Pre and Post Shipment Financing

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Government Programs to Help Finance Exports

- Governments of most export-oriented industrialized countries have special financial institutions that provide some form of subsidized credit to their own national exporters.
- These export finance institutions offer terms that are better than those generally available from the competitive private sector.
- Thus domestic taxpayers are subsidizing lower financial costs for foreign buyers in order to create employment and maintain a technological edge.
- The most important institutions usually offer export credit insurance and a government-supported bank for export financing.

INSTITUTIONAL FRAMEWORK FOR EXPORT FINANCE

- Several financial benefits were made available to Indian exporters
- To accelerate the flow of credit financial institutions have been established in India.
- **Regulatory Institutions:**
    1. Reserve Bank of India (RBI)
    2. Directorate General of Foreign Trade (DGFT)
    3. International chamber of Commerce (ICC)
    4. Foreign Exchange Dealer's Association of India
- **Other important Institutions:**
    1. Commercial Banks
    2. Export-Import Bank of India (EXIM)
    3. Export Credit guarantee Corporation Of India ltd.(ECGC)

RESERVE BANK OFINDIA

- Central bank and apex body of all financial institutions in India.
- It's major role in trade is concerned with:
  - Exchange Control: It overseas the payments and receipts by residents to non-residents and vice versa
  - Credit Norms of RBI: Any credit being extended to another party is controlled by RBI credit norms
- So, both international trade and currency transactions come within the scope of various RBI regulations
- RBI also closely monitors international transactions in order to ensure compliance with various forex regulations
- FEMA (Foreign Exchange Management Act) is an important act that lays down the underlying regulations governing all foreign currency transactions in India

Director General of Foreign Trade (DGFT)

- DGFT operates under Ministry of Commerce and it lays down policies and regulations relating to physical movements of goods into India
- Any company undertaking imports or exports of goods/services requires to get itself registered with DGFT
- DGFT issues an Importer Exporter Code (IEC) to the company which is a unique code that the company needs to provide to bank and to customs/other regulatory agencies while making International transactions
- IEC code also helps DGFT and other regulatory agencies in keeping track of various International Transactions done by the company

International Chamber of Commerce (ICC)

- ICC is an apex international body, which forms the guidelines for smooth functioning of trade and forex transactions across countries
- It has created a set of rules called UCP600 (Uniform Customs and Practices for Documentary Credit) to be used by banks throughout the world for LC transactions
- The interests of India, with regards to ICC regulations is looked after by Indian National Chapter (INC) which is based in New Delhi

Foreign Exchange Dealers’ Association of India (FEDAI)

- FEDAI is the apex forum of all banks authorized to deal in forex issues and guidelines.
- It is self regulated organization (SRO)
- It’s major activities include:
  - framing of rules governing the conduct of inter-bank foreign exchange business
  - liaison with RBI for reforms and development of forex market
  - Training of bank personnel in the areas of forex business
  - Accreditation of Forex brokers

Commercial Banks

- Commercial banks provide major part of export finance.
- They extend financial assistance both at pre-shipment and post-shipment.
- The directives of RBI under Exchange Control Regulation Act make it obligatory for payments of exports to be settled through the medium of a bank in India authorized to deal in foreign exchange.

COMMERCIAL BANKS
SERVICES ARE DIVIDED INTO TWO

- Fund based assistance also known as Financial Services.
- Non-fund based assistance also known as non-financial assistance.
- Fund based assistance These are in the form of advances, credits and loans offered at various stages.

