Foreign Trade & Foreign Trade Financing

BY

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The finance function in the foreign trade is similar to the finance function in any other economic activity, but with this essential difference—that in international business the 'seller' and the 'buyer' firms located in different parts of the world run business risks that are somewhat at variance with the risks undertaken by the buyer and the seller located in the same country. The personal relationship and the trust that results from dealing with customers face to face regularly are not present to the same degree in foreign trade. There are also political and commercial risks which are difficult to evaluate from a distance.

The finance is needed for both exports and imports. The requirements of finance may be for a short term, medium term and long term. Short term credit includes credit up to 180 days; credits for periods ranging between six months and five years are normally classified as medium term while those beyond five years are treated as long term credits[1]

The present chapter deals with a detailed discussion on the financing of exports and imports in the short period and the long period. The first part of the chapter deals with the financing of the exports. Financing of imports is discussed in the second part of the chapter.

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1. S. K. Verghese — Export Credit and Credit Insurance Facilities in India and Abroad — P. 4, Indian Institute of Foreign Trade, 1970.

Financing of Exports

The areas where finance is needed by an exporter are as follows :

(a) Procuring raw materials and components and manufacturing the product i.e. 'Pre-shipment Finance' or 'Packing Credit'.

(b) Refinance facilities so as to get the proceeds of export bills at the time of negotiation of export documents soon after shipping the goods, i. e. 'Post Shipment' finance.

(c) Availability of funds until the export benefits are realized and refinance facilities for long term credits offered for the export of products.

Pre-Shipment Finance - Packing Credit :

Packing credit relates to the requirement of credit for purchase of raw materials, its processing and packing. Different countries have different arrangements for packing credit. There are special facilities in Japan for financing exports at the pre-shipment stage. In Japan credit is provieed by commercial banks by means of 'export advance bills'. Under the export advance bill scheme, an exporter who has entered in a contract with an importer abroad is accommodated with advance money, purchasing funds and other kinds of expenditure necessary for exporting his goods.[1] This facility is available to exporters of both goods and services. The advance is normally available for a period up to six months.[2] In 'Finance pre-shipment' credits take the form of discounting of bills drawn by the exporter. The credit may be either 'revolving' or 'specialised'. In India, preshipment finance is known as packing finance. It is provided by commercial banks in the form of cash or loan up to a period of six months.

Generally, a packing credit is granted against an irrevocable letter of credit, established in favour of the exporter by the importer or against a firm export contract entered into by the exporter with a foreign buyer of good standing. A packing credit advance can be by way of pledge or hypothecation of goods or against a trust receipt.

Post Shipment Finance—Short Term :

Normally exporters offer payment facilities of 30 days, 60 days or 90 days from the date of the bill to the importers. In such a situation a '*Usance Bill*' is drawn.[3] The importer has to accept the Usance bill before he can get the custody of the documents.

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1. S. K. Verghese — Export Credit and Insurance Facilities in India & Abroad, p. 2.
2. Japan Foreign Trade News — Japan Trade News Publishers Ltd., No. 212, p. 98.
3. Usance bill is a draft for payment on a specified date of presentation. To become legally acceptable it must bear a stamp duty.

Thus, it is evident that a definite time period elapses before an exporter realises full payment for the goods exported. An exporter would like to realise the payment at the earliest. For this, he can approach his bank for Post Shipment finance. The banks can arrange the post shipment finance either by way of negotiation of bills or by way of discount or purchase of bills.

Negotiation of Bills :

When an exporter receives an *irrevocable letter of credits*[1] in his favour covering a particular shipment, he can draw a draft or bill under the credit and hand it over to his bank together with shipping documents. If the bank is satisfied that the documents are drawn stricktly in compliance with the terms of the letter of credit, the bank can negotiate the bill and pay the proceeds to the exporter.

Discount or Purchase of Bills :

In case a shipment is not covered by a letter of credit and the exporter has shipped the goods against a firm contract received by him from the buyer, the exporter's bank may extend post shipment finance to its customer by purchasing the bill of exchange or draft on the importer and the related shipping documents. Thus, the exporter will be able to receive the proceeds immediately. The amount paid may not be the full amount of the bill, but only a part of it.

Thus, the short term credits at the post shipment stage are generally made available through negotiation of bills or advances tendered for collection abroad. The range of facilities available for acceptance and discount of bills varies from country to country. In the U. K., a wide range of institutions such as deposit banks, accepting houses and discount houses provide or facilitate provision of short term credits. In Japan and India, commercial banks constitute the main source of short term export credits. The commercial banks in both the countries, in turn, can rediscount these bills from the central bank of the country.

Medium and Long-Term Export Credits :

Medium and Long Term export credits granted to foreign buyers generally take the form of suppliers' credits. Suppliers' credits are granted by suppliers to buyers abroad

1. An 'irrevocable letter of credit' is a definite undertaking on the part of an issuing bank and constitutes the undertaking of the bank to the beneficiary or, as the case may be, to the beneficiary and the bonafide holders of drafts drawn and/or documents presented thereunder, that the provisions for payment, acceptance or negotiations contained in the credit will be duly fulfilled provide that all the terms and conditions of the credit are complied with. (Article 2 of Uniform Customs and Practice for Documentary Credits).

and the former in turn finance the credit by borrowing from a financial institution against promissory notes signed by the buyer or by the negotiation of such bills or notes. A part of the trade in capital goods is also financed by 'buyers' credits. In U. K. and France, the medium and long term export credits are provided by commercial banks. In Japan, The Export-Import Bank of Japan provides suppliers' credits with maturities in excess of six months, in collaboration with commercial banks. Besides, the Exim bank also provides buyers' credit and credit for financing overseas investment and overseas technical services. The Overseas Economic Corporation Fund, established in 1960 extends loans to Japanese enterprises which independently or in collaboration with others, undertake development projects in overseas areas for which it is difficult to obtain funds from the Export-Import Bank or from private financial institutions. In India, the medium term export credit is being provided by the commercial banks. Refinancing facilities are being provided by the Industrial Development Bank of India (IDBI) in respect of export credits with a maturity of more than six months. In 1968, the IDBI introduced a scheme for direct participation in medium term export credits in collaboration with commercial banks. The long term finance, in India, is being provided by the Exim Bank of India.

Export Credit Insurance Facilities :

It is generally recognized that selling abroad is more risky than selling within the country. Apart from the difficulty of obtaining reliable credit information on distant buyers and legal redress in foreign countries in the event of default, the risks arising from political upheavels such as war, civil war, and transfer, difficulties are real and significant in export business. In the developed countries, it has been found necessary to devise facilities which protects exporters against credit risks. In their anxiety to promote exports, governments in these countries have taken active part in instituting export credit insurance facilities. The chief advantage of export insurance is that it enables exporters to sell on deferred credit terms without at the same time having to shoulder credit risks. In addition, credit insurance policies enhance the bankability of the export credit instruments. These policies and the direct guarantees, which protect banks against credit risks help exporters in obtaining finance from banks and other financial institutions.

FINANCING OF IMPORTS

There are many common features in the financing of imports and exports. They are, so to say, two sides of the same coin. Similar to the export credit, the import credits can be for a short period and long period.

1. Buyers' Credits are granted by a credit institution in the suppliers' country to foreign buyers directly in order to enable them to make purchase on a cash basis.