become liable for payment.

How They Work:

Creation: A seller (drawer) draws a bill on a buyer (drawee) for goods/services, ordering payment on a future date.

Acceptance: The buyer signs the bill, agreeing to pay.

Maturity: On the due date, the bill is presented for payment.

Transferability: The holder of the bill can transfer it to others (e.g., to get cash or pay debts), with a "holder in due course" getting strong legal protection.

Importance:

Facilitates credit sales and modern commerce.

Provides security for sellers and time for buyers.

Crucial in international trade for managing payment risks.

Legal Enforcement:

If unpaid, the aggrieved party (holder) can take legal action under the Act.

Failure to pay makes the instrument dishonored, triggering legal remedies.

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# Bill of Exchange: What it is, how it works, Features, Types, Format, and Examples

All you need to know about bills of exchange.

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A bill of exchange often includes details such as the amount to be paid, the date of payment, and the parties involved. Bills of exchange are commonly used in trade finance to bridge the gap between the shipment of goods and the receipt of payment, ensuring that sellers receive payment and buyers obtain goods on credit. This instrument is crucial in maintaining the smooth flow of international commerce by mitigating risks and providing legal recourse in the event of non-payment. Additionally, understanding the **working capital cycle** is essential in leveraging instruments like bills of exchange effectively, and for businesses looking to enhance their financial position, **checking your business loan** eligibility can provide further opportunities for growth and stability.

## What is a bill of exchange?

A bill of exchange is a legal financial instrument widely used in trade, especially in international transactions, to guarantee payment between parties. It is a written agreement where one party commits to paying a specified amount to another, either on demand or at a future date. This document acts as a safeguard against payment risks often encountered in cross-border trade. To manage these tools effectively, businesses need to understand **capital structure** and how it affects financial decisions. This is especially important for entrepreneurs in international business, as it plays a key role in decision-making and financial leverage in **entrepreneurship**. At times, businesses might also require additional financial support, and **applying for a business loan** could be a strategic way to address cash flow needs during such transactions.

Issued by banks or individuals, a bill of exchange can be transferred to others through endorsements, offering both flexibility and security in business dealings. Essentially, it streamlines trade by formalising payment obligations, fostering trust, and ensuring reliability between trading partners.

## Characteristics of Bill of Exchange

A bill of exchange is a legal document used in business that can be transferred from one person to another. It acts like a promise to pay money and is treated as a movable property.

It has three key features:

### 1) Easy to transfer:

A bill of exchange can be passed on just by handing it over. This means that ownership of the bill changes as soon as it is delivered. However, if the bill is not made out to the bearer (the person holding it), and it is given with a signature on the back (called indorsement), the new holder only gets the rights that the previous

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protected from most problems related to how the bill was handled earlier. The law assumes that most people holding a bill of exchange are holders in due course.

### 3) No need for payment or exchange at the time of transfer:

The bill of exchange can be legally transferred even if nothing is given in return (like money or goods) at the time. While this could allow the person who is supposed to pay (drawee) to refuse payment, the original owner of the bill cannot say the transfer was invalid just because no money or goods were exchanged.

## Functions of Bill of Exchange

Bills of exchange are important documents used in international trade and finance.

They serve three main purposes:

#### 1. A way to make payments in global trade:

In long-term international deals, exchange rates between currencies can change a lot, which may lead to losses. A bill of exchange helps reduce this risk by locking in a fixed payment amount, giving both sides more certainty.

#### 2. A way to raise money:

When a bill of exchange mentions a future date for payment, the seller (drawer) can sell the bill to a third party, usually a bank, for immediate cash. This process is called discounting. The third party then becomes the new holder and will collect the payment from the buyer (drawee) when the time comes.

#### 3. Proof that money is owed:

A bill of exchange is also a written record showing that the buyer (drawee) has to pay the seller (payee) a certain amount.

## Endorsement of Bill of Exchange

Bills of exchange can be transferred from one person to another. This transfer is called endorsement, and it helps reduce the risk for both parties if payment is not made. Moreover, understanding **network marketing** can provide insights into innovative ways businesses extend credit and manage endorsements, particularly in entrepreneurial ventures that rely on networking.

Endorsement is when the person who issued the bill (the drawer) gives their right to receive payment to someone else. This process is important because it makes bills of exchange negotiable, meaning they can be used as a way of making payments or obtaining credit in business dealings.

## Importance of bill of exchange

The bill of exchange plays a pivotal role in international trade and finance for several key reasons:

- **Facilitating trade:** By ensuring secure payment, bills of exchange simplify commercial transactions. They allow businesses to extend credit terms to buyers while guaranteeing payment, thereby boosting trade activities.
- **Mitigating risks:** Exporters face significant risks of non-payment or delayed payment in cross-border transactions. A bill of exchange reduces these risks by creating a legally binding obligation for the

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Bill of exchange is crucial for businesses to calculate and allocate resources effectively.