    1.Pre-shipment finance

    2.Post-shipment finance

NON-FUND BASED ASSISTANCE

1. Bank guarantees
    - Performance guarantee
    - Advance payments guarantee
    - Guarantee for payment of retention money
    - Guarantee for loans in foreign currency
2. credit ratings of importers.
3. Information about foreign exchange.
4. Dollar account
5. Confirmation of letters of credit
6. Forward exchange contracts

Export Import (EXIM) Bank of India

- EXIM bank, a premier export finance institution of the country was set up in 1982
- Objective was not just to enhance exports from India but also to integrate country's foreign trade and investments with the overall economic growth.
- Role of EXIM Bank:
    1. Coordinator: between financial institutions to help exporters get finance from financial institutions
    2. Source of Finance: Pre shipment, Post shipment, Buyer's Credit, BG especially for capital projects; Line of credit to overseas financial institutions or governments of other nations
    3. Consultant: research and analysis; export advisory; marketing advisory
    4. Financing international joint ventures both in debt and equity
- Agri export Advantage: multi-lingual, quarterly publication

Export Credit Guarantee Corporation (ECGC) of India

- **ECGC was established in 1957 by Government of India to strengthen export promotion drive by covering risk of exporting on credit**
- **Role of ECGC in export promotion:**
  - Offers insurance protection to exporters against commercial and political risk
  - Provides guidance in export related activities
  - Credit ratings for different countries
  - Makes it easy to obtain export finance from banks/financial institutions
  - Assist exporters in recovering bad debt
  - Provides information about credit worthiness of foreign buyers
  - Different types of credit insurance covers to bank and other financial institutions to enable them to extend credit facility to exporters
  - Factoring service to MSME sector

Pre-Shipment Finance

- Packing Credit (PC)

Requirements for getting Packing Credit

- Exporter should have 10 digit importer-exporter code (IEC) number allotted by DGFT
- Exporter should not be in cautious list of RBI
- Exporter should not be in Specific Approval List of ECGC
- For restrictive category goods (as per current FTP), exporter should have requisite authorization/quota permit from DGFT to export Goods

Quantum of Pre-Shipment Finance

- Quantum of finance is granted to exporter on the basis of **“Need based”** principle
- It is granted against either LC or an expected order
- Banks decide financing based on:
    - Nature of order
    - Nature of commodity
    - Capability of exporter to bring in the requisite contribution in terms of forex

Pre-Shipment Credit Facility: Why?

- Suppose Mr. John places, an order of Basmati Rice in 6 months to be shipped in 5 months
- John has to:
    - Buy raw-material
    - Incur Manufacturing expenses like machine, labor etc.
    - Work in Progress (Storage Cost)
    - Finished Stock (say in 4 months)
    - Packing
    - Transportation to Port
    - Custom Clearance
    - Shipping
- In order to meet working capital needs, an exporter requires credit known as pre-shipment credit or packing credit

Pre-Shipment Credit Facility: Why?

- Suppose his operating cycle is as follows:

Process	Time Period
Manufacturing	4 months
Shipping	15 days
Goods Reaching Destination	15 days
If DA Bill	2 months
Total working Capital	7 months

- Now, suppose he gets another order to export, he won't be able to execute it as his money is blocked
- Solution: Pre-shipment Credit

