SYLLABUS

Class – B.Com (FT) II Year

Subject – Finance & Procedure

Unit I	Export Payments terms Including Letters of Credit and their operation. Pre shipment and post shipment finance
Unit II	Import Finance, Letter of Credit and operation there of Role of Bank in foreign trade Finance
Unit III	Obtaining ECGC policy and filling claims. Obtaining long term export credit from EXIM/Bank.
Unit IV	Costing and Pricing for Export.
Unit V	International Capital Markets, Foreign exchange rates, exchange fluctuations and obtaining forward cover.

UNIT-I
METHODS OF PAYMENT INTERNATIONAL TRADE

1) Advance Payment –
- Money is paid first & then goods are sent.
- Suitable for sellers market or sellers monopoly situation.
- Based on trust of buyers on exporters.
- Don't sent advance if you don't know sellers.
- Ask for credit report of exporter.
- If product does not come to India against advance payment it is a criminal offence under Anti Money Laundering Act.
- 24 hours buyers risk.
- Buyers credit – Buyers organize for funds to procure goods.

2) Open Account –
- Market condition – Buyers market or recession in market (over supply and no buyer condition)
- Goods are sent first for selling, if sold payment is made for the goods sold & remaining goods sent back to exporter.
- Based on seller trust on buyers.
- Suppliers credit – When supplier organize for funds to send/selling of goods. Suppliers money at risk.

3) Collection Bills –
- Goods shipped to importer.
- Exporter presents documents to his bank along with bill of exchange for collection of payment/acceptance.
- Collecting bank which forwards the documents for collection/acceptance of the draft to the importers bank.
- Remitting bank – which forwards the documents for collection/acceptance the draft to the importer.
- Based on limited trust of seller on Buyer.
- 24 hrs suppliers risk.
- Bank acts as service agent/collecting agent and charges fee for services provided.
- Two types
  - i) Documents against payment (D/P) – Payment against sight draft sent along with documents.
  - ii) Documents against acceptance (D/A) – Remitting Bank hands over documents to the importer only upon acceptance of accompanying draft. Importer agrees to pay on due date. Under D/A always a period of credit (usance period), on expiry of which importer is required to make payment.

4) Letter of credit (Documentary credit)
- L/C also called as documentary credit
- Bank acts as committing agent.
- Bank charges L/C commission (for commitment and usance charge for the period.

FOREIGN TRADE FINANCING AND PROCEDURE
Letter of Credit (UNIT-1)

In international marketing, while there are very few sales on barter basis, cash and carry transactions are almost non-existent. Credit is inherent to some extent in all export sales and has assumed such importance that completion is no longer confined to quality. Price or delivery schedule of products but on the term and period of credit granted to foreign buyers. There are various methods of payment or methods of financing which exporters should know before deciding on the term for receiving payment against exports.

The best and the most prevalent system of receiving payment against exports is through the method of Letter of credit (L/c). It is an instrument issued by a bank in favour of the exporter (known as beneficiary) whereby the issuing bank undertakes to pay to the beneficiary a certain amount of money against delivery of specified documents within a said period of time. Hence it is also known as documentary credit. Letter of credit is more commonly referred to as the most appropriate and currently adopted practice in international transactions.

L/c is an signed instrument containing an undertaking by the importer bank to pay to seller, the stipulated amount on shipment of specifying goods and subject to compliance with the stated terms and condition.

L/c is one of the most common instrument for setting payment between buyer and seller.
A L/c is demanded by the seller as a guarantee of the payment before affecting shipment.

Definition: “Letter of credit is a payment assurance from the issuing bank to the beneficiary which guarantees the payments to the beneficiary provided he fulfills all the conditions mentioned in the contract in right order and at the right time”.

“Among all the international document letter of credit considered as the most essential one. It is also very important document for custom clearance of export and import consignment.”

Parties to a letter of credit –

1) Importer/Applicant –
Applicant basically is a person who applies for letter of credit in the bank, he is the opener whose behalf the letter of credit is issued by Bank. Applicant is the importer and his credibility is very necessary in bank.

2) Applicants/Importers (Bank)/Issuing Bank –
Issuing bank is the Bank, which is in the importers country issues or opens the letter of credit on behalf of the importers.

3) Exporter/Beneficiary –
Exporter is the beneficiary of the letter of credit who is entitled to receive the payment of its bills according to the terms of credit.

4) Exporters Bank –
The bank who negotiates with exporter and provide him payment of shipment.

5) Confirming Bank –
It is the bank usually a branch or correspondent of the opening bank through which the credit is advised to the exporter. If it merely forwards the credit without any obligation on its part, it is called the Advising or Notifying Bank.

6) Negotiating Bank –
The Bank, which negotiates the Beneficiary bill under the credit and pays for it is known as paying/negotiating bank.

Contents of Letter of Credit –
1. Correct and complete name and address of the beneficiary (exporter)
2. Correct and complete name and address of the applicant (importer)
3. Type of the L/C
4. Amount of L/C
5. How the credit shall be available, i.e. by sight payment, deferred payments, acceptance or negotiation.
6. Name of the nominated bank, which shall make the payment to the beneficiary.
7. The name of the drawee on the draft and the tenor of the draft.
8. Term of delivery: FOB, CFR, CIF etc.
9. Description of goods, quantity and unit price.
10. List of documents required to be submitted by the beneficiary.
11. Port of discharge and place of final destination.
12. Status of transshipment; whether allowed or not.
13. Status of partial shipment; whether allowed or not.
14. Last date of sending shipment.
15. Date and place of expiry of the L/C
16. Time period for the presentation of the documents for negotiation by the beneficiary after the dispatch of the shipment.
17. Transfer of the L/C; whether allowed or not.
18. Mode of advice of the L/C; by mail or teletransmission.

Procedure/Steps Involved in L/C
1. Importer (opener) has concluded a purchase conduct for buying of certain goods with his overseas supplier who wants payment by a letter of credit. The importer asks his bank to open a letter of credit in favour of his overseas supplier (exporter).
2. After the request from the importer, bank consider the proposal his bank open its letter of credit in favour of the overseas supplier (exporter).
3. The advising bank can be intermediary bank in exports country which receives credit from the opening bank and after satisfying itself about the authenticity of the credit, it forwards the same to the beneficiary.
4. After receiving the credit form the advising bank the exporter checks it to ensure that it confirms to the terms of sale of contract and if necessary, asks the importer to effect amendments to the credit then proceeds to effect the shipment of the goods.
5. After the shipment is effected the exporter prepares the documents and draws his bill under the letter of credit for obtaining payment from the negotiating bank.
6. After getting the documents and bills from the exporter the negotiating bank checks them with letter of credit terms and condition and if in order, negotiates the bill payable to the exporter.
7. The importer's bank receives the bill and documents from negotiating bank (exporter's bank) checks them and if found in order, reimburses of, if reimbursement is obtained already confirms it to the negotiating bank. The importers bank presents the bill for acceptance/payment to the importer.
8. The importer receives the bill, checks the documents and accepts/pays the bill. On acceptance/payments importer gets the shipping documents covering the goods purchased.

Types of L/C
1. **Revocable L/C** – A revocable letter of credit on amended or cancelled by the issuing bank at any moment without prior notice to the beneficiary. The credit does not constitute a legal binding

between the bank or banks concerned and the beneficiary because such a creditability be modified or cancelled at any moment without prior notice to the beneficiary.

2. **Irrevocable Letter of Credit** – An irrevocable letter of credit constitutes a definite undertaking of the issuing bank for the payment of the bills drawn under it. The L/C can neither be modified nor cancelled without prior approval of the beneficiary concerned and it is, therefore, widely accepted.
3. **Confirmed L/C** – When an issuing bank authorizes or request another bank to confirm its irrevocable L/C. A letter from the confirming bank added its confirmation. Such a confirmation constitutes a definite undertaking/guarantee of the confirming bank, then it can not claim to the exporter if issuing bank fails to give the payment.
4. **Unconfirmed L/C –** Unconfirmed letter of credit is one, which is not supplemented by additional guarantee from a bank in exporters' country.
5. **With Recourse L/C** – In the case of this L/C. if the overseas buyer fails to make payment with in a specified period then the negotiating or paying bank can ask the beneficiary/exporter for the refund of the payment made under the L/C.
6. **Without Recourse L/C** – In this L/C the paying bank can not ask the exporter to refund the payments make to the exporter, if realization of payment from importer has become impossible.
7. **Revolving L/C** – In a revolving letter of credit, the credit is renewed automatically for the same amount and for the same period made available to the beneficiary again after a period of time on the advice of payments by the applicant or merely the fact that shipment has been made.
8. **Restricted and Unrestricted L/C** – Credit which do not specify any particular bank who is authorized to negotiate etc. is termed as unrestricted credit or open or general credit. If a specified bank is designed to pay accept or negotiate the credit it is termed as restricted or special credit.
9. **Back to Back L/C** – When the exporter uses his export letter of credits as a cover for opening a credit in favour of the local suppliers this credit is called back to back letter of credit.
10. **Anticipatory (letter of credit) (Red clause & green clause) –** The anticipatory credit provides for advance payment or at least part payment to the beneficiary against his undertaking to effect the shipment and submit the bill and/or documents in terms of credit with in the validity. Red Clause – Red clause credit bears a clause in red authorizing negotiating bank to make on advance to the seller prior to shipment and tender of the documents. The advance will be liquidated from the proceeds of the bill negotiated. This advance is granted against exporters undertaking to tender documents in terms of credit with the validity. Green Clause – The green clause is an extension of the Red clause. In addition to pre shipment finance, it provides credit to the exporter to cover the period of storage of goods at the sea port.
11. **Deferred payment L/C** – In this sort of credit the exporter supplies plant and Machinery, capital goods etc. on deferred payments terms to an importer and no draft is drawn and payments by the opening bank is determined in accordance with the terms laid down in the credit.
12. **Transferable credit** – In a transferable letter of credit, the amount of credit may be transferred either in full or in part to a second beneficiary at the request of first beneficiary. This kind of credit is very useful in those cases where the importer is making imports through agent in the exporting country.
13. **Transit Credit** – It is issued in one foreign country with the beneficiary in another but it is advised through and usually confirmed by a bank in London.
14. **The Sight L/C** – In this credit the amount is payable as the prescribed documents have been presented and the bank has checked them, so the proceeds are normally immediately disposed of to the beneficiary. In case of unconfirmed credit situations can arise where the advising bank delays payments to the beneficiary until it has received the amount specified by the documents from the issuing bank.
15. **Usance L/C –** In addition to presenting the documents, the beneficiary is required to draw a time draft on a specific bank (issuing, advising). After the documents have been found to be in order, the exporter received the draft back after it has been accepted by the importers bank. It is

possible to discount this bank acceptance, so the draft can be cashed in immediately by the seller while the draft amount will be charged by the buyer only upon maturity.

16. **Acceptance Credit –** An acceptance credit stipulates that the beneficiary must draws a bill of exchange for a particular tenor e.g. 60, 90 or 120 or 180 days sight and that the draft will be accepted by one of the following parties e.g.: (i) The applicant (ii) The advising bank (iii) The negotiating bank. But these credit are regarded as unsecured credits and therefore opened for the first class customers of undoubted standing who are considered capable enough to provide funds at maturity of the bill.
17. **Fixed L/C** – This L/C is used for a fixed amount only, which may be utilized in one or more drawings. The validity period is usually restricted and when the period expires or the total amount stands drawn, the facilities terminates.

Advantages of L/C to Exporter –

1. Prevents Blockage of finance.
2. Prevents bad debts
3. Fulfillments of import regulations.
4. Importer's obligation.
5. Help to procure pre-shipment finance.
6. Security against exchange control regulation of other country.
7. It forms more strong binding between seller and buyer.

Limitation of L/C to exporter –

1. Conditional undertaking – Quality quantity change bank will stop our payment.
2. Govt. Restriction – In certain circumstance L/C can't protect you to govt. action and it may become difficult to negotiate. It any policy is change in one country the payment is stop or delivery is stop so in some govt. restriction in L/C is limited.

Advantage of L/C to importer –

1. Better Terms of Trade: Better negotiation of the terms of trade is possible.
2. Guaranteed shipment.
3. Delivery in time.
4. Overdraft facility: On the basis of overdraft facility extended to the importer by the issuing bank, helps the importer to get the possession of goods without making actual payment against the L/C.
5. No advance payment is required.
6. Assurance about the quality.
7. Full scope of objection in case of slight non compliance with any condition and he will deliver the goods.

Limitation of L/C to importer –

1. It involves various banks so more charges has given to the bank.
2. If confirm L/C is demanded it puts a question mark on credibility of importer and his bank.

Need of L/C –
Assurance of credibility of exporter –

a) Before opening the L/C importer should check whether the exporter could be able to execute the project within the specified time period given in L/C or not.
b) Before opening the L/C the importer should check the part performance and record of the exporter.
c) As per the term and condition of L/C whether the exporter could be able to give right quality and quantity of goods.

Assurance of Payment –

a) Before opening of the L/C the exports should check the past performance of the importer.

b) Exporter should check the credibility of importer through his bank, embassy yellow pages or from relevant agents.

Availing Finance from Bank –
The bank give pre and post shipment finance to the exporter depending upon past performance good track or trade records and relation with bank.

Assurance of quality of goods –
As per the terms and conditions of L/C whether the exporter and condition of L/C whether the exporter could be able to give the right quality of goods according to international standard norms.

Evidence on terms & condition among the parties –
The terms and conditions of L/C should be obeyed by both importer & exporter and all the procedure should run according to L/C only. If any disputes arise on the subject matter of L/C than it act as a written proof.

Widely used & secured form of term of payment –
L/C is only secured form of terms of payment because various banks are involved in it and therefore less risk is involved in it.

Precaution for L/C –
Precaution mean exporters or importers take relevant precautions in making the L/C at the time of contracting which are useful for the making of L/C.

- To check the beneficiary (exporter) by the importers Bank who is providing the money to the exporter on behalf of importer.

PRE SHIPMENT FINANCE

Introduction - Pre Shipment Finance is issued by a financial institution when the seller want the payment of the goods before shipment. The main objectives behind pre-shipment finance or pre export finance is to enable exporter to:

- Procure raw materials.
- Carry out manufacturing process.
- Provide a secure warehouse for goods and raw materials.
- Process and pack the goods.
- Ship the goods to the buyers.
- Meet other financial cost of the business.