- **Serving as a credit instrument:** For buyers, bills of exchange act as a credit tool, allowing deferred payments while still securing the required goods or services. This flexibility can facilitate larger deals and strengthen business relationships.
- **Providing legal protection:** As enforceable legal documents, bills of exchange offer a clear framework for resolving disputes in cases of non-payment. They serve as evidence of transaction terms and payment obligations, supporting legal recourse if needed.
- **Enabling global acceptance:** Widely recognised across borders, currencies, and legal systems, bills of exchange are a trusted and versatile instrument for conducting business in the international marketplace.

## How does a bill of exchange work?

Here's how a bill of exchange works:

- **Drawing up the bill:** The drawer creates the bill of exchange, detailing the amount, the drawee, and the payee.
- **Acceptance:** The drawee accepts the bill by signing it, acknowledging the obligation to pay.
- **Endorsement:** The bill can be endorsed to another party, making it transferable.
- **Discounting:** The payee can sell the bill to a bank at a discount for immediate cash. Learn about the **cost of capital** to understand how businesses manage such transactions efficiently.
- **Presentment:** The bill is presented to the drawee for payment on the due date.
- **Payment:** The drawee pays the amount to the holder of the bill.
- **Dishonour:** If the drawee fails to pay, the bill is dishonoured, and legal action can be taken.
- **Noting and protesting:** In case of dishonour, the bill is noted and protested to create evidence for legal proceedings.

## Features of a bill of exchange

- **Negotiability:** This can be transferred to another party.
- **Unconditional order:** Clear instructions to pay a specified amount.
- **Fixed amount:** Clearly stated sum to be paid.
- **Specified date:** Payment date or on demand.
- **Acceptance:** Requires drawee's agreement.
- **Endorsement:** Allows transfer of ownership.
- **Discounting:** Can be discounted for immediate cash.
- **Legal enforceability:** Provides legal recourse in case of non-payment.
- **Documentation:** Often accompanies trade documents.
- **Flexibility:** Used in various types of transactions.

## Types of bills of exchange

- **Demand bill:** Payable immediately upon presentation.
- **Usance bill:** Payable after a specified period.
- **Documentary bill:** Accompanied by shipping documents.



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Recommendation EMI drawn for lending money, not related to goods sold.

## Format of bill of exchange

- **Header:** Title stating it is a bill of exchange.
- **Date:** When the bill is drawn.
- **Amount:** The sum to be paid, both in figures and words.
- **Drawer details:** Name and address of the drawer.
- **Drawee details:** Name and address of the drawee.
- **Payee details:** Name and address of the payee.
- **Payment terms:** Date of payment or terms if on demand.
- **Acceptance:** Space for drawee's acceptance signature.
- **Endorsements:** Area for endorsements if the bill is transferred.

## Bill of exchange terms

- **Drawer:** The party who creates the bill.
- **Drawee:** The party on whom the bill is drawn.
- **Payee:** The party to whom payment is to be made.
- **Acceptance:** Drawee's signed agreement to pay.
- **Endorsement:** Transfer of the bill to another party.
- **Discounting:** Selling the bill to a bank for less than its value.
- **Dishonour:** Failure of the drawee to pay.
- **Noting:** Recording the non-payment officially.
- **Protesting:** Legal certification of dishonour.
- **Maturity:** The due date for payment.

## Example of a bill of exchange

A company in India exports goods to a buyer in the UK. The Indian exporter draws a bill of exchange on the UK buyer for £10,000, payable in 90 days. The UK buyer accepts the bill by signing it, and agreeing to pay the amount on the due date. The exporter can then either wait for 90 days to receive payment or discount the bill at a bank for immediate cash. This process demonstrates the interconnectedness of the **business environment** and financial tools like bills of exchange.

## Advantages of a bill of exchange

- **Credit facility:** Provides a credit period to buyers.
- **Security:** Acts as a promise to pay, reducing payment risk.
- **Negotiability:** Can be endorsed and transferred to others.
- **Discounting:** Can be sold to a bank for immediate cash.
- **Legal protection:** Offers legal recourse in case of non-payment.
- **Flexibility:** Can be used for different types of transactions.
- **Record-keeping:** Provides documented evidence of the transaction.
- **Trade facilitation:** Smoothens international trade by assuring payments.
- **Cash flow management:** Helps in managing business cash flows efficiently.

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- A bill of exchange is issued by the creditor or beneficiary, instructing the debtor or buyer to pay a specific amount within a designated timeframe.
- The creditor, as the issuer, defines the terms of the payment obligation, including the due amount and payment deadline.
- This document acts as a directive from the issuer to the debtor, promoting secure and reliable financial transactions.
- It provides the issuer with a formal right to claim payment, ensuring a structured framework for commercial dealings.
- By establishing clear payment terms, a bill of exchange mitigates the risk of non-payment and supports smoother trade operations.