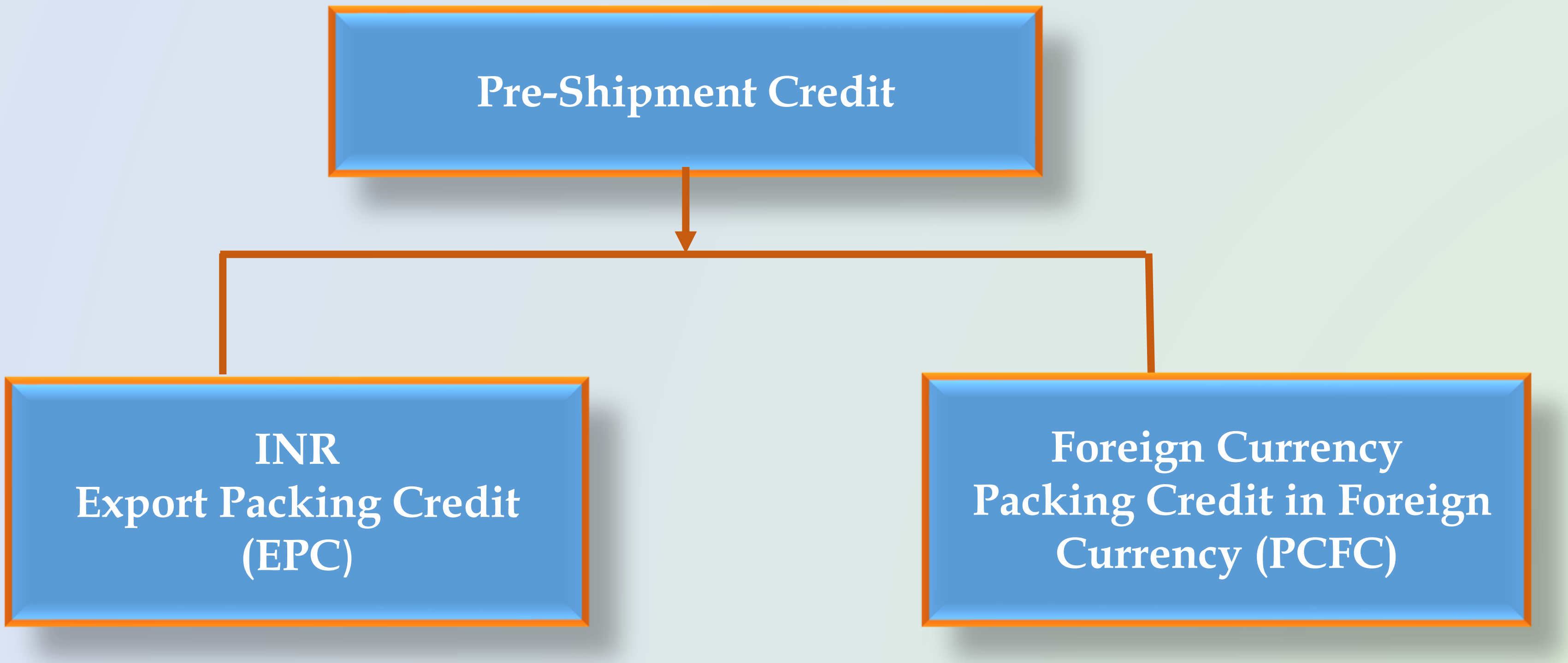
Pre-Shipment Credit Facility: Process

- Exporter would approach a bank and request for pre-shipment credit based on order received to meet working capital requirement
- Banks after making due diligence provide exporter packing credit. Due diligence includes:
    - Export order
    - Financial statements of exporter
    - Part Funding
    - CIBIL Score (Credit Information Bureau (India) Ltd.)
    - Property Mortgage
- Exporter has to repay bank on the day bill of lading is generated i.e. shipment is done
- Otherwise loan would stand in 'overdue'
- Bank would do pre-shipment financing based on :
    - Stock
    - Manufacturing Expenses
    - Packing
    - Less: any credit received from vendor

Note: Pre-shipment Finance is 'Stock financing' while post shipment financing is 'Debtor Financing'

Pre-Shipment Credit Facility: Process

Pre-shipment Facility Time: Normally it is given for 180 days in maximum cases which may be extended by two times of 90 days each (i.e. 180 extension days making total period of 360 days) by special approval of bank



EPC Vs PCFC

- Bank will open Pre-shipment credit A/C like a running account and make disbursement in that account
- PCFC: Bank can open separate PCFC account for each currency
- Benefits of PCFC:
    - Low rate of interest and is linked with LIBOR (London Interbank Offered Rate)
    - Generally, EPC is given for 8-9% (MCLR or Repo) while PCFC rate is around 3-4%
    - Hedges Exchange Risk: As you avail credit in foreign currency, it is repaid with export proceeds while in EPC currency is risk is high
- So, why should exporter take EPC?
- **Interest Equalization Scheme:** If packing credit is taken by MSME client in INR, then government gives 5% interest subsidy
- So, if bank charges 8% interest and subsidy is 5%, net credit rate is 3% which is almost equal to PCFC.
- However, this scheme is available in few sectors which are mostly labor intensive sectors like processed agriculture' food item sectors, handicrafts, coir, readymade garments etc.