Types of Pre Shipment Finance

- Packing Credit
- Advance against Cheques/Draft etc. representing Advance Payments. Pre-shipment finance is extended in the following forms :
- Packing Credit in Indian Rupee
- Packing Credit in Foreign Currency (PCFC)

Requirement for Getting Packing Credit

This facility is provided to an exporter who satisfies the following criteria

- A ten digit importer exporter code number allotted by DGFT.
- Exporter should not be in the caution list of RBI.
- If the goods to be exported are not under OGL (Open General License), the exporter should have the required license /quota permit to export the goods.

Packing credit facility can be provided to an exporter on production of the following evidences to the bank:

1. Formal application for release the packing credit with undertaking to the effect that the exporter would be ship the goods within stipulated due date and submit the relevant shipping documents to the banks within prescribed time limit.
2. Firm order or irrevocable L/C or original cable / fax / telex message exchange between the exporter and the buyer.
3. License issued by DGFT if the goods to be exported fall under the restricted or canalized category. If the item falls under quota system, proper quota allotment proof needs to be submitted.

The confirmed order received from the overseas buyer should reveal the information about the full name and address of the overseas buyer, description quantity and value of goods (FOB or CIF), destination port and the last date of payment.

Eligibility - Pre shipment credit is only issued to that exporter who has the export order in his own name. However, as an exception, financial institution can also grant credit to a third party manufacturer or supplier of goods who does not have export orders in their own name.

In this case some of the responsibilities of meeting the export requirements have been out sourced to them by the main exporter. In other cases where the export order is divided between two more than two exporters, pre shipment credit can be shared between them

Quantum of Finance - The Quantum of Finance is granted to an exporter against the LC or an expected order. The only guideline principle is the concept of NeedBased Finance. Banks determine the percentage of margin, depending on factors such as:

- The nature of Order.
- The nature of the commodity.
- The capability of exporter to bring in the requisite contribution.

Different Stages of Pre Shipment Finance

Appraisal and Sanction of Limits - Before making any an allowance for Credit facilities banks need to check the different aspects like product profile, political and economic details about country. Apart from these things, the bank also looks in to the status report of the prospective buyer, with whom the exporter proposes to do the business. To check all these information, banks can seek the help of institution like ECGC or International consulting agencies like Dun and Brad street etc.

The Bank extended the packing credit facilities after ensuring the following"

1. The exporter is a regular customer, a bona fide exporter and has a goods standing in the market.
2. Whether the exporter has the necessary license and quota permit (as mentioned earlier) or not.
3. Whether the country with which the exporter wants to deal is under the list of Restricted Cover Countries(RCC) or not.

Disbursement of Packing Credit Advance - Once the proper sanctioning of the documents is done, bank ensures whether exporter has executed the list of documents mentioned earlier or not. Disbursement is normally allowed when all the documents are properly executed.

Sometimes an exporter is not able to produce the export order at time of availing packing credit. So, in these cases, the bank provide a special packing credit facility and is known as Running Account Packing.

Before disbursing the bank specifically check for the following particulars in the submitted documents"

1. Name of buyer
2. Commodity to be exported
3. Quantity
4. Value (either CIF or FOB)
5. Last date of shipment / negotiation.
6. Any other terms to be complied with

The quantum of finance is fixed depending on the FOB value of contract /LC or the domestic values of goods, whichever is found to be lower. Normally insurance and freight charged are considered at a later stage, when the goods are ready to be shipped.

In this case disbursals are made only in stages and if possible not in cash. The payments are made directly to the supplier by drafts/bankers/cheques.

The bank decides the duration of packing credit depending upon the time required by the exporter for processing of goods.

The maximum duration of packing credit period is 180 days, however bank may provide a further 90 days extension on its own discretion, without referring to RBI.

Follow up of Packing Credit Advance - Exporter needs to submit stock statement giving all the necessary information about the stocks. It is then used by the banks as a guarantee for securing the packing credit in advance. Bank also decides the rate of submission of this stocks.

Apart from this, authorized dealers (banks) also physically inspect the stock at regular intervals.

Liquidation of Packing Credit Advance - Packing Credit Advance needs be liquidated out of as the export proceeds of the relevant shipment, thereby converting preshipment credit into post shipment credit.

This liquidation can also be done by the payment receivable from the Government of India and includes the duty drawback, payment from the Market Development Fund (MDF) of the Central Government or from any other relevant source.

In case if the export does not take place then the entire advance can also be recovered at a certain interest rate. RBI has allowed some flexibility in to this regulation under which substitution of commodity or buyer can be allowed by a bank without any reference to RBI. Hence in effect the packing credit advance may be repaid by proceeds from export of the same or another commodity to the same or another buyer. However, bank need to ensure that the substitution is commercially necessary and unavoidable.

Overdue Packing - Bank considers a packing credit as an overdue, if the borrower fails to liquidate the packing credit on the due date. And, if the condition persists then the bank takes the necessary step to recover its dues as per normal recovery procedure.

SPECIAL CASES

Packing Credit to Sub Supplier - Packing Credit can only be shared on the basis of disclaimer between the Export Order Holder (EOH) and the manufacturer of the goods. This disclaimer is normally issued by the EOH in order to indicate that he is not availing any credit facility against the portion of the order transferred in the name of the manufacturer.

This disclaimer is also signed by the bankers of EOH after which they have an option to open an inland L/C specifying the goods to be supplied to the EOH as a part of the export transaction. On basis of such an L/C, the subsupplier bank may grant a packing credit to the subsupplier to manufacture the components required for exports.

On supply of goods, the L/C opening bank will pay to the sub supplier's bank against the inland documents received on the basis of the inland L/C opened by them.

The final responsibility of EOH is to export the goods as per guidelines. Any delay in export order can bring EOH to penal provisions that can be issued anytime.

The main objective of this method is to cover only the first stage of production cycles, and is not to be extended to cover supplies of raw material etc. Running account facility is not granted to subsuppliers.

In case the EOH is a trading house, the facility is available commencing from the manufacturer to whom the order has been passed by the trading house. Banks however, ensure that there is no double financing and the total period of packing credit does not exceed the actual cycle of production of the commodity.

Running Account facility - It is a special facility under which a bank has right to grant preshipment advance for export to the exporter of any origin. Sometimes banks also extent these facilities depending upon the good track record of the exporter.

In return the exporter needs to produce the letter of credit / firms export order within a given period of time.

Preshipment Credit in Foreign Currency (PCFC) - Authorised dealers are permitted to extend Preshipment Credit in Foreign Currency (PCFC) with an objective of making the credit available to the exporters at internationally competitive price. This is considered as an added advantage under which credit is provided in foreign currency in order to facilitate the purchase of raw material after fulfilling the basic export orders.

The rate of interest on PCFC is linked to London Interbank Offered Rate (LIBOR). According to guidelines, the final cost of exporter must not exceed 0.75% over 6 month LIBOR, excluding the tax.

The exporter has freedom to avail PCFC in convertible currencies like USD, Pound, Sterling, Euro, Yen etc. However, the risk associated with the cross currency truncation is that of the exporter.

The sources of funds for the banks for extending PCFC facility include the Foreign Currency balances available with the Bank in Exchange, Earner Foreign Currency Account (EEFC), Resident Foreign Currency Accounts RFC(D) and Foreign Currency(Non Resident) Accounts.

Banks are also permitted to utilize the foreign currency balances available under Escrow account and Exporters Foreign Currency accounts. It ensures that the requirement of funds by the account holders for permissible transactions is met. But the limit prescribed for maintaining maximum balance in the account is not exceeded. In addition, Banks may arrange for borrowings from abroad. Banks may negotiate terms of credit with overseas bank for the purpose of grant of PCFC to exporters, without the prior approval of RBI, provided the rate of interest on borrowing does not exceed 0.75% over 6 month LIBOR.

Packing Credit Facilities to Deemed Exports- Deemed exports made to multilateral funds aided projects and programmes, under orders secured through global tenders for which payments will be made in free foreign exchange, are eligible for concessional rate of interest facility both at pre and post supply stages.

Packing Credit facilities for Consulting Services - In case of consultancy services, exports do not involve physical movement of goods out of Indian Customs Territory. In such cases, Preshipment finance can be provided by the bank to allow the exporter to mobilize resources like technical personnel and training them.

Advance against Cheque/Drafts received as advance payment - 6. Where exporters receive direct payments from abroad by means of cheques/drafts etc. the bank may grant export credit at concessional rate to the exporters of goods track record, till the time of realization of the proceeds of the cheques or draft etc. The Banks however, must satisfy themselves that the proceeds are against an export order.

POST SHIPMENT FINANCE

Introduction - Post Shipment Finance is a kind of loan provided by a financial institution to an exporter or seller against a shipment that has already been made. This type of export finance is granted from the date of extending the credit after shipment of the goods to the realization date of the exporter proceeds. Exporters don't wait for the importer to deposit the funds.

Basic Features - The features of post shipment finance are:

- **Purpose of Finance -** Post shipment finance is meant to finance export sales receivable after the date of shipment of goods to the date of realization of exports proceeds. In cases of deemed exports, it is extended to finance receivable against supplies made to designated agencies.
- **Basis of Finance-**Post shipment finances is provided against evidence of shipment of goods or supplies made to the importer or seller or any other designated agency.
- **Types of Finance -** Post shipment finance can be secured or unsecured. Since the finance is extended against evidence of export shipment and bank obtains the documents of title of goods, the finance is normally self liquidating. In that case it involves advance against undrawn balance, and is usually unsecured in nature.
- Further, the finance is mostly a funded advance. In few cases, such as financing of project exports, the issue of guarantee (retention money guarantees) is involved and the financing is not funded in nature.
- **Quantum of Finance -** As a quantum of finance, post shipment finance can be extended up to 100% of the invoice value of goods. In special cases, where the domestic value of the goods increases the value of the exporter order, finance for a price difference can also be extended and the price difference is covered by the government. This type of finance is not extended in case of preshipment stage.
  Banks can also finance undrawn balance. In such cases banks are free to stipulate margin requirements as per their usual lending norm.
- **Period of Finance-** Post shipment finance can be off short terms or long term, depending on the payment terms offered by the exporter to the overseas importer. In case of cash exports, the maximum period allowed for realization of exports proceeds is six months from the date of shipment. Concessive rate of interest is available for a highest period of 180 days, opening from the date of surrender of documents. Usually, the documents need to be submitted within 21days from the date of shipment.

Financing For Various Types of Export Buyer's Credit
Post shipment finance can be provided for three types of export :

- **Physical exports:** Finance is provided to the actual exporter or to the exporter in whose name the trade documents are transferred.
- **Deemed export:** Finance is provided to the supplier of the goods which are supplied to the designated agencies.
- **Capital goods and project exports:** Finance is sometimes extended in the name of overseas buyer. The disbursal of money is directly made to the domestic exporter.

Supplier's Credit
Buyer's Credit is a special type of loan that a bank offers to the buyers for large scale purchasing under a contract. Once the bank approved loans to the buyer, the seller shoulders all or part of the interests incurred.

Types of Post Shipment Finance
The post shipment finance can be classified as :

1. Export Bills purchased/discounted.
2. Export Bills negotiated
3. Advance against export bills sent on collection basis.
4. Advance against export on consignment basis
5. Advance against undrawn balance on exports
6. Advance against claims of Duty Drawback.

1. Export Bills Purchased/ Discounted.(DP & DA Bills) - Export bills (Non L/C Bills) is used in terms of sale contract/ order may be discounted or purchased by the banks. It is used in indisputable international trade transactions and the proper limit has to be sanctioned to the exporter for purchase of export bill facility.

2. Export Bills Negotiated (Bill under L/C) - The risk of payment is less under the LC, as the issuing bank makes sure the payment. The risk is further reduced, if a bank guarantees the payments by confirming the LC. Because of the inborn security available in this method, banks often become ready to extend the finance against bills under LC.
However, this arises two major risk factors for the banks:

1. The risk of nonperformance by the exporter, when he is unable to meet his terms and conditions. In this case, the issuing banks do not honor the letter of credit.
2. The bank also faces the documentary risk where the issuing bank refuses to honour its commitment. So, it is important for the for the negotiating bank, and the lending bank to properly check all the necessary documents before submission.
3. **Advance Against Export Bills Sent on Collection Basis -** Bills can only be sent on collection basis, if the bills drawn under LC have some discrepancies. Sometimes exporter requests the bill to be sent on the collection basis, anticipating the strengthening of foreign currency. Banks may allow advance against these collection bills to an exporter with a concessional rates of interest depending upon the transit period in case of DP Bills and transit period plus usance period in case of usance bill.
4. The transit period is from the date of acceptance of the export documents at the banks branch for collection and not from the date of advance.
5. **Advance Against Export on Consignments Basis -** Bank may choose to finance when the goods are exported on consignment basis at the risk of the exporter for sale and eventual payment of sale proceeds to him by the consignee.
6. However, in this case bank instructs the overseas bank to deliver the document only against trust receipt /undertaking to deliver the sale proceeds by specified date, which should be within the

prescribed date even if according to the practice in certain trades a bill for part of the estimated value is drawn in advance against the exports.

In case of export through approved Indian owned warehouses abroad the times limit for realization is 15 months.

5. Advance against Undrawn Balance - It is a very common practice in export to leave small part undrawn for payment after adjustment due to difference in rates, weight, quality etc. Banks do finance against the undrawn balance, if undrawn balance is in conformity with the normal level of balance left undrawn in the particular line of export, subject to a maximum of 10 percent of the export value. An undertaking is also obtained from the exporter that he will, within 6 months from due date of payment or the date of shipment of the goods, whichever is earlier surrender balance proceeds of the shipment.

6. Advance Against Claims of Duty Drawback - Duty Drawback is a type of discount given to the exporter in his own country. This discount is given only, if the inhouse cost of production is higher in relation to international price. This type of financial support helps the exporter to fight successfully in the international markets.

In such a situation, banks grants advances to exporters at lower rate of interest for a maximum period of 90 days. These are granted only if other types of export finance are also extended to the exporter by the same bank.

After the shipment, the exporters lodge their claims, supported by the relevant documents to the relevant government authorities. These claims are processed and eligible amount is disbursed after making sure that the bank is authorized to receive the claim amount directly from the concerned government authorities.

Crystallization of Overdue Export Bills - Exporter foreign exchange is converted into Rupee liability, if the export bill purchase / negotiated /discounted is not realize on due date. This conversion occurs on the 30th day after expiry of the NTP in case of unpaid DP bills and on 30th day after national due date in case of DA bills, at prevailing TT selling rate ruling on the day of crystallization, or the original bill buying rate, whichever is higher.

