UNIT 16 FOREIGN TRADE FINANCING

Structure