EPC and PCFC Account

- **Both credit facilities can be taken in two forms:**
  - Order Based
  - Running Limit
- **Order Based Packing Credit Facility:**
  - Importer places export order
  - Exporter goes to bank for credit facility
  - In order based facility, for every order there would be ‘unique reference number’
  - Payment against this credit has to be made by payment received against same client
  - Banks track and monitor this order through unique reference number
  - Exporter can not settle this payment through any other export’s payment received
  - However, if the first client against whom credit was taken sends payment against some other order it can settle

EPC and PCFC Account

- **Merit and Demerit of Order Based Financing:**
  - Merit is that it leads to better control through tracking of order
  - If repayment is not done on time it will be traded as 'overdue' and bank can charge hefty penalty against it and it also leads to poor CIBIL score and decrease in creditworthiness of exporter
  - ***Order based system is generally bad for both client and bank; for bank it may lead to high NPAs and for client high risk***

EPC and PCFC Account: Running Order

- In this system, payment can be settled from any client
- It is less risky system and is like a cash credit limit
- Exporter opens an account and banks provide a credit limit
- Example: Suppose exporter takes 3 month packing credit with sanctioned limit as INR 15 Lakhs

Date	Particular	Dr.	Cr.	Limit Utilized
1st July	PC disburses (David)	7500		(7,5,00)
20th July	PC Disburses (Richard)	10,000		(17,500)
31st August	PC disburses (John)	20,000		(37,500)
30th September	Payment Received (John)		18,000	(19,500)

Note: Payment under this method is adjusted on FIFO (First in First Out)method and hence, risk of overdue is very less in this method

Advances Against Cheques/Drafts received as Advance Payment

- If exporter receives advance payment in form of cheque/draft etc., bank may grant export credit at concessional rate to exporters of good track record, till the realization of such cheques/drafts etc.
- Bankers must satisfy themselves that proceeds are against export order

Liquidation of Packing Credit

- By discounting/negotiating LC and converting packing credit to Post shipment credit
- Through Export remittances if no post shipment credit is availed
- Payment receivable through government in terms of duty drawbacks etc.
- If export does not takes place or exporter does not pay packing credit on time, bank would term it as 'overdue' and may recover its entire amount along with market rate of interest

Rupee Packing credit to specific sectors

- **Rupee Packing Credit to manufacturers or suppliers for exports routed through STC/MMTC/Other Export Houses/Agencies etc.**
  - Banks may grant PC to manufacturers or suppliers who do not have export orders/letters in their own name and goods are exported through STC/MMTC etc.
- **Rupee Export Packing Credit to sub-suppliers: Packing credit can be shared between an Export Order Holder (EOH) and sub-supplier of raw materials, components etc. of the exported goods as in the case of EOH and manufacturer suppliers, subject to the following:**
  - ❖Running Account facility is not contemplated under the scheme. The scheme will cover the LC or export order received in favor of Export Houses/Trading Houses/Star Trading Houses etc. or manufacturer exporters only. The scheme should be made available to the exporters with good track record.

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- Bankers to an EOH will open an inland LC specifying the goods to be supplied by the sub-supplier to the EOH against the export order or LC received by him as a part of the export transaction. On the basis of such a LC, the sub-supplier's banker will grant EPC as working capital to enable the sub-supplier to manufacture the components required for the goods to be exported.

- It is upto the EOH to open any number of LCs for the various components required with the approval of his banker/leader of consortium of banks within the overall value limit of the order or LC received by him.

- The EOH will be responsible for exporting the goods as per export order or overseas LC and any delay in the process will subject him to the penal provisions issued from time to time.

- The scheme is an additional window besides the existing system of sharing of packing credit between EOH and manufacturer in respect of exported goods in addition to available against Export houses/Agencies as above

Contd……….

- **EOUs/EPZ/SEZ units supplying goods to another EOU/EPZ/SEZ unit for export purposes are also eligible for rupee pre-shipment export credit under this scheme**. However, the supplier EOU/EPZ/SEZ unit will not be eligible for any post-shipment facility as the scheme does not cover sale of goods on credit terms.