Unit-II

IMPORT FINANCE

Introduction
Imports play an important role in the economy of every country, rich and poor alike. Rich countries need to import capital goods, raw materials and technology to ensure an optimum utilisation of their production capacity. They need to import a wide variety of consumer goods to enable their people to enjoy a high standard of living. Poor countries need to import technology and capital equipment and some time strategic raw materials to develop industries for accelerating pace of their development.

Import Financing
Import financing involves making payment to foreign entities for the goods purchased from them. From the management decision making viewpoint, it means making decision regarding terms of payment (Le. Choosing one among several alternatives), arranging funds, involving choice of financial institution, and the instrument to be used for making payment and involving choice of intermediary, through whom the payment is to be made.

The Regulatory Frame Work
These are:
1) Foreign Trade (Development 8c Regulation) Act, 1993 administered by Director General, Foreign Trade (DGFT)
2) Foreign Exchange Management Act, 1999 administered by the Department of Economic Affairs, Ministry of Finance and the Exchange Control Development of the Reserve bank of India, FEMA has been brought is place of Foreign Exchange Regulation Act.
3) Indian Customs and Excise Acti-1962 administered by Central Board of Excise and Custom.

Physical control over imports is exercised by DGFT and the Customs Dept. RBI exercise financial controls through the guidelines provided to authorized dealers. Of late, tariffs rather than quantitative restrictions are being used to regulate import trade.

Under the existing regulations, ADS provide foreign currencies to importers:
i) For remittance to foreign supplies as advance payments. .
ii) Paying the foreign supplies in compliance of their undertaking under the letter of credit.
iii) Discounting on purchasing except documents,
iv) Advances against shipping documents.

Authorised dealers can open a letter of credit (L/c) to facilitate imports, subject to following regulations:
a) Letters of credit may be opened by banks only on behalf of their-customers who maintain account with them.
b) L/C should be opened in favour of overseas suppliers of shipper of goods.
c) Application for L/C must be accompanied by sale contract and other documentary evidence relating to the order and its confirmation and import licence, if any.

Methods of import Finance
1. Financing Import under Letter of Credit Letter of credit can be defined as a commitment of bank to pay the seller of goods or services a certain amount provided he presents stipulated documents evidencing the shipment of goods or the performance of services within a prescribed period of time. As a credit instrument and as -a means of making and securing payment, the letter of credit is an essential instrument for conducting world trade today.
Import letters of credit financing involves three principal Stages:
i) Requesting bank to open a letter of credit
ii) Retiring documents under letter of credit

iii) Import Trust receipt facility

Each time a UC is opened, the importers has to file a formal stamped "Letter of credit application and Agreement" in the prescribed form. The application should set forth the precise, terms and conditions under which the importer wishes his bank to establish the credit, and describe the documents covering the goods purchased which the bank is to receive in exchange for payments.

As the correct opening of the credit is the first essential to the ultimate success of the transaction and as the UC will be issued on the basis of information supplied by the importer in the 1/C application, it is absolutely necessary that the information supplied by him must be complete and precise, After due scrutiny of the application form, the relevant letters are issued by the bankers subject to the Uniform Customs And Practice for Documentary Credits, in order to guard against confusion and misunderstanding.

Letters of credit may be opened by mail or Fax depending upon the urgency of the situation. It may be revocable or irrevocable. Irrevocable UC implies that the terms and conditions of the credit can be amended only with the consent of all the concerned parties. At times, the importer may ask the issuing bank to get the credit confirmed by another bank. It means that in addition to the issuing bank (the confirming bank) assumes the commitment to pay provided the terms of the credit are fulfilled.

L/C is sent by the issuing bank to a bank in the suppliers country with a request to deliver the same to the supplier, called the beneficiary. If the beneficiary is satisfied with terms and conditions mentioned in L/C, he ships the goods, obtains the required documents and submits them to bank, usually his own, unless a name has been specified in the credit. Bank scrutinizes the documents and if he finds them in conformity with the L/C and the reimbursement instruction, he pays the suppliers. Thereafter he sends the documents to the issuing banker who again scrutinizes the documents with references to the terms of the credit. If he is satisfied, he pays the negotiating banker.

After paying the negotiating banker the issuing banker releases documents of title to the importer on his executing a stamped Letter of Trust (Trust Receipt). It means that the importer undertakes to deposit with the bank the sale proceeds immediately on relisation but in no case later then period stipulated in the trust letter. The import trust receipts facility is given by the banks to first class customers only.

Bankers also grant import loans to their approved customers and undertake the clearance of goods on their behalf. In such cases, the bills received under letter of credit are retired to debit of loan account of the customer by the bank and the relative documents forwarded to an approved clearing agents for clearance of goods. After the goods are cleared, dispatched and receipts are delivered to the importer after receiving the due amount. Where arrangements exist, the goods may be stored in the bank godown under bank's lock and released against proportionate payments as when desired by the importer.

2. Financing against Bills under Collection –

In the case of imports not covered by letters of credit, the documents are forwarded by a bank in the supplier's country, known as the collecting bank, for collection of proceeds from the importer and payment to the supplier through the remitting bank. In such cases, the collecting bank would examine the documents and the instructions stated I the covering schedule to ensure that all the stated documents have been received intact and the bill of lading and the bill of exchange are endorsed in its favor or blank endorsed to enable the bank to handle the documents the bank than presents the documents to be importer on payment (in case of sight or D/P Bill) or against written acceptance (in case of usance or d/p bill). Where the importer is eligible to receive the documents only on payment, he can avail an import loan or a trust receipt facility, as discussed before. Obligations of various parties involved are provided in Uniform Rules for Collection (URC) Publication No.322 issued by International Chamber of Commerce, Paris.

Sometimes, shipping documents may be sent by the exporter directly to his importer. In such a case, the bank may receive clean bills for collection of proceeds. In such cases, banks are required to call for documentary evidence of imports such as custom noted invoice, exchange control copy of bill of entry and import license, if any.
Payment for bills in respect of imports through post can also be arranged through a bank. In such cases, the relative postal receipts must be produced as evidence of shipment through post and an undertaking to submit postal wrappers within three months from the date of wrappers.

3. Financing Imports against Deferred Payment Imports Under deferred payment implies that the supplier has agreed to supply goods on credit terms extending beyond six months. In such cases, authorized dealer has to refer each deferred payment case to RBI for prior approval of advance payment, bank guarantee and installments (Principal and interest) with documents viz. exchange control copy of import license, if any, contract copy and statement of desired facilities.

Appraisal for issue of guarantees or loans is similar to term finance. For importing under deferred payment, the importer should have sufficient cash generated to pay the due installments. He should arrange for payment of advance and down payments from his own resources which would cover bank's margin requirement. Imported machinery has to be hypothecated to the bank and the importer should counter guarantee the transaction.

4. Financing under Foreign Credit –
Government of India gets assistance in the form of loans and development credits from international financial institutions as also foreign governments. The loans are of two types - tied loans and loans in free foreign currencies. Toms and conditions of each loan along with detailed instructions regarding the procedure to be followed for opening letters of credit, submission of documents etc. are set out in public notices issued' by DGFT. RBI also issues circulars for each foreign credit giving important instructions relating to such imports.

Payment under foreign credit may be made under
(a) Letter of commitment method or
(b) Reimbursement method.

Under the letter of commitment procedure, remittances from India for the relative imports amined. The importer in India obtains a letter of commitment from the Government of India after furnishing a bank guarantee for payment of rupee equivalent of the import value. The importer furnishes the letter of commitment to the bank opening L/C. Then the usual procedure follows. The shipping documents are deliver to the importer on payment I acceptance. Where no L/C is opened at all and on receipt of document covering imports rupee deposits are made to Government account by the importer through the bank.

Under the reimbursement method, the aid giving the country makes available to the Government of India on production of evidence of payment of imports. Hence, payment to the suppliers is made by L/C opening bank through the normal banking channels and reimbursement is by the Government of India by submitting the required documents.

5. Import Loans by Export-Import Bank of India Bank finances imports from third countries required for executing projects overseas for which Indian exports have won contracts.

Regarding imports into India, Exim Bank finance such imports which are export, related, i.e. imports by Export Oriented Units, import of computer systems for development and export of software, import of plant, machinery, technology for upgradation/expansion of production capability for export markets.

Exim Bank also finance bulk imports of consumable inputs and canalized items. Under this scheme, promissory notes drawn in favour of commercial banks by their importer borrowers are discount will issue letter of commitment for finance on request from commercial bank indicating its requirement the quantum of finance depends on the condition that import order should not be less than Rupees one Crore.

6. Counter Trade –
Counter trade is a specific type of international trade in which certain export and import transactions are directly linked with each other and imports of goods are paid for by export of goods instead of money payment. It is a barter type of bilateral trade. Due to international payment Problems, many countries encourage counter trade as a means of financing imports. Under this system, imports are paid in the form of goods and not in terms of monetary units. India had a practice of counter trade with earstwhile U.S.S.R. and some eastEuropean countries. Imports by India fro, these countries paid for by way of purchase of goods and services of countries.

7. Forfeiting –
This is a method under which the bank purchases the claims of exporter on buyer. In simple sense, forfeiting the purchase, at a fixed rate of medium term claims of an exporter on the foreign importer without recourse to the exporter. It is arrangement for giving time to the importer for making payment It is a cash transaction as far as the exporter is concerned his claims are purchased by the bank or other financial institutions without recourse to him. These forfeiting claims generally represented by bills of exchange or promissory notes payable by the importer on maturity.

Forfeiting is a commercial source of external finance and -a credit insurance or other costs are involved. Forfeiting is one or' the method which is used for imports of capital goods, project export commodities and services with deferred credit period between Ito 5 years. Forfeiting method is primarily evolved in certain European countries like Austria, Switzerland, Germ Italy and UK. it is also gaining importance in the developing countries also as an external source of finance.
Transactions in forfeiting, both in the primary and secondary markets, are growing in number and volume

8. International Leasing –
On the basis of principles and economies of I easing, the international leasing It as also be an important source of import finance for importing capital goods and assets like ships and aircrafts. The main advantage international leasing is that it is usually for die full value of the asset acquired unlike in other forms of traditional roan international leasing is dependent basically on the tax laws of the country of the lessor, other calculations are similar to costing of domestic lease.

9. Import TRUST RECEIPT –
The importer has other facilities with the bank like key cash credit or open cash credit. When a bill received covering import of raw materials or other items, is released by payment by the importer out of his own sources or by debit to the cash credit account. The imported goods thus stand as security for the cash credit account. If the goods are to be charged as security for key cash credit facility (i.e., pledge), it is essential that the goods are in the possession of the bank and not delivered to the importer. If the goods are delivered to the importer, the essential of pledge is lost and the bank loses its right over the goods. But unless the importer is allowed to take delivery of the goods from the port and place them in the godown pledge cannot be created.

The difficulty is obviated by taking a Trust Receipt from the importer and allowing him to take delivery of the goods and place item in the godown. In the Trust Receipt the importer specifies the goods and agrees that he is holding the goods not as their owner but as an agent for the bank. Thus the bank continues to have the rights of the pledge.

"The need for Trust Receipt facility also arises in case of letters of credit calling for usance bills. Suppose the letter of credit calls for 90 days sight bill. The exporter on shipment tenders the bill through the negotiating bank and gets it accepted by Line issuing bank. Since the bill bears the bank's acceptance he is assured of payment at maturity. If he is in urgent need of funds he can discount the bill with his bank.

As far as the issuing bank is concerned, it would like to retain possession of the goods till payment is made by the importer. Importer, on the other hand, would like to take possession of the goods as soon as they arrive, use them in the manufacture and/or sell them and pay a &Unfit/MI a e again the bank may release the goods against the trust receipt of the importer. Depending upon the credit rating of the customer, the bank may –
(a) allow the customer to use the products as well as sell the goods;
(b) allow the goods to be used for manufacture only;
(c) insist on margin; and
(d) agree for release only in parts.

10. Guarantees –
In addition to all the above-mentioned methods of' import finance, an importer is also required by exporter to furnish a bank guaranty particularly under the deferred payment import to ensure prompt payments on due dates of the instable Reserve Bank guarantee in favour of foreign supplier for payment on deferred terms.

11. Value of Trust Receipt –
In the trust letter the importer acknowledge that goods are held him in trust for the bank and agrees to make over the Sale proceeds to the bank. He further undertakes to keep the goods and transactions arising out of these goods separate from other transaction. In the case of insolvency of the importer, the bank can repossess the goods; the official receiver cannot claim the goods. The banker can appropriate the sale proceeds, if the goods were already sold by the borrower.

However, in practice, trust receipt does not secure the position of the bank to a significant extent. The risks are that –
(a) the importer may repledge the goods with another bank or person;
(b) the importer may sell the goods without remitting the amount into the bank; and
(e) in Case of insolvency of the importer, it would be difficult to trace the proceeds of the goods. Therefore, release of goods against trust receipt involves additional credit risk to the bank

BANKS

Definition:

- **Oxford Dictionary** defines a bank as "an establishment for custody of money, which it pays out on customer's order."
- In the words of **Waller Leaf** "A bank is a person or corporation which holds it out to receive from the public, deposits payable on demand by cheque".
- According to the **World Bank**, "Banks are financial institutions that accept funds in the form of deposits repayable on demand or in short notice".
- According to **Kinley**, "Bank is an establishment which makes to individuals such advances of money or other means payments as may be required and safely made and to which individuals entrust money or means of payment when by them for use".
- In the words of **Gillbert**, "A bank is a dealer in capital, or more properly a dealer in money. He is the intermediate party between the borrower and lender".

Functions of Bank:

The functions of commercial banks are of two types.

A) Primary functions; and
B) Secondary functions.

Let us discuss details about these functions.

i) Primary functions

The primary functions of a commercial bank include:

a) Accepting deposits; and
b) Granting loans and advances.

a) **Accepting deposits** – The most important activity of a commercial bank is to mobilize deposits from the public. People who have surplus who have surplus income and savings find it convenient to deposit the amounts with banks. Depending upon the nature of deposits, funds deposited with bank also earn interest. Thus, deposits with the bank grow along with the interest earned. If the rate of interest is higher, public are motivated to deposit more funds with the Bank. There is also safety of funds deposited with the bank.
b) **Grant of loans and advances** – The second important function of a commercial bank is to grant loans and advances. Such loans and advances are given to members of the public and to the business community at a higher rate of interest than allowed by banks on various deposit accounts. The rate of interest charged on loans and advances varies according to the purpose and period of loan and also the mode of repayment.