### Parties of a bill of exchange

- **Drawer:** The person who writes and issues the bill.
- **Drawee:** The person or entity on whom the bill is drawn and who is ordered to pay.
- **Payee:** The person or entity to whom payment is to be made.
- **Endorser:** The person who transfers the bill to another party.
- **Endorsee:** The person to whom the bill is endorsed.
- **Holder in due course:** A person who holds the bill for value and in good faith.

### Difference between Cheque and Bill of Exchange

Cheque	Bill of exchange
A cheque is a written order from a bank account holder to the bank, asking it to pay a certain amount to the person named on the cheque or to the person holding it	A bill of exchange is a written order from one person (the drawer) to another (the drawee), asking them to pay a specific amount to a third person (the payee) on a set date
A cheque is always drawn on a bank	A bill of exchange can be drawn on a bank or any other person or organisation
A cheque is always payable on demand (immediately)	A bill of exchange may be payable on demand or on a specific date in the future
It is mainly used for transactions between individuals or between individuals and businesses	It is mainly used for business transactions between companies

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A cheque is a simple and easy-to-use instrument	A bill of exchange is more complex and requires greater understanding and expertise
It is typically used for small personal transactions and payments	It is used for larger business transactions and commercial payments
A cheque is always paid in cash	A bill of exchange can be paid either in cash or in kind (goods or services)
Once a cheque is issued, the drawer cannot stop payment	In the case of a bill of exchange, the drawer can stop the payment before the due date
A cheque can be dishonoured due to reasons like insufficient funds, signature mismatch, etc.	A bill of exchange can be dishonoured if the drawee does not accept it before the due date

## What are some differences between a bill of exchange and a cheque?

A bill of exchange and a cheque are both financial instruments used for payment, but they have distinct differences. Firstly, a bill of exchange is generally used in international trade and can be drawn on any party, while a cheque is a specific type of bill of exchange drawn on a bank. Secondly, a bill of exchange requires acceptance by the drawee before it becomes binding, whereas a cheque does not require acceptance as it is payable on demand.

Thirdly, the payment term for a bill of exchange can be at a future date or on demand, whereas a cheque is always payable on demand. Fourthly, a bill of exchange can be used as a financing tool by being discounted or endorsed to a third party, while a cheque is primarily used for straightforward payments. Lastly, the legal recourse for non-payment differs: a bill of exchange involves legal procedures for dishonour and noting, whereas a cheque can lead to criminal liability under certain jurisdictions.

## What is a promissory note?

- **Written promise:** A promissory note is a written promise to pay a specific amount of money.
- **Unconditional:** The promise to pay is unconditional.
- **Two parties:** Involves a maker (promisor) and a payee (promisee).
- **Fixed amount:** Specifies the amount to be paid.
- **Specified time:** Payment is due either on demand or at a future date.

Importance of a promissory note in a bill of exchange





- Flexibility: Can be tailored to specific terms and conditions.
- **Simplifies transactions:** Makes financial dealings more straightforward.
  - **Record-keeping:** Provides a clear record of the debt.
  - **Dispute resolution:** Helps in resolving disputes over payments.
  - **Facilitates trade:** Encourages trade by providing a secure payment mechanism.
  - **Supports business loans:** Used as collateral for business loans.

What are the differences between a bill of exchange and a promissory note

This table outlines the key distinctions between a bill of exchange and a promissory note, focusing on aspects such as the parties involved, payment direction, legal standing, commercial applications, and other essential features.

Feature	Bill of Exchange	Promissory Note
Parties involved	Three parties: Drawer, Drawee, Payee	Two parties: Maker, Payee
Direction of payment	Drawer directs the drawee to pay the payee	Maker unilaterally promises to pay the payee
Payment terms	Usually used for commercial transactions with a fixed maturity date	Can be used for various purposes with flexible payment terms
Acceptance	Requires acceptance by the drawee to become binding	Unilateral promise by the maker is binding
Transferability	Can be transferred to third parties through endorsement	Typically non-transferable unless specified
Legal standing	Governed by the Bills of Exchange Act in many jurisdictions	Governed by general contract law and negotiable instruments law

Obligation	Imposes a primary obligation on the drawee to make payment	Imposes a primary obligation on the maker to make payment
Format	More formal and structured with strict requirements	Less formal and can vary in format
Examples	Trade transactions, credit purchases, financing arrangements	Personal loans, mortgages, IOUs

Conclusion

Bills of exchange and promissory notes are vital tools in trade and finance, ensuring secure transactions and fostering trust. However, businesses often need additional funding to manage expenses effectively. A business loan can bridge this gap.

- Easy applications with minimal paperwork
- High loan amounts up to Rs. 80 lakh
- Quick disbursal within 48 hours
- Affordable interest rates starting at 14% p.a.

Leverage a business loan to support your financial needs and drive growth effortlessly.

Frequently asked questions

What do you mean by a bill of exchange? 

A bill of exchange is a written instruction from one person (the drawer) to another person (the drawee), asking them to pay a certain amount of money to a third person (the payee) on a specific date or when requested.

What is an example of a bill exchange? 

Who draws a bill of exchange? 

Who will issue the bill of exchange? 