- The scheme does not envisage any change in the total quantum of advance or period. Accordingly, the credit extended under the system will be treated as export credit from the date of advance to the sub-supplier to the date of liquidation by EOH under the inland export LC system and upto the date of liquidation of packing credit by shipment of goods by EOH.. It has to be ensured that no double financing of the same leg of the transaction is involved.

- Banks may approach the ECGC for availing suitable cover in respect of such advances.

- The scheme does not envisage extending credit by a sub-supplier to the EOH/manufacturer and thus, the payment to sub-suppliers has to be made against submission of documents by LC opening bank treating the payment as EPC of the EOH.

Rupee Packing credit to specific sectors

- **Rupee Pre-shipment Credit to Construction Contractors**

a) The packing credit advances to the construction contractors to meet their initial working capital requirements for execution of contracts abroad may be made on the basis of a firm contract secured from abroad, in a separate account, on an undertaking obtained from them that the finance is required by them for incurring preliminary expenses in connection with the execution of the contract e.g., for transporting the necessary technical staff and purchase of consumable articles for the purpose of executing the contract abroad, etc.

b) The advances should be adjusted within 365 days from the date of advance by negotiation of bills relating to the contract or by remittances received from abroad in respect of the contract executed abroad.

c) To the extent the outstandings in the account are not adjusted in the stipulated manner, banks may charge normal rate of interest applicable for working capital finance.

Rupee Packing credit to specific sectors

Export of Services

- Pre-shipment and post-shipment finance may be provided to exporters of all the 161 tradable services covered under the General Agreement on Trade in Services (GATS) where payment for such services is received in free foreign exchange as stated at Chapter 3 of the Foreign Trade Policy 2009-14. All provisions of this circular shall apply mutatis mutandis to export of services as they apply to export of goods unless otherwise specified. A list of services is given in Appendix 10 of HBPv1. The financing bank should ensure that there is no double financing and the export credit is liquidated with remittances from abroad. Banks may take into account the track record of the exporter/overseas counter party while sanctioning the export credit. The statement of export receivables from such service providers may be tallied with the statement of payables received from the overseas party.

- In view of the large number of categories of service exports with varied nature of business as well as in the environment of progressive deregulation where the matters with regard to micro management are left to be decided by the individual financing banks, the banks may formulate their own parameters to finance the service exporters.

Rupee Packing credit to specific sectors

Pre-shipment Credit to Floriculture, Grapes and Other Agro-based

i. In the case of floriculture, pre-shipment credit is allowed to be extended by banks for purchase of cut-flowers etc. and all post-harvest expenses incurred for making shipment.

ii. However, with a view to promoting export of floriculture, grapes and other agro-based products, banks are allowed to extend credit for working capital purposes in respect of export-related activities of all agro-based products including purchase of fertilizers, pesticides and other inputs for growing of flowers, grapes etc., provided banks are in a position to clearly identify such activities as export-related and satisfy themselves of the export potential thereof, and that the activities are not covered by direct/indirect finance schemes of NABARD or any other agency, subject to the normal terms & conditions relating to packing credit such as period, quantum, liquidation etc.

iii. Export credit should not be extended for investments, such as, import of foreign technology, equipment, land development etc. or any other item which cannot be regarded as working capital

Rupee Packing credit to specific sectors

Export Credit to Processors/Exporters - Agri-Export Zones

- Government of India has set up Agri-Export Zones in the country to promote Agri Exports. Agri-Export Oriented Units (processing) are set up in Agri- Export zones as well as outside the zones and to promote such units, production and processing are to be integrated. The producer has to enter into contract farming with farmers and has to ensure supply of quality seeds, pesticides, micro-nutrients and other material to the group of farmers from whom the exporter would be purchasing the products as raw material for production of the final products for export.

- The Government, therefore, suggested that such export processing units may be provided packing credit under the extant guidelines for the purpose of procuring and supplying inputs to the farmers so that quality inputs are available to them which in turn will ensure that only good quality crops are raised.

- Banks may treat the inputs supplied to farmers by exporters as raw material for export and consider sanctioning the lines of credit/export credit to processors/exporters to cover the cost of such inputs required by farmers to cultivate such crops to promote export of agri products.