- **Loans**: A long is granted for a specific time period. Generally commercial banks provide short-term loans. But term loans, i.e., loans for more than a year may also be granted. The borrower may be given the entire amount in lump sum or in installments. Loans are generally granted against the security of certain assets. A loan is normally repaid in installments. However, it may also be repaid in lump sum.
- **Advances**: An advance is a credit facility provided by the bank to its customers. It differs from loan in the sense that loans may be granted for longer period, but advances are normally granted for a short period of time. Further the purpose of granting advances is to meet the day-to-day requirements of business. The rate of interest charged on advances varies from bank to bank. Interest is charged only on the amount withdrawn and not on the sanctioned amount.

Secondary Functions:

In addition to the primary functions of accepting deposits and lending money, banks perform a number of other functions, which are called secondary functions. These are as follows –

a. Issuing letters of credit, traveler's cheque, etc.
b. Undertaking safe custody of valuables, important document and securities by providing safe deposit vaults or lockers.
c. Providing customers with facilities of foreign exchange dealings.
d. Transferring money from one account to another; and from one branch to another branch of the bank through cheque, pay order, demand draft.
e. Standing guarantee on behalf of its customers, for making payment for purchase of goods, machinery, vehicles etc.
f. Collecting and supplying business information.
g. Providing reports on the credit worthiness of customers.
h. Providing consumers finance for individuals by way of loans on easy terms for purchase of consumer durables like television, refrigerators, etc.
i. Educational loans to students at reasonable rate of interest for higher studies, especially for professional courses.

Role of Bank –

A proper financial sector is of special importance for the economic growth of developing and underdeveloped countries. The commercial banking sector which forms one of the backbones of the financial sector should be well organized and efficient for the growth dynamics of a growing economy. No underdeveloped country can progress without first setting up a sound system of commercial banking. The importance of a sound system of commercial banking for a developing country may be depicted as follows:

- **Capital formation**: The rate of saving is generally low in an underdeveloped economy due to the existence of deep-rooted poverty among the people. Even the potential savings of the country cannot be realized due to lack of adequate banking facilities in the country. To mobilize dormant savings and to make them available to the entrepreneurs for productive purpose, the development of a sound system of commercial banking is essential for a developing economy.
- **Monetization**: An underdeveloped economy is characterized by the existence of a large nonmonetized sector, particularly, in the backward and inaccessible areas of the country. The existence of this non-monetized sector is a hindrance in the economic development of the country. The banks, by opening branches in rural and backward areas, can promote the process of monetization in the economy.
- **Innovations**: Innovations are an essential prerequisite for economic progress. These innovations are mostly financed by bank credit in the developed countries. But the entrepreneurs in underdeveloped countries cannot bring about these innovations for lack of bank credit in inadequate measure. The banks should, therefore, pay special attention to the financing of business innovations by providing adequate and cheap credit to entrepreneurs.
- **Finance for Priority Sectors**: The commercial bank in underdeveloped countries generally hesitate in extending financial accommodation to such sectors as agriculture and small scale industries, on account of the risks involved there in. They mostly extend credit to trade and commerce where the risk involved is far less. But for the development of these countries it inessential that the banks take risk in extending credit facilities to the priority sectors, such as agriculture and small scale industries.
- **Provision for Medium and Long term Finance**: The commercial banks in under developed countries invariably give loans and advances for a short period of time. They generally hesitate to extend medium and long term loans to businessman. As is well known, the new business need medium and long term loans for their proper establishment. The commercial banks should, therefore, change their policies in favor of granting medium and long term accommodation to business and industry.
- **Cheap Money Policy**: The commercial banks in an underdeveloped economy should follow cheap money policy to stimulate economic activity or to meet the threat of business recession. Infect, cheap money policy is the only policy which can help promote the economic growth of an underdeveloped country. It is heartening to note that recently the commercial banks have reduced their lending interest rates considerably.
- **Need for a Sound Banking System**: A sound system of commercial banking is an essential prerequisite for the economic development of a backward country.

LETTER OF CREDIT

In international marketing, while there are very few sales on barter basis, cash and carry transactions are almost non-existent. Credit is inherent to some extent in all export sales and has assumed such importance that completion is no longer confined to quality. Price or delivery schedule of products but on the term and period of credit granted to foreign buyers. There are various methods of payment or methods of financing which exporters should know before deciding on the term for receiving payment against exports.

The best and the most prevalent system of receiving payment against exports is through the method of Letter of credit (L/c). It is an instrument issued by a bank in favour of the exporter (known as beneficiary) whereby the issuing bank undertakes to pay to the beneficiary a certain amount of money against delivery of specified documents within a said period of time. Hence it is also known as documentary credit. Letter of credit is more commonly referred to as the most appropriate and currently adopted practice in international transactions.

L/c is an signed instrument containing an undertaking by the importer bank to pay to seller, the stipulated amount on shipment of specifying goods and subject to compliance with the stated terms and condition.

L/c is one of the most common instrument for setting payment between buyer and seller.
A L/c is demanded by the seller as a guarantee of the payment before affecting shipment.

Definition: "Letter of credit is a payment assurance from the issuing bank to the beneficiary which guarantees the payments to the beneficiary provided he fulfills all the conditions mentioned in the contract in right order and at the right time".

"Among all the international document letter of credit considered as the most essential one. It is also very important document for custom clearance of export and import consignment."

Parties to a letter of credit –

1) Importer/Applicant –
Applicant basically is a person who applies for letter of credit in the bank, he is the opener whose behalf the letter of credit is issued by Bank. Applicant is the importer and his credibility is very necessary in bank.

2) Applicants/Importers (Bank)/Issuing Bank –
Issuing bank is the Bank, which is in the importers country issues or opens the letter of credit on behalf of the importers.

3) Exporter/Beneficiary –
Exporter is the beneficiary of the letter of credit who is entitled to receive the payment of its bills according to the terms of credit.

4) Exporters Bank –
The bank who negotiates with exporter and provide him payment of shipment.

5) Confirming Bank –
It is the bank usually a branch or correspondent of the opening bank through which the credit is advised to the exporter. If it merely forwards the credit without any obligation on its part, it is called the Advising or Notifying Bank.

6) Negotiating Bank –
The Bank, which negotiates the Beneficiary bill under the credit and pays for it is known as paying/negotiating bank.

Contents of Letter of Credit –
1. Correct and complete name and address of the beneficiary (exporter)
2. Correct and complete name and address of the applicant (importer)
3. Type of the L/C
4. Amount of L/C
5. How the credit shall be available, i.e. by sight payment, deferred payments, acceptance or negotiation.
6. Name of the nominated bank, which shall make the payment to the beneficiary.
7. The name of the drawee on the draft and the tenor of the draft.
8. Term of delivery: FOB, CFR, CIF etc.
9. Description of goods, quantity and unit price.
10. List of documents required to be submitted by the beneficiary.
11. Port of discharge and place of final destination.
12. Status of transshipment; whether allowed or not.
13. Status of partial shipment; whether allowed or not.
14. Last date of sending shipment.
15. Date and place of expiry of the L/C
16. Time period for the presentation of the documents for negotiation by the beneficiary after the dispatch of the shipment.
17. Transfer of the L/C; whether allowed or not.
18. Mode of advice of the L/C; by mail or teletransmission.

Procedure/Steps Involved in L/C
1. Importer (opener) has concluded a purchase conduct for buying of certain goods with his overseas supplier who wants payment by a letter of credit. The importer asks his bank to open a letter of credit in favour of his overseas supplier (exporter).
2. After the request from the importer, bank consider the proposal his bank open its letter of credit in favour of the overseas supplier (exporter).
3. The advising bank can be intermediary bank in exports country which receives credit from the opening bank and after satisfying itself about the authenticity of the credit, it forwards the same to the beneficiary.
4. After receiving the credit form the advising bank the exporter checks it to ensure that it confirms to the terms of sale of contract and if necessary, asks the importer to effect amendments to the credit then proceeds to effect the shipment of the goods.
5. After the shipment is effected the exporter prepares the documents and draws his bill under the letter of credit for obtaining payment from the negotiating bank.
6. After getting the documents and bills from the exporter the negotiating bank checks them with letter of credit terms and condition and if in order, negotiates the bill payable to the exporter.
7. The importer's bank receives the bill and documents from negotiating bank (exporter's bank) checks them and if found in order, reimburses of, if reimbursement is obtained already confirms it to the negotiating bank. The importers bank presents the bill for acceptance/payment to the importer.
8. The importer receives the bill, checks the documents and accepts/pays the bill. On acceptance/payments importer gets the shipping documents covering the goods purchased.

Types of L/C
1. **Revocable L/C** – A revocable letter of credit on amended or cancelled by the issuing bank at any moment without prior notice to the beneficiary. The credit does not constitute a legal

binding between the bank or banks concerned and the beneficiary because such a creditability be modified or cancelled at any moment without prior notice to the beneficiary.

2. **Irrevocable Letter of Credit** – An irrevocable letter of credit constitutes a definite undertaking of the issuing bank for the payment of the bills drawn under it. The L/C can neither be modified nor cancelled without prior approval of the beneficiary concerned and it is, therefore, widely accepted.
3. **Confirmed L/C** – When an issuing bank authorizes or request another bank to confirm its irrevocable L/C. A letter from the confirming bank added its confirmation. Such a confirmation constitutes a definite undertaking/guarantee of the confirming bank, then it can not claim to the exporter if issuing bank fails to give the payment.
4. **Unconfirmed L/C –** Unconfirmed letter of credit is one, which is not supplemented by additional guarantee from a bank in exporters' country.
5. **With Recourse L/C** – In the case of this L/C. if the overseas buyer fails to make payment with in a specified period then the negotiating or paying bank can ask the beneficiary/exporter for the refund of the payment made under the L/C.
6. **Without Recourse L/C** – In this L/C the paying bank can not ask the exporter to refund the payments make to the exporter, if realization of payment from importer has become impossible.
7. **Revolving L/C** – In a revolving letter of credit, the credit is renewed automatically for the same amount and for the same period made available to the beneficiary again after a period of time on the advice of payments by the applicant or merely the fact that shipment has been made.
8. **Restricted and Unrestricted L/C** – Credit which do not specify any particular bank who is authorized to negotiate etc. is termed as unrestricted credit or open or general credit. If a specified bank is designed to pay accept or negotiate the credit it is termed as restricted or special credit.
9. **Back to Back L/C** – When the exporter uses his export letter of credits as a cover for opening a credit in favour of the local suppliers this credit is called back to back letter of credit.
10. **Anticipatory (letter of credit) (Red clause & green clause) –** The anticipatory credit provides for advance payment or at least part payment to the beneficiary against his undertaking to effect the shipment and submit the bill and/or documents in terms of credit with in the validity. Red Clause – Red clause credit bears a clause in red authorizing negotiating bank to make on advance to the seller prior to shipment and tender of the documents. The advance will be liquidated from the proceeds of the bill negotiated. This advance is granted against exporters undertaking to tender documents in terms of credit with the validity. Green Clause – The green clause is an extension of the Red clause. In addition to pre shipment finance, it provides credit to the exporter to cover the period of storage of goods at the sea port.
11. **Deferred payment L/C** – In this sort of credit the exporter supplies plant and Machinery, capital goods etc. on deferred payments terms to an importer and no draft is drawn and payments by the opening bank is determined in accordance with the terms laid down in the credit.
12. **Transferable credit** – In a transferable letter of credit, the amount of credit may be transferred either in full or in part to a second beneficiary at the request of first beneficiary. This kind of credit is very useful in those cases where the importer is making imports through agent in the exporting country.
13. **Transit Credit** – It is issued in one foreign country with the beneficiary in another but it is advised through and usually confirmed by a bank in London.
14. **The Sight L/C** – In this credit the amount is payable as the prescribed documents have been presented and the bank has checked them, so the proceeds are normally immediately disposed of to the beneficiary. In case of unconfirmed credit situations can arise where the

advising bank delays payments to the beneficiary until it has received the amount specified by the documents from the issuing bank.

15. **Usance L/C –** In addition to presenting the documents, the beneficiary is required to draw a time draft on a specific bank (issuing, advising). After the documents have been found to be in order, the exporter received the draft back after it has been accepted by the importers bank. It is possible to discount this bank acceptance, so the draft can be cashed in immediately by the seller while the draft amount will be charged by the buyer only upon maturity.
16. **Acceptance Credit –** An acceptance credit stipulates that the beneficiary must draws a bill of exchange for a particular tenor e.g. 60, 90 or 120 or 180 days sight and that the draft will be accepted by one of the following parties e.g.: (i) The applicant (ii) The advising bank (iii) The negotiating bank. But these credit are regarded as unsecured credits and therefore opened for the first class customers of undoubted standing who are considered capable enough to provide funds at maturity of the bill.
17. **Fixed L/C** – This L/C is used for a fixed amount only, which may be utilized in one or more drawings. The validity period is usually restricted and when the period expires or the total amount stands drawn, the facilities terminates.

Advantages of L/C to Exporter –

1. Prevents Blockage of finance.
2. Prevents bad debts
3. Fulfillments of import regulations.
4. Importer's obligation.
5. Help to procure pre-shipment finance.
6. Security against exchange control regulation of other country.
7. It forms more strong binding between seller and buyer.

Limitation of L/C to exporter –

1. Conditional undertaking – Quality quantity change bank will stop our payment.
2. Govt. Restriction – In certain circumstance L/C can't protect you to govt. action and it may become difficult to negotiate. It any policy is change in one country the payment is stop or delivery is stop so in some govt. restriction in L/C is limited.

Advantage of L/C to importer –

1. Better Terms of Trade: Better negotiation of the terms of trade is possible.
2. Guaranteed shipment.
3. Delivery in time.
4. Overdraft facility: On the basis of overdraft facility extended to the importer by the issuing bank, helps the importer to get the possession of goods without making actual payment against the L/C.
5. No advance payment is required.
6. Assurance about the quality.
7. Full scope of objection in case of slight non compliance with any condition and he will deliver the goods.

Limitation of L/C to importer –

1. It involves various banks so more charges has given to the bank.
2. If confirm L/C is demanded it puts a question mark on credibility of importer and his bank.

Need of L/C –

Assurance of credibility of exporter –

1. Before opening the L/C importer should check whether the exporter could be able to execute the project within the specified time period given in L/C or not.

2. Before opening the L/C the importer should check the part performance and record of the exporter.
3. As per the term and condition of L/C whether the exporter could be able to give right quality and quantity of goods.

Assurance of Payment –

1. Before opening of the L/C the exports should check the past performance of the importer.
2. Exporter should check the credibility of importer through his bank, embassy yellow pages or from relevant agents.

Availing Finance from Bank –

The bank give pre and post shipment finance to the exporter depending upon past performance good track or trade records and relation with bank.

Assurance of quality of goods –

As per the terms and conditions of L/C whether the exporter and condition of L/C whether the exporter could be able to give the right quality of goods according to international standard norms.

Evidence on terms & condition among the parties –

The terms and conditions of L/C should be obeyed by both importer & exporter and all the procedure should run according to L/C only. If any disputes arise on the subject matter of L/C than it act as a written proof.

Widely used & secured form of term of payment –

L/C is only secured form of terms of payment because various banks are involved in it and therefore less risk is involved in it.

Precaution for L/C –

Precaution mean exporters or importers take relevant precautions in making the L/C at the time of contracting which are useful for the making of L/C.

- To check the beneficiary (exporter) by the importers Bank who is providing the money to the exporter on behalf of importer.

UNIT-III
EXPORT CREDIT GUARANTEE CORPORATION OF INDIA (ECGC)

The risk element in the export business is greater than the risk involved in domestic trade because the two parties of the export contract belong to different countries. The export contract involves a number of complications economic, legal, political and social. For minimizing the risk element in export business and to facilitate the flow of finance from banks and other institutions to exporters there is an export credit guarantee corporation (ECGC).

The ECGC was established in 1954 and the export risk insurance corporation (ERIC) was merged in it. The corporation is under the administrative control of the Ministry of Commerce. Its head office is in Bombay and regional offices are at Calcutta madras, Delhi and Bombay. It is wholly owned by the Government of India and works on 'no profit no loss' basis.

Functions of the Corporation:
The main function of the corporation are –
1) By issuing suitable policies, it insures exporters against the attendant risks of export operations.
2) It provides financial guarantees to banks and exporters for exporters against deferred credit payment terms.
3) Any other activity assigned to it by the Government of Indian from time to time.

Insurance policies issued by ECGC.
The ECGC has issued the following two types of policies –
1) Standard policies,
2) Special policies

1) **Standard Policies** – Standard policies are issued by the ECGC to exporters to protect them against the risks of international trading especially those relating losses in exports on deferred terms of payment. There are three types of standard policies.
   a. ***Specific shipment policy (Political risk)*** – This policy covers the risks caused by the political reasons such as importer's government action to block or delay payment, war, revolution or civil disturbance, cancellation of import license, demurrage or addition handling charges due to delay and the other causes of loss occurring outside India.
   b. ***Specific shipment policy (comprehensive risks)*** – Such policy covers both the political and commercial risks involved in export transactions. The policy covers the commercial risks caused to the exporter to the insolvency of the buy delay in payments for more than 4 month, non-acceptance of goods not on to exporter's default.
   c. ***Contract Policy*** – Contract policy covers the additional risk due to cancellation of export license or import on of new export restrictions in India. The above two specific policies covers risks from the time the goods are shipped but the contract policy covers the risks from the date of contract.

   The extent of coverage of financial losses (on account of political or commercial risks) under the ECGC standard policy is 90% of the losses.
2) **Special polices** – Special polices, besides the risks covered under standard policies, are issued by the ECGC to cover the risks as desired by the exporters to meet their needs in export transactions. To suit the various needs of the exporters, the ECGC has devised the following polices -
   a. Constructions works policy covers the risk of non-payment of contract price to the contractor by the foreign contractee.
   b. Policy for consignment export covers the loss on consignment transactions.
   c. Services policy covers the risks of non-payment for services rendered abroad. Policy covers only technical and professional service.

d. Manufacturer's credit insurance policy covers 80% of the risks due to default on insolvency of the part of exporter.
e. Exporter's credit insurance policy. This policy covers 50% of losses arising out of default or insolvency of manufacturers.
f. Market development policies covers losses on market development on 50:50 basis if market surveys are done by an independent agency.

Financial Guarantees –
ECGC provides financial guarantee to the blanks advancing credits to exporters. Some of the guarantees offered by the ECGC are –

i) Packing credit guarantee or pre-shipment guarantee
ii) Post-shipment exporter credit guarantee.
iii) Export finance guarantee.
iv) Export production finance guarantee
v) Export performance guarantee.
vi) Transfer guarantee.

Special schemes –

i) ***Overseas investment insurance*** – With the increasing export of capital goods and turnkey projects from India, the involvement of exporters in capital participation in overseas projects has assumed importance. ECGC has evolved a scheme to provide cover for such investment.
ii) ***Exchange fluctuations risk cover schemes*** – The ECGC has evolved recently two new schemes to provide greater protection to exporter of capital goods and turnkey projects against the risks of fluctuation in foreign currency.
The first scheme is known as the 'Exchange Fluctuation Risks (Bid) Scheme to give protection in respects of bids tendered in approved foreign currencies between the date of bid and the date of contract. If the contract is won, the ECGC refunds 75% of the premium.
If the contract is won, the exporter will be required to obtain the 'Exchange Fluctuation Risk (contract) cover and eligible deterred receivables and in that event he will be allowed in terms of this scheme to have the rate of exchange prevailing as on the date of bid if it is more advantageous than the rate of exchange on the date of the contract.
iii) ***Special scheme for small scale exporters*** – For small scale exporters, the ECGC offers a higher cover (95% against commercial rises and 100 percent against political rises) and makes procedural relaxation in mattes of settlement of claims; section of credit limit, etc. The scheme applies the exporters whose annual exports turnover is not more than Rs. 10,00,000/-.

FILLING CLAIMS WITH ECGC

Note: A claim will arise when any of the risks insured under the policy materializes.
The ECGC expects the exporter to take all possible steps to minimize the loss arising on account of non-payment by his overseas importer; he has to be very prompt and effective in taking any action to minimize the loss. However, the action that needs to be taken in any particular case will depend upon the facts and circumstances of the case. The amount of the bill, the reason for non-payment by the buyer, the stand taken by the buyer the buyer's financial position, the state of goods, market conditions, etc., will dictate the course of action most suitable for minimizing the loss. Listed below are the essential steps that the ECGC recommends.

Action in case of Defaults –
(a) In the event of non-acceptance of goods/documents –

a. The goods must be safeguarded by getting them moved to a bonded warehouse and keeping them adequately insured;

b. The bill should be noted and protested through a Notary public for non-acceptance;
c. The reason for non-acceptance should be ascertained and the buyer be persuaded to accept the goods/documents; the assistance of the Indian Trade Representative in the buyer's country should be sought;
d. If the buyer fails to accept the goods/documents, attempt should be made to find an alternative buyer for the goods and, if one is found, the re-sale should be made after giving a notice of re-sale to the original buyer after obtaining prior permission of the ECGC.
e. If re-sale is made on credit terms, a suitable credit limit should be obtained on the new buyer, if no such limit has been previously obtained and is in force;
f. If the re-sale is to be made at a price lower than the original price, prior approval of the corporation as well as that of the reserve bank of India, should be obtained;
g. Action including legal steps should be taken against the original buyer for recovery of the loss if any sustained in the re-sale, if it is considered that such action is not necessary or not useful for reasons like the loss being negligible or the hopeless financial position of the buyer, concurrence of the corporation and that of the reserve bank of India should be obtained; and
h. If it is not possible to re-sell the goods, they should be brought back to India, with the prior approval of the corporation.

(b) In the event of non-payment of bills already accepted –

a. The bill should be noted and protested through a Notary public for non-payment;
b. The reason for non-payment should be ascertained and the buyer be persuaded to make the payment; the assistance of the Indian Trade Representative in the buyer's country should be obtained;
c. If persuasion fails, steps should be taken to file a suit against the buyer in a competent court of law in the buyer's country, (Name of suitable lawyer can be obtained from the corporation); and
d. If legal action is considered unnecessary, the reason for such a conclusion should be explained to the corporation and its approval should be obtained for waiver of legal action,

(c) In case of insolvency or other causes –

If non-payment is due to insolvency of the buyer prompt and adequate action should be taken by the exporter to file his claim, with the insolvency court. If any other event occurs which may lead to a loss, the exporter should take appropriate action to avoid or to minimize his loss.

(d) Default declaration –

Notification of all payments received within thirty days of their due dates should be sent to the corporation on Form No.205 {Annexure 21}. This declaration should be sent on before the 15th of every month.

(e) Conclusion –

The exporter should keep the corporation informed of all actions taken by him to recover amounts in default. The corporation will do all it can to help the exporter in his recovery action and may also suggest certain courses of action. The exporter must act on the basis of such advice.

Due date –

The due date of bill has to reckoned from the date of shipment. Where, however, the exporter desires to reckon the due date from the date of acceptance, as result of which the period actually allowed to the buyer may exceed the period for which he has paid premium to the corporation, he should intimate the correct position to the corporation if for any reason the bill is not accepted on first presentation immediately after the shipment is made and pay the requisite premium, as otherwise the corporation shall not have liability for period allowed by the exporter to the buyer in excess of the period for which he has paid premium to the corporation,

Extension of due dates –
If a buyer who is unable to make payment on the due date asks for more time to pay the amount, the exporter should make a good commercial judgment on the request, based on facts and circumstances of the case. If it appears that extending the due date of the bill is the proper course of action, the exporter should seek the approval of the corporation, giving in detail the reasons justifying such action. He should also pay the corporation an additional premium for the extended terms of payment, RBI's Approval. Approval of the reserve bank of india will have to be taken if the total period from the date of shipment to the extended due date of the bill exceeds 180 days.

Shipments to a buyer in default –
In the normal course, no exporter should make further shipment to a buyer who has not paid the bills relating to earlier shipments if, however, it is considered advisable to effect further shipment to such a buyer, prior approval in writing of the corporation must be obtained. The corporation will not admit liability for any shipment made to a buyer in default without its approval.

In case of Disputes –
In the buyer raises any dispute regarding the execution of the export order or if he raises a counter-claim, the claim for the resultant loss will not be admitted by the corporation until the exporter obtains a decree in his favour from a competent court of law in the buyer's country. This is because the corporation cannot pay claims for losses caused by the exporter's own failure to supply the goods as per contract. If, however, he considers legal action either inadvisable or impracticable, the exporter should explain to the corporation reasons for the same. If the reasons advanced by the exporter acceptable to the corporation and if the corporation is satisfied that the exporter is not at fault, the corporation may waive legal action and settle the claim.

Sale on discount to the same buyer –
If in order to induce the buyer to accept the goods and/or to pay them, the exporter allows a discount to the buyer and accepts an amount lower than the invoice value in full settlement of bill, the corporation will not accept liability for the resultant loss.

Time for filling claims –
Claims can be filed with the corporation after expiry of a waiting period counted from the date of the bill or from the event causing the loss. The time for filing claims arising due to different reasons are given below.

Normal Circumstances –

(a) ***Insolvency of Buyer*** – One month. Claims due to the insolvency of buyer can be filed either after one month from the date of which the exporter's claim has been admitted to rank against the insolvent's estate, or after four months from the due date of the bill whichever date is earlier. In case the claim is filed after four months from the due date of the bill but before the claim is admitted by the official receiver liquidator, the exporter has to give documentary evidence of the claim having been filed with receiver/liquidator and also a declaration to the effect that he has done, or omitted nothing, whereby the claim is liable to be rejected by the receiver/liquidator.

(b) ***Default by the Buyer by Non-payment on Due Date*** – Claims due to protracted default can be filed with the corporation after four months from the due date of the bill or the extended due date of the bill,

(c) Default by the Buyer by Non-acceptance of goods/documents is cases where the goods/documents have not been accepted by the buyer, claim can be filed with the corporation after one month from the date on which the goods were resold or brought back to India with the approval of the corporation. Where the goods are brought back to India, claims will be admitted only for the reshipment expenses.

Where the buyer does not accept goods or pay for them because of differences over fulfillment of the terms of contract by the exporter, counter-claims or set-off, ECGC considers claims after the dispute between the parties is resolved and the amount payable is established by obtaining a decree from a court in buyer's country. This condition is waived if ECGC is satisfied that exporter is not at fault and that no useful purpose would be served by proceeding against the buyer.

(d) ***Transfer delay*** – Where payments are not realized due to exchange transfer delay, claims can be filed with the corporation after four months from the date on which the buyer has, after to making the payment in local currency, completed exchange control formalities necessary for the transfer of funds of India. Where the corporation has stipulated a longer waiting period, claim can be filed only after competition such period.

(e) ***Diversion of Voyage*** – Claims due to diversion of voyage outside India can be filed as soon as the exporter is in a position to produce to the corporation the necessary documentary proof of the cause and extent of toss.

(f) ***Other causes*** – Claims due to all other causes covered by the policy can be filed after the expiry of the four months from the event which is the cause of the loss.

Restricted Cover Countries –
It may be specially noted that the various period mentioned above are applicable in normal circumstance, where, however a country is placed under restricted cover, period specially stated for those countries will apply.

Last Date of Filling Claim –
No claim will be entertained by the corporation if it is not filed within a period of 24 months from the due date of the concerned bill.

EXPORT-IMPORT BANK OF INDIA (EXIM BANK)

The export-import bank of India (Exim Bank) is a public sector financial institution, Established on January 1, 1982. It was established by an Act of Parliament for the purpose of financing, facilitating, promoting foreign trade of India. It is the principal financial institution for coordinating the working of institutions engaged in financing export and import. The Exim Bank Act also empowers the Bank to finance export of consultancy and related services, assist Indian joint ventures in third countries, conduct export market studies, finance export-oriented industries and provide international merchant banking services. Exim Bank concentrates on medium and long-term financing, leaving the short-term financing to be handled by commercial banks.

Externally oriented companies form the target group for the Bank. The Bank's primary objective is to develop commercially viable relationships with such companies by offering them a comprehensive range of products and services, aimed at enhancing their internationalization efforts. Its fee based services help identify new business propositions, source trade and investment related information, create and enhance presence through joint network of institutional linkages across the globe. Services include search for overseas partners, identification of technology suppliers, negotiating alliances, and development of joint ventures in India and abroad. The Bank also supports Indian project exporters and consultants to participate in projects funded by multilateral funding agencies.

The activities of the Bank extend to different fields of lending, offering advisory services and promotional activities. The activities of the Bank can be grouped as under:

S.No.	Particular
1	Lending a) to Indian companies b) to foreign Government/companies

	c) to Indian Banks
2	Guaranteeing
3	Advisory
4	Promotional

Lending to Indian Exporters-

1) Supplier's credit for deferred payment exports –

Exim Bank offers supplier's credit in Rupees or in Foreign Currency at post-shipment stage to finance export of eligible goods and services on deferred payment terms. Supplier's credit is available both for supply contracts as well as project exports; the latter includes construction, turnkey or consultancy contracts undertaken overseas. Finance up to 100% of post-shipment credit extended by exporter to overseas buyer is available under the scheme.

2) Consultancy and Technology Service Finance Programme –

Indian consultants executing overseas involving consultancy and technology services, wherein deferred payment terms need to be offered to the client, can utilize the facility. The credit will be extended by Exim Bank in participation with commercial banks or the commercial bank may finance and obtain refinance form Exim Bank.

3) Pre-shipment Rupee Credit –

Credit is available to eligible exporters to buy raw materials and inputs required to produce capital equipment that has to be exported. Exim Bank participates in the credit, if the requirement is for periods in excess of 180 days. Pre-shipment credit up to 180 days is available from commercial bank and, therefore, Exim Bank does not entertain proposals not exceeding this period.

4) Foreign Currency Pre-shipment Credit (FCPC) –

Under this programme, short-term foreign currency finance is available to eligible exporters for financing inputs for export production such as raw materials, components and consumables. The finance is repayable in foreign currency from proceeds of the relative exports.

5) Finance for Rupee Expenditure for Project Contracts (FREPEC) –

This programme seeks to finance Rupee Expenditure incurred/required to be incurred for execution of overseas project export contracts such as for mobilization/purchase/acquisition of materials and equipment, mobilization of personnel, payments to be made in India to staff, sub-contractors, consultations and to meet project related overheads in Indian Rupees.

6) Lending Programme for Export-oriented Units –

Units set up/proposed to be set up in Export Processing Zones, Export-oriented Units, units importing capital goods under Export Promotion Capital Goods Scheme, and units undertaking expansion/modernization/up gradation/diversification programmes of existing export-oriented units with export orientation of minimum 10% of sales of Rs. 5 crores per annum, whichever is lower, are eligible.

7) Working Capital Term Loan Programme for Export-oriented Units (WCTL) –

The eligible units are as under the previous scheme. Working capital term loans in Indian rupees or in foreign currency, upto 80% of the demand loan component of working capital with a minimum 20% margin.

8) Production Equipment Finance Programme –

Under the Production Equipment Finance Programme (PEFP), Exim Bank seeks to finance non-project related capital expenditure of export-oriented units. PEFP is structured as an umbrella arrangement under which various equipment, imported and indigenous, can be financed, thus obviating the need to arrange finance for every such procurement. It is not necessary to identify specific equipment sought to be financed at the time of application; this could be done at the time of disbursement. PEFP is a fast-disbursing window available to export-oriented units. Existing export-oriented units with minimum export orientation (present or targeted) of 10% of total sales or Rs. 5 crores in value, whichever is lower, are eligible.

9) Import Finance –

Term loans in Indian rupees/foreign currency is available to Indian manufacturing companies for import of capital goods/plant and machinery, technology/know-how. The interest, rate will be based on prevailing market rates. Rupee term loan is linked to Bank's minimum lending rate and the foreign currency term loan at floating or fixed interest rates based on Bank's cost of funds. Maximum period for repayment is seven years.

10) Bulk Import Finance Programme (BIF) –

Short term working capital finance in Indian rupees or foreign currency is provided to manufacturing companies to access consumable inputs. The import of eligible items should be with a minimum order size of Rs. 1 crore. For Rupee loans interest rate will be 1% below the rate on cash credit facility charged by the commercial (lead) banker subject to a minimum interest rate fixed by Exim Bank. For foreign currency loan interest will depend on cost of funds to Exim Bank with a maximum of 0.75% over LIBOR. Repayment is in 1 year.

Lending to Foreign Government, Companies, Etc –

1) **Buyer's Credit** – Credit is extended by Exim Bank to buyers abroad to enable them to import engineering goods and projects from India on deferred credit terms. Similar to direct lending to exporters, the facility is to be secured by a letter of credit or bank guarantee or guarantee from government or promissory note from government.
2) **Lines of Credit** – Exim Bank extends lines of credit to overseas governments or agencies nominated by them, to enable buyers in these countries to import capital/engineering goods from Indian on deferred credit terms. This facility enables Indian exporters to offer deferred credit to customers in these countries, as per terms and conditions already negotiated between Exim Bank and the overseas government. The exporter can obtain payment from Exim Bank against negotiation of shipping documents, without recourse to the exporters.
3) **Re-lending facility** – Credit is made available to overseas banks fro their lending to importers of capital goods from India. Overseas banks thus would intermediate between foreign buyer and Exim Bank, who intermediates with the suppliers. The borrowing bank may be a commercial bank, a central bank, an investment bank or merchant bank of a country with a good credit standing. The loan made by these bank to the importers should be for import of capital goods/equipments and/or services from India. The credit limit for each bank would normally be USD 5-10 million and may be raised to USD 15 million in select cases. The loan is extended up to 85% to 90% of any single contract.

Loans to Commercial Bank in India –

1) Refinance of Export Credit
2) Export Bills Rediscounting Facility
3) Syndication of Export Credit Risks – Under this, commercial bank can support export proposals without blocking their funds for long terms. They can participate in the syndication arrangement. At the Working Group meeting which accords clearance to the export proposals, the participation arrangement for the funding of export credit is also determined. Exim Bank and other banks participating in the funding of the loan would syndicate the respective credit risks to other eligible commercial banks, who would then assume part of the total risk.

Guaranteeing of Obligations –
Exim Bank issues guarantees on behalf of exporters of construction and turnkey projects. Exim Bank issues following guarantees directly or in participation with other banks, for project export contract:

- Bid Bond
- Advance Payment Guarantee
- Performance Guarantee
- Guarantee for Release of Retention Money
- Guarantee for Raising Borrowing Overseas
- Other Guarantees

Advisory Services –
Through its International Merchant Banking Division, Exim Bank offers the following advisory services:

i) Work closely with Indian companies in designing financing packages for joint ventures in third countries.
ii) Advise Indian companies, executing contracts abroad, on source of favourable financing overseas;
iii) Provide access to euro financing sources and global credit sources to Indian companies engaged in exports;
iv) Advise on exchange control practices globally.
v) Advise and design financinal packages for export-oriented industries in India.

These services are being added to, in order that tailor-made financing packages for high value export contracts are available.

Promotion Activities –
Under the Export Import Bank of India Act, 1981, the promotional activities expected of Exim Bank are:

i) Undertaking and financing of research, surveys, techno-economic or another study in connection with the promotion and development of international trade;
ii) Providing technical, administrative and financial assistance of any kind for export and import.
iii) Planning, promoting, developing and financing export-oriented concerns; and

Collecting, compiling and disseminating market and credit information in respect of international trade.

B.Com IV Sem. (FT) Subject: Finance & Procedure

UNIT-IV

COSTING & PRICING FOR EXPORT

COSTING FOR EXPORT

The first step is to use below cost-plus method to determine the export pricing competitiveness of your products.

The cost plus method of calculation require a costing sheet so that it enable the exporter or manufacturer to:

Check that every expense has been covered in arriving at the selling price and provide a detailed record of the terms that have been quoted to the foreign buyer.

The items covered by the export costing sheet are-

1) ***Unit cost of product*** – The starting point in export pricing is the production cost per unit of the product. This would be the variable cost plus fixed cost or overhead.
2) ***Profit*** – Normally, profit will have already been included in the domestic price. However, if it is insufficient for the risk involved in selling abroad, an extra allowance for profit can now be added.
3) ***Agent's commission abroad*** – This is usually calculated on a percentage basis.
4) ***Packing*** – The cost of packing for overseas shipment will vary according to the product, destination, and means of transportation. The manufacturer must include reasonable provision for it.
5) ***Labels*** – These may have to be printed in a foreign language, perhaps containing information not included in the labels used within the exporter's country. Also, from the sales point of view, they must be suitable to the foreign consumer. The selling price of the product must include sufficient allowance for these extra labeling costs.
6) ***Marketing*** – A small cost is involved in stenciling an identification mark on each package for export.
7) ***Strapping*** – Each carton may have to be wire-strapped to help prevent it from being accidentally opened en route to its destination. Small packages must be wire-strapped together to discourage pilferage and other loss.
8) ***Cartage*** – Allowance must be made for transporting the goods to be transported to the local railway station or container depot.
9) ***Freight to sea board*** – The cost of transporting the goods from the inland town or city to the seaport for shipment abroad e.g. K.L. to Port Klang.
10) ***Unloading charge –*** There is a charge for unloading goods from railway cars or trucks. This cost will be incurred when the goods arrive at the seaport.
11) ***Terminals*** – These are handling, wharfage and harbor dues that must be paid by the exporter to the wharfage company.
12) ***Long or heavy load charge*** – If the shipment is exceptionally long or heavy, an extra charge may be incurred.
13) ***Consular Documents*** – These documents can be quite expensive, particularly in the case of export to the Latin American countries. Initially, the exporter may wish to quote to the foreign customer a price of so many dollars plus the cost of consular documents. If not, it must make adequate provision in the price to cover their cost.
14) ***Other charges*** – Here, space is left for the inclusion of unexpected additional expenses such as the cost of overseas telegrams or telephone calls, extra storage charges etc.
15) ***Ocean freight*** – The cost of shipping the goods by sea to the foreign port. The cost may be quoted by the ocean carrier in local currency or U.S. dollars.
16) ***Freight forwarder's fee*** – If the exporter uses the services of "Freight Forwarder" for documentation and book the shipping space required, allowance must be made for the fee involved. The amount of these fees can be obtained in advance from the forwarder on shipping agent.

17) ***Financing charges*** – Until payment is received, the export firm will have part of its working capital tied up in export merchandise. Even if no credit is given, it will have to wait until the goods are shipped or delivered before payment is made.
If credit are given to the foreign customer, it may have to wait an additional 60, 90 or 180 days for payment. The selling price should include an amount to cover the cost of this working capital.
If the exporter intends to discount at its bank a time draft that has been accepted by the foreign importer, so that the exporter can obtain its money sooner. Then allowance must be made in the export price for bank discount charges.
18) ***Export credits insurance*** – The exporter may buy insurance or "Factoring" on its credit sales abroad,. Allowance should be made for it.
19) ***Total (C. & F.)*** – The total of the previous items, each of which should be rechecked, is the C. and F. cost of the export goods.
20) ***Marine Insurance*** – The exporter will want to insure itself against financial loss from all possible risks, including damage to the goods or theft, while they are being shipped abroad. Usually, ocean ships are insured for 110 percent of their total cost to cover anticipated profit and the interest cost of working capital tied up in the shipment.
21) ***Total (C.I.F. local funds)*** – This is the total price of the goods calculated in such a way as to include all the various costs involved, including insurance and freight. It is the total in item 19, plus the insurance premium.
22) ***Conversion into Foreign Exchange*** – The foreign buyer will usually ask for a price quotation in U.S. dollars or perhaps in German marks, Japanese yen, or some other currency. Therefore, the price in the exporter's local currency must be converted to a price into the foreign currency.

    Care must be taken to use the correct exchange rate. The exporter may wish to eliminate the risk of an exchange loss by selling the foreign currency to a bank on a forward basis, in exchange for local currency.
    The cost of this bank service, which provides the exporter with a predetermined, fixed rate of exchange for its foreign currency, should be included in the export price quoted to the foreign importer.

INTERNATIONAL PRICING

Price is an important element of marketing mix decision that is often adopted in international markets with least commitment of firm's resources. Price is the sum of values received from the customer for the product/service. Price plays significant role in bringing market product integration for international marketing companies. Price is terms of amount of money, but it may also include other tangible and intangible items of utility.
According to W.J. Stanton – "Price is the amount of money which is needed to acquire a product". Pricing is a managerial activity.

Pricing objectives –
Pricing objectives set guidelines for price setting and these are varies country to country for an individual firm. They must be compatible with company's overall goals and its marketing objectives. Following are the major pricing objective –
a. Return on Investment
b. Profit maximization
c. Maintain or increase market share
d. Price stabilization
e. Meeting competition

Difference in price determination of domestic and international marketing –

Price determination in domestic marketing is relatively easy job in comparison to international marketing. The major point of differences are discussed under following headings –

1) Cost differences
2) Three-tire competition
3) Support and subsidies
4) Impact of factors of External Environment

Role of Price and Non-price factors in International Marketing –

Price and non-price factors make their impact in international pricing decision. Both these factors play their vital role in pricing decisions of exporting firms. The impact for individual firm or for country may be positive or negative. Impact of these factors may be discussed in following point –

a) Role of price factor
b) Role of non-price factor
    1) Bais regarding price quality co-relation
    2) Country of origin
    3) Brand image
    4) Product differentiation
    5) Speed of delivery
    6) Capacity of bulk supply
    7) Type of product
    8) Sales services
    9) Credit terms
    10) Quick settlement of claims

Factors influencing pricing –

The important factors affecting pricing decisions in international marketing may be described as under –

1) Costs
2) Trade cycle
3) Marketing objectives of the company
4) Competition
5) Government policies
6) Elasticity of demand
7) Type of product
8) Product substitution
9) Image
10) Stages of product life cycle
11) Capacity utilization ratio
12) Product differentiation
13) Consumer profile
14) Exchange rate

Process of price determination –

Various steps in the general process of price determination may be described as under –

1) Estimate the prospective demand
2) Sales forecasting
3) Estimating cost
4) Evaluation of company's policies
5) Selection of pricing method and policies
6) Analysis of competitive influence
7) Selection of specific price
8) Readjustment of pricing

Pricing Method –

Many methods are used in international marketing for setting prices of products and services by the different companies; selection of appropriate method depends on overall corporate goals, marketing objectives of the firm and prevailing global environment. Following methods are used for pricing in international marketing –

A) Cost based pricing method –

1) Cost plus pricing method – In this method of pricing an anticipated of profit is added in the cost of production to calculate selling price.

Advantages

- Simple method
- Having no complicated calculation
- Method cover all the costs
- Firm can get desired "Return on investment".
- Profitable sales volume can be generated

Disadvantages

- It is unrealistic & week method
- It ignores market demand & influence of competition
- It does not consider price elasticity of demand
- If firm use market penetration strategy, then method is useless.

Feasibility – Cost plus pricing method is best suited for those firms, who are operating in seller's market, sellers market is a situation, where infinite demand is prevailing in the market and combined supply of all seller's is unable to meet it.

2) Marginal cost pricing – Marginal cost is the cost of producing one additional unit. The curve of fixed cost will be horizontal, means that upto a specific level of production the fixed cost will remain same fixed cost involves salaries, rent, minimum water and electricity expenditure, interest etc.

Advantages

- It is useful for market penetration
- Firm may increase its turnover
- Price can be made very competitive by using this method
- This method is appropriate for price sensitive foreign markets.

Disadvantages

- If company ignored fixed cost for international market then it is to be recovered from domestic market.
- Method is not useful where the variable cost is very high on total cost.
- Loading of fixed cost of export marketing may be done on other product, which can bear high cost. It may lead to cannibalization of its own products by the firm.
- Under penetration strategy may keep lower price for exports but it difficult to increase price in future.
- Firm may be charged for dumping its product in foreign markets.

Feasibility – It is appropriate method for those international marketing firms operating in the construction/in turn-key projects. It is useful when the management want to keep its man power engaged during the slack season. It is also appropriate when domestic customer can afford higher price and firm is planning to adopt techniques of mass production to reduce the gap between total cost and marginal cost. It Is also useful when capacity utilization ratio is low.

3) Break-even pricing (BE Pricing) – Break even pricing is no profit no loss marketing, BE point is that quantity of production at which total revenue equals total cost, assuming a specific selling price.

B.E.P. calculated with following formula –

$$\text{In units} = \frac{Total\ \ fixed\ \ cost}{unit\ \ contr\,ibution\ \ to\ over\,head}$$

Or

(Selling price – Average variable cost)

To attain BEP in sales volume, multiply the BEP in units with selling price.

Advantages	Disadvantages
Marketing company may safeguard against possible losses.	Basic assumption of BEP analysis generally not valid for two reasons. a) Total fixed costs are constant is not fully valid. b) Variable costs remain constant is not fully valid.
Calculation of BEP, is very simple	The method does not tell us whether we can actually sell the breakeven point.

Feasibility – Though the break even pricing method ignores market circumstances, but it is having its limited uses. This method may be useful in following situations –

a. It is appropriate for new entrant firms in international marketing.
b. It can be effective when exporting firms apply market penetration strategy means firms keeps the prices of its products below in order to get established in the market.
c. If the stiff competition is prevailing in export market, then break even pricing may be used to defeat competitor.

B) Market-Oriented Pricing Method –

Market-oriented pricing method gives proper weightage to need of customers and different elements of external macro environment. These methods can be discussed under the following headings –

1) **Pricing above the market** – This method of the firm changes higher prices for its product/service in comparison to its competitions apply by international marketing company, whose marketing strategy is non price competition.
   Feasibility –
   a. This method is appropriate for those firms, who are operating in quality sensitive foreign markets. There is positive co-relation between quality of product and its prices, and firm can psychologically satisfy to customers and they will never mind the high prices.
   b. This method is also useful when the firm is pricing an innovative product in the market.
   c. And also method appropriate when the firm is going to create substantial differentiations in its product/services.

2) **Pricing below the market** – This method of the firm sets the prices for its product/service below the level of its competitor/below the standard price range accepted by the market. Usually market leader retrain from this method because if they do so, consumers may doubts, regarding the quality of product.
   Feasibility –
   a. The method is a appropriate for the "Follower firms" of the market.
   b. The method is also having utility for those foreign markets that are price sensitive.
   c. It is useful for small marketing companies.

3) **Pricing to meet competition** – In this pricing method the price of product is set at the balancing point of prevailing demand and supply in the market. Market accepted price for the product or service, serves a basis for price setting, under this method. Price depends on the demand of product.
   Feasibility – The method is appropriate in free economics, having least government interference.

4) **Transfer Pricing** – This pricing refers to prices charged as good or products sold within corporate family. Determination of mode of transfer of pricing becomes necessary when a firm begin to establish joint ventures/foreign subsidiaries/setting collaboration with other partners/going to appoint franchise-holders in foreign countries, in order to give boost to its global operations. When goods moving from one unit to another unit situated in other countries at that time this method is appropriate.

Basic objectives –

a) To facilitate the control of parent company over its subsidiaries.
b) To keep the operations of all units across the world profitable.
c) To reduce the problems related to tax structures.
d) To maintain harmony among the different units or with subsidiaries.
e) To keep the price of firms products competitive to its rival foreign companies.

Method of charging transfer pricing –

a) Transfer of manufacturing cost
b) Transfer of arm's length
c) Transfer of cost plus
d) Transfer of negotiation prices

Export price quotations and Inco terms –

Export price quotations and Inco terms plays vital role in international marketing. Buyer in international trade inquires from number of foreign companies regarding product or goods foreign companies who are interest to export provide full details of desired product along with price quotation. Purchasing decision is significantly affected by price quotation. The details of widely used price quotations in international marketing is as under –

1) ***Ex-works/Ex-factory (EXW) –*** This price quotation refers to floor cost of seller.
2) ***Free carrier (FCA)*** – This price quotation the exporter's obligation to deliver the goods is over when he delivers it.
3) ***Free alongside ship (FAS)*** – This price quotation the exporter delivers the goods by placing it alongside the ship at the specified poll.
4) ***Free on board (FOB)*** – In this price, if the loading expenditure is added into FAS the new price quotation will be FOD.
5) ***Cost and freight (C&F)*** – This price quotation refers that exporters has added the amount of foreign firm is country's port to the port of importer.
6) ***Cost, Insurance & freight (CIF)*** – In this price, if the amount of insurance premium is added in the C&F. The new quotation will be C/F.
7) ***Delivered Ex-ship (DES)*** – This price quotation indicates that the exporter will deliver the goods by placing it at the disposal of importer's port the exporter bears all the risk & cost involved in briniging the goods.
8) ***Delivered at frontier (DAF) –*** Under this price quotation exporter delivers the goods at the disposal of importer on means of transport not unloaded, cleared for exports but cleared for import at the specified destination at the frontier, but before the custom post of the adjoining country.
9) ***Delivered Ex quay (DEQ)*** – In this price quotation the importer clears the goods for import and he has to pay all the taxes, duties and for other formalities, imposed by the government of his country.
10) ***Delivered duty unpaid (DDU)*** – In this price quotation the exporter delivers the goods, which is not cleared for import but not unloaded from at any destination. The exporter bears the risks and cost of transportation of goods, excluding the import duty.
11) ***Delivered duty paid (DDP)*** – In this price quotation the exporter delivers the goods to the importer cleared for import but is to be loaded from at any desitnation. In the price quotation obligation of exporter become grater & importer's becomes grater & importer's become minimum.

An export offer or quotation is the basis of any export transaction and may be made in any of the following four ways –

1) A proform invoice indicates the price as well as other charges as per terms of contract incurred in shipment. This is an exact duplicate of the invoice which will be sent to the importer just after export.

2) The offer may be made in response to a public global tender floated by a buyer. It should be comprehensive. It covering ll the conditions of tender & listing out price with other changes such as freight.
3) An offer may also be in the form of printed price list where goods have standard export price and also mention other terms & conditions.
4) An offer can be given in the form of a letter indicating the price terms of payment & delivery period what every may be made of offer at should be written in a simple and easily understand style.

Factors in drawing up Quotations or Impact of Different contract conditions on export price quotations–

The base price determines the expenses and the risks which are to be borney by the exporter. Besides these are certain other specific conditions which the buyer would like to include in the contract to be fulfilled by the exporter. Implications of contract conditions tend to be stronger in case the merchandise in questions is the capital goods involving installation. Performance guarantees, supply of spare parts etc. the implication of such conditions & their effect on price calculations are–

1) Exchange rate variation
2) Packing of export consignment
3) Guarnatees
4) Spare parts
5) Price variation formula
6) Change in specification
7) Penalty/Liquidated damages provision.

Thus the above factors which really affect the price to be quoted the exporter/seller should take them into account while preparing an export price quotation so that he may be fully protected against any subsequent loss.

UNIT-V
FOREIGN EXCHANGE RATES, EXCHANGE FLUCTUATIONS & OBTAINING FORWARD COVER

Foreign Exchange: Meaning -
Foreign exchange is the mechanism by which the currency of one country gets converted into the currency of another

In the sense of rate of exchange – According to this sense, foreign exchange refers the rate of exchange or the rate at which the currency of one country is converted into the currency of another country. In other words, the external value of domestic currency is the rate of exchange.

FERA/FEMA defines the term "Foreign exchange means foreign currency and includes –
1) All deposits, credits and balances payable in any foreign currency and any drafts, traveler cheque, letters of credit and bills of exchange, expressed or drawn in Indian currency but payable in any foreign currency.
2) Any instrument payable at the option of the drawer or holder thereof or any other party thereto, either in Indian currency or in foreign currency or partly in one and partly in the other. Thus, foreign exchange includes foreign currencies, balances kept abroad and instruments payable in foreign currency with the help of which countries of the world clear off their international obligations.

Problems of Foreign Exchanges –
1) Existence of different currencies with different values
2) Disequilibrium in demand and supply of currencies
3) Lack of stability in exchange rates
4) Problem of the methods of international payments
5) Problem of the methods of international payments
6) Problem of transfer of payments
7) Problems of determination of rate of exchange
8) Problems of restrictions imposed by countries

Causes of Exchange Rate Fluctuations –

1) ***Changes in the demand and supply of foreign exchange*** – The changes in demand and supply of foreign exchange influence the balance of payment of a country in short-term and it also affects the aggregate volume of capital movement. These changes in demand and supply will either increase or decrease the rate depending upon the changes in the supply and demand of foreign exchange.
2) ***State of International Trade*** – The state of international trade of a country or changes in the volume of imports and exports will also affect the rate. If there is adversity in trade and it increases further, this deficit in trade will adversely affect the rate and vice versa in case of a favorable trade balance.
3) ***Monetary Policy*** – Monetary policy particularly the regulation of money supply and frequent changes in money supply will affect the fluctuation in rate of exchange.
4) ***Speculative Activities*** – These activities substantially affect the exchange rate as under speculative activities the exchange rate is highly fluctuated.
5) ***Capital Movement*** – External borrowing assistance and aid and other financial foreign investment will affect the exchange rate.
6) ***Activities of Middlemen and Brokers*** – These activities are carried out to dispose off securities by buying in cheaper market and selling in the expensive and costlier security markets to earn

profit by the brokers and these activities affect the demand and supply of foreign exchange, it naturally affects exchange rate.

7) ***Industrial Factors*** – In case of industrial development, there is more investment of foreign capital and rate will be favourably affected and vice versa.

8) ***Currency Conditions*** – The currency conditions also deeply affect the rate of exchange.

   a. *Inflation* – Due to decrease in purchasing power, the rate turns against the country.

   b. *Deflation* – Due to deflation, there will be more foreign capital into the country and the rates will turn in favour of the country.

   c. *Devaluation* – The policy of devaluation will also affect the rate as it will affect the import, export and capital movement.

9) ***Political Conditions*** – There are several political factors which also affect the rate, like political stability in the country. The position of peace or war or national security problems, need heavy expenses on defence etc.

10) ***Fiscal and other economic policies*** – If government is adopting deficit fiscal policy, it will enhance inflation and rate will be adversely affected.

11) ***Policy of protection*** – In case of extending protection to domestic industries for promoting export and substituting imports in the long run, there will be positive effect on exchange rate.

12) ***Exchange Control*** – A country will like to stabilize the rate through various measures of exchange controls. These controls invariably affect exchange rate.

13) ***Capital Market and Stock Exchange Condition*** – The rate is also influenced by various transactions performed at stock exchanges or capital market. As it is well-known various type of securities like shares, stocks, debentures, bonds are bought and sold everyday on the stock exchanges and they affect the demand and supply of foreign exchange.

14) ***Banking Condition*** – Many factors related with banking also influence the rate like;

   a. Bank rate of the central bank

   b. Arbitrage operations

   c. Sale and purchase of bills, instruments and traveler cheques etc.

   d. Issuing of credit instruments

15) ***National Income*** – Increase in national income will lead to an increase in investment, production and consumption and accordingly these it will have effect on the exchange rate.

16) ***Resources Discoveries*** – When there are discoveries of resources that will help those countries to rise in their value of exchange rate. A good example is the "Petrol-dollar" in many gulf countries due to "oil".

17) ***Psychological Factors*** – It has powerful influence on exchange rates sometimes aggravating the trend set by other factors. The bull (Purchasing heavily expecting a rise in price) and bear (selling heavily expecting a fall in price) operations are the example of psychological factors.

18) ***Technical and Market Factors*** – There are huge isolated transactions in the market and seasonal variations in the demand and supply. These factors may upset the balance of demand and supply of foreign exchange.

19) ***Other Factors and Conditions*** – There are several other factors like aid, gift, amount of compensation and many other transfer payments which also affect the rate.

Foreign Exchange Rates (Meaning and types) –

Foreign exchange rate refers to the rate at which the currency of one country can be converted into the currency of another country, the rate of exchange, thus, indicates the exchange ratio between the currencies of two countries, for example, if one US$ is equal to forty Indian Rupees. What this implies that one US$ can fetch forty rupees in the exchange market.

Dealings in foreign exchange market are carried out at specified rate or price of a unit of one currency in terms of other currency. It could be regarded as an external value of domestic currency in terms of other foreign currencies. Simply the rate is parity between two currencies. The rate at which one currency buys exchanges for another currency is known as foreign exchange rate. The rate of exchange is expressed in foreign exchange market in two ways-

i) Expressing the rate in terms of domestic currency. By taking the one unit of foreign currency we take the value of domestic currency. For example, one US dollar is equal to forty Indian rupees. This is also called as direct rate
Direct method US$ 1 = Rs. 40.00

ii) Expressing the rate of exchange in terms of foreign currency or indirect rate method – In this method, the home currency unit is kept constant and foreign currency unit is varied. The rate is stated to be quoted in the indirect method. For example Indirect Method – Rs. 100 = $2.50.