- Banks have to ensure that the exporters have made the required arrangements with the farmers and overseas buyers in respect of crops to be purchased and products to be exported respectively.

Post Shipment Finance: Types

- Majorly Post-shipment Financing happens in 3 ways:
  - Foreign Bill Discounting (FBD): Financing of DA bill without LC
  - Foreign Bill Negotiated (FBD): Financing of DA bills with LC
  - Foreign Bill Purchase (FBP)
- Note: Only DA bills are fundable in post shipment since credit period is involved for only DA bills as DP bills are settled on sight
- Documents need to be sent to issuing bank through nominated/negotiating bank

Post Shipment Finance: Types

- Foreign Bill Negotiated (FBN) and LC Bill Discounting (LCBD)
- Example:
    - Manufacturing Period: 2-3 months
    - Custom Clearance: 10-15 days
    - Complying Documents sent by exporter: 15 days
    - Total Period = Approx. 4 months
- In case of sight LC: Payment received once LC reaches along with documents to issuing bank
- In case of Usance LC: There is suppose acceptance period of 90 days from bill of lading
- In the above example if BL is generated after 3.5 months, LC payment would be received after 6.5 months (3.5+3)
- Hence, compared to sight LC, exporter will have to wait for another 2.5 months.
- Next option is monetization of assets i.e. FBN where exporter will ask his bank to negotiate LC against documents submitted

Post Shipment Finance: Types

Foreign Bill Negotiated (FBN): Steps for Indian Exporter

1. Advising bank (SBI) sends LC with documents to Negotiating Bank (Axis Bank)
2. Negotiating bank (Axis Bank) confirms that documents are in confirmation with terms of LC and sends it to issuing bank (Citi Bank) who after getting satisfied in turn intimates the same to applicant as well
3. Once advising bank (SBI) gets confirmation from negotiating and issuing bank, it is sure that now issuing bank is liable to make payment
4. Exporter requests negotiating bank (Axis Bank) to negotiate LC and make immediate release of payment
5. Negotiating bank takes interest of 90 days (in case of 90 days usance LC) and give remaining amount to exporter.
6. On maturity negotiating bank (Axis bank) gets its claims from issuing bank (Citibank) who gets claim from applicant.
7. This is called as Foreign bill negotiated and one major benefit of it is that exporter does not have to mortgage any property/security for taking money as LC by issuing bank serves as a security to the discounting bank.

Note:

- Any bill that gets discounted against LC domestically is called LCBD and in case of international trade it is called as FBN
- FBN is done only for usance LC

Post Shipment Finance

- Post-Shipment Finance is also called as ‘Debtor Financing’ as it is required from the shipment date till the debtor pays
- Exporter would receive period till debtor pays, but he has to manage working capital for that period as well as to process new orders and run business
- This is met by Post Shipment Finance facility