Types of foreign exchange rates –

There are several types of foreign exchange rates. The important types are as follows –

1) ***Normal rate and actual rate*** – Normal or true rate or par of exchange rate is determined by forces that are of different nature from those influencing the actual rate. Normal rate may be fixed through exchange control while the actual rate or current rate or market rate is determined by the market forces of demand and supply of foreign exchange. This actual rate fluctuates from day to day due to changes in demand and supply but these changes take place around the rate which is called normal rate. The actual rate may be above or below the normal rate. For example, if the normal rate of Re and $ is 40:1 the actual rate may be 42:1 or 33:1.
2) ***Spot rate and forward rate*** – The spot rate refers to that rate of exchange at which the delivery of foreign exchange is made to the buyer by the seller at the spot or delivery of currency bought or sold is immediate. Forward rates are those quoted for forward or future delivery of currency, the rate off exchange is fixed at the time of deal but actual delivery is affected at contacted future date at this rate. The forward rate is quoted either at premium or at a discount over the spot rate. This rate is calculated by making an allowance of premium or discount or in other words, forward margin is adjusted.
3) ***Single rate and multiple rates*** – In general circumstances, there is only one single rate for all purposes. But in certain special circumstances, a country may adopt more than one, two or three rates with another currency. This is known as the multiple exchange rate system. For example, the government of a country adopts one rate for export and another for imports.
4) ***Direct rate and indirect rate*** – From the point of view of expressing the quotation in the foreign exchange market, the rate could be direct and indirect. Under direct rate, the foreign currency unit is kept constant and the home currency is varied, the rate is said to be quoted in direct method. While in indirect method of quotation, the home currency unit is kept constant and foreign currency unit is varied, the rate is called indirect. For example: Direct rate US$ 1 = Rs. 40/-
Indirect rate Rs. 100 = $2.50.
5) ***Buying rate and selling rate*** – As the foreign market is very lucrative and competitive market, the parties engaged in this business, naturally desire to earn maximum profit. The dealers will quote the rates of foreign currencies in two ways. They will give low rate when they will buy foreign currency and change high rates in case of sale of foreign exchange. These buying and selling rates are quoted on the basis of T.T., M.T. or bills.

6) ***Favourable Rate and Unfavourable Rate*** – The rate of exchange can either be favourable or unfavourable to a country. It the external value of the domestic currency increased in terms of the foreign currency, there will be favourable rate and vice-versa.
7) ***Official and Unofficial exchange Rates*** – When the International trade and other transactions are carried on the basis of pre-determined and authorized rates, these rates are called official rates and if the transactions are executed on the basis of other rates, they are called unauthorized and unofficial rates. These rates are also termed as Black Market rates.
8) ***Fixed and Flexible Exchange Rates*** – The fixed rates of exchange refer to maintenance of external value of the currency at a pre-determined level that is fixed by the country. Whenever the rate differs from this level, it is corrected through official intervention. After the collapse of gold standard, IMP was instituted under article IV of IMP fixed exchange rates system was adopted and member countries adopted this system and agreed not to change these rates except in consultation with the fund. This system was abolished in 1978 with the amendment in the article of IMF, still the fixed rates continue in many countries in the form of pegging their currencies to a major currency. The world economy now has been living in an era of flexible or floating exchange rates. Currencies outside their home countries have lost the character of money and have become more like commodities.
   The flexible free or floating rates refer to the system where the exchange rates are determined by the conditions of market forces viz the demand and supply of foreign exchange in the market. The rates are free to fluctuate according to the changes in demand and supply forces with no restrictions on buying and selling of foreign currencies in the exchange market.

Advantages/Arguments in Favour of Flexible or Floating Rate –
1) Independent monetary policy
2) Adjustment of Balance of Payments
3) It does not Affect International Trade Adversely
4) It enables to have natural rate
5) Protection from shocks of inflation
6) It does not adversely affect investment
7) Easy in Operation
8) Indicator of real economic position
9) Control on speculation

Exchange rate adjustment –
The Indian rupee is linked to a basket of important currencies of the country's major trading partners. The major objective of exchange rate policy is to adjust exchange rates in such way as to promote the competitiveness of Indian exports in the world market. Adjustments in the external value of the rupee are therefore made from time to time.

The Reserve Bank of India effected an exchange rate adjustment on 1 July, 1991 in which the value of the rupee declined by about 7 to 9 percent against the major currencies (the pound sterling, the US dollar, the deutsche mark, the French franc and the yen). There was another exchange rate adjustment on 3 July, 1991 in which the value of the rupee declined by about 10 to 11 percent against the major currencies. Between 28 June and 3 July, 1991, the rupee depreciated by about 8 percent vis-à-vis the basket of 5 currencies while this, basket appreciated vis-à-vis the rupee by about 23 percent. These adjustments had been necessitated by the growing external and internal imbalances in the economy. The balance of payments situation had become very critical and that was reflected in the sharp drawdown on, and low level of, foreign exchange reserves. Since October, 1990 there has been an appreciation in the relatively high rate of inflation in the country and a much slower rate of depreciation in the nominal exchange rate leading to erosion in the international competitiveness of the economy. It was equally necessary to curb destabilizing market expectations which were generated by perceptions of a growing misalignment of the exchange rate. It is expected that these exchange rate adjustments will stop further deterioration in the country's balance of payments in the short run and improve it in the medium term by improving the trade balance.

The primary objective of the exchange rate adjustment is one of strengthening the viability of external payments position, i.e., to ensure that exchange rate movements maintain a reasonable incentive for export promotion and encourages efficient import substitution activities, and at the same time, to stem the flight of capital from Indian and discourage flow of remittances from abroad through illegal channels. In the immediate short run, exchange rate adjustment is expected to facilitate realization of outstanding export receipts the accelerate, in general, the inflow of remittances by quelling de-stabilizing market expectations. Downward adjustment in the exchange rate raises the relative price of traded goods (by increasing the domestic price of foreign currency) to non-traded (or home) goods, thereby encouraging production of tradable while discouraging their consumption. This expenditure-switching effect at a macro level results in correcting the imbalances in the trade and current account.

Many of India's trade competitors made substantial exchange rate adjustments over the past few years. China and Indonesia, for instance, depreciated their currencies against the US dollar more than India did despite their lower inflation. Over the period end-December 1980 to end-December 1989, China depreciated by 68 per cent and Indonesia by 65 percent while India depreciated by only 53 percent against US dollar, whereas the increase in consumer prices in China and Indonesia were lower at 100 percent, and respectively, against India's 114 percent over the same period.

Between October 1990 and March 1991 the REER of the rupee appreciated by about per cent as a result of a much slower rate of depreciation in the nominal exchange rate (2.4 per cent against the major five currencies over the same period) and the widening inflation differentials as the country's domestic inflation accelerated after October 1990. Further, in the five month period between February 1991 and Jun 1991, the nominal effective exchange rates of rupee decreased only by 2.5 percent while the inflation differentials continued to widen. All this resulted in an erosion of India's international competitiveness.

To restore the competitiveness of our exports and to bring about a reduction in trade and current account deficits, a downward adjustment of the rupee had become inevitable. The Reserve Bank of India effected the exchange rate adjustment in two steps in early July 1991. The timing of the exchange rate adjustment was necessitated by the need to nullify adverse expectations and restore international confidence. On the other hand, the magnitude of the adjustment was predicted on the need to restore competitiveness of the country vis-à-vis her competitors in trade. On July 1, 1991 the value of the rupee declined by 8 to 9 per cent against the major currencies (pound sterling, the US dollar, the deutsche mark, the yen and then French franc). On July 3, 1991, the value of the rupee was further lowered by 10 to 11 percent against the major currencies.

In determining the extent of adjustment, the relevant factors were differentials in the price levels between Indian and her major trading partners; the extent of real depreciation of the currencies of competitors; the degree of correction required in our balance of payments; and market expectations. Taking all these factors into account the magnitude of downward adjustment in external value of the rupee by about 23 percent was appropriate.

A basic requirement for the success of this policy is that relative price change should bring forth requisite change in production and consumption patterns. Exchange rate depreciation could lead to an improvement of the current account only if export volumes rise and/or import volumes fall sufficiently to outweigh the price effect. Besides, lags in such response to exchange rate changes are also to be reckoned with. There is the well known "J curve" effect of the improvement in balance of trade occurring after an initial deterioration. However, following the stringent monetary restrictions on imports, the expected deterioration of trade deficit did not happen. The trade deficit during the first six months of the financial year 1991-92 contracted significantly.

INTERNATIONAL CAPITAL MARKET

The subject of foreign exchange is, in the words of H.E. Evitt, "… that section of economics science which deals with the means and methods by which rights to wealth in one country's currency are converted into rights to wealth in terms of another country's currency." As the further observes, it "involves the investigation of the method by which the currency of one country is exchanged for that another, the causes which render such exchange necessary, the forms which such exchange may take, and the ratios or equivalent values at which such exchanges are affected."

There are different interpretations of the terms foreign exchange, of which the following two are most important and common:

1) Foreign exchange is the system or process of converting one national currency into another, and of transferring money from one country to another (Dr. Paul Einzig).
2) Secondly, the term foreign exchange is used to refer to foreign currencies. For example, the Foreign Exchange Regulation Act, 1973 (FERA) defines foreign exchange as foreign currency and includes all deposits, letters of credits and bills of exchange, expressed or drawn in Indian currency, but payable in any foreign currency.

Functions of International Capital Market –
The foreign exchange market is a market in which foreign exchange transaction take place. In other words, it is a market in which national currencies are bought and sold against one another.

A foreign exchange market performs three important functions:

Transfer of Purchasing Power: The primary function of a foreign exchange market is the transfer of purchasing power from one country to another and from one currency to another. The international clearing function performed by foreign exchange markets plays a very important role in facilitating international trade and capital movements.

Provision of Credit: The credit function performed by foreign exchange markets also plays a very important role in the growth of foreign trade, for international trade depends to a great extent on credit facilities. Exporters may get pre-shipment and post-shipment credit. Credit facilities are available also for importers. The Euro-dollar market has emerged as a major international credit market.

Provision of Hedging Facilities: The other important function of the foreign exchange market is to provide hedging facilities. Hedging refers to covering of export risks, and it provides a mechanism to exporters and importer to guard themselves against losses arising from fluctuations in exchange rates.

Dealings on the Foreign Exchange Market –
A very brief account of certain important types of transactions conducted in the foreign exchange market is given below –

- ***Spot and Forward Exchanges:*** The term spot exchange refers to the class of foreign exchange transaction which requires the immediate delivery, or exchange of currencies on the spot. In practice, the settlement takes place within two days in most markets. The rate of exchange effective for the spot transaction is known as the spot rate and the market for such transactions is known as the spot market.
  The forward transaction is an agreement between two parties, requiring the delivery at some specified future date of a specified amount of foreign currency by one of the parties, against payment in domestic currency by the other party, at the price agreed upon in the contract. The rate of exchange applicable to the forward contrat is called the forward exchange rate and the market for forward transactions is known as the forward market.

The foreign exchange regulations of various countries, generally, regulate the forward exchange transactions with a view to curbing speculations in the foreign exchanges market. In India, for example, commercial banks are permitted to offer forward cover only with respect to genuine export and import transactions.
Forward exchange facilities, obviously, are of immense help to exporters and importers as they can cover the risks arising out of exchange rate fluctuations by entering into an appropriate forward exchange contract.

- ***Forward Exchange Rate***: With reference to its relationship with the spot rate, the forward rate may be at par, discount or premium.
    - At par: If the forward exchange rate quoted is exactly equivalent to the spot rate at the time of making the contract, the forward exchange rate is said to be at par.
    - At Premium: The forward rate for currency, say the dollar, is said to be at a premium with respect to the spot rate when one dollar buys more units of another currency, say rupee, in the forward than in the spot market. The premium is usually expressed as a percentage deviation from the spot rate on a per annum basis.
    - At Discount: The forward rate for a currency, say the dollar, is said to be at discount with respect to the spot rate when one dollar buys fewer rupees in the forward than in the spot market. The discount is also usually expressed as a percentage deviation from the spot rate on a per annum basis

- ***Futures***: While a futures contract is similar to a forward contract, there are several differences between them. While a forward contract is tailor-made for the client by his international bank, a futures contract has standardized features – the contract size and maturity dates are standardized. Futures can be traded only on an organized exchange and they are traded competitively. Margins are not required in respect of a forward contract but margins are required of all participants in the futures market – an initial margin must be depositied into a collateral account to establish a futures position.

- ***Options***: While the forward or futures contract protects the purchaser of the contract from the adverse exchange rate movements, it eliminates the possibility of gaining a windfall profit from favorable exchange rate movements. For example, if an Indian exporter has forward contract to sell his future dollar receipts at $1 = Rs 48, he is protected against the risk of a depreciation of the dollar by the time he receives the payment (for example, $1 = Rs. 46). However, the forward contract prevents him from gaining the profit of possible appreciation of the dollar (say, $1 = Rs. 50). Currency options are designed to overcome this problem.
  An option is a contract or financial instrument that gives the holder the right, but not the obligation, to sell or buy a given quantity of an asset at a specified price at a specified future date. An option to buy the underlying asset is known as a call option, and an option to sell the underlying asset is known as a put option. Buying or selling the underlying asset via the option is known as exercising the option. The stated price paid (or received) is known as the exercise or striking price. The buyer of an option is known as the long and the seller of an option is known as the writer of the option, or the short. The price for the option is known as premium.

- ***Swap Operation***: Commercial banks who conduct forward exchange business may resort to a swap operation to adjust their fund position. The term swap means simultaneous sale of spot currency for the forward purchase of the same currency or the purchase of spot for the forward sale of the same currency. The spot is swapped against forward. Operations consisting of a simultaneous sale or purchase of spot currency accompanied by a purchase or sale, respectively, of the same currency for forward delivery, are technically known as swaps or double deals, as the spot currency is swapped against forward.

- ***Arbitrage***: Arbitrage is the simultaneous buying and selling of foreign currencies with the intention of making profits from the differences between the exchange rate prevailing at the same time in different markets.

  For illustration, assume that the rate of exchange in London is £1 = $2 while is New York £1 = $2.10. This presents a situation where in one can purchase one pound sterling in London for two dollar and earn a profit of $0.10 by selling the pound sterling in New York for $2.10. This situation would, hence, lead to an increase in demand for sterling in London and consequently, an increase in the supply of sterling in New York. Such operation, i.e., arbitrage, could result in equalizing the exchange rates in different markets (in our example London and New York).
  Arbitrage in foreign currencies is possible because of the case and speed of modern means of communication between commercial centers throughout the world. Thus, an operator in New York might buy dollars in Amsterdam and sell them a few minutes later in London.
  The effect of arbitrage, as has already been mentioned, is to iron out differences in the rates of exchange of currencies in different centers, thereby creating, theoretically speaking, a single-world market in foreign exchange.