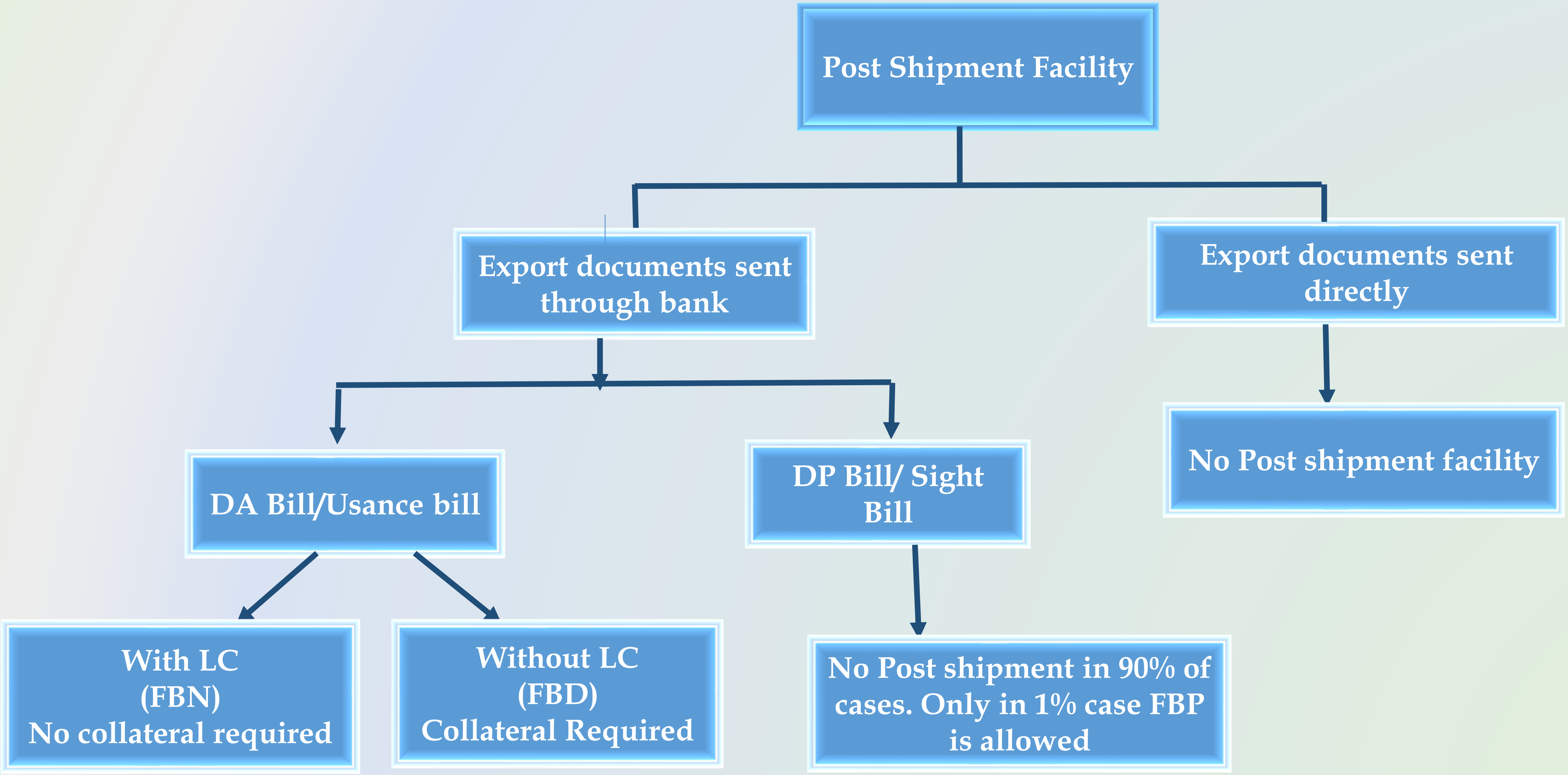
Post Shipment Finance: Example

Particular	Date	Remarks
Export Order Received	1^{st} May	
Shipment Date (Bill of lading generated)	31^{st} July	3 month period for shipping goods (met by Pre-shipment credit)
Payment Terms	60 days from sight	
Documents submitted to Advising bank	5^{th} August	It takes around 1 week from shipment to preparation of documents and submitting them to bank
Ship Reaches destination	31^{st} August	1 month time from shipment
Advising Bank takes 1 day (submitted on 5^{th} as above) to check documents and sends it to issuing bank	7^{th} August	Documents reach issuing bank on 7^{th} August
Issuing bank checks documents and take acceptance from importer	12^{th} August	5 Working Days
Due Date	11^{th} October	60 days from sight

Post Shipment Finance: Example

- So in above example, from bank's perspective, Post-shipment credit period is from 12th August to 11th October
- However, shipment was done on 31st July. So what happens to 12 days interim period?
- Generally, client will have to manage funds for this period, but if exporter has good relationship with bank and track record; bank would consider interim period also as post shipment period for granting credit. Such financing is called FBP (Foreign Bill Purchase)
- If payment term were 60 days from shipment, then payment would become due on 30th September, but bank would finance only when acceptance and confirmation is done by issuing bank

Post Shipment Finance: Types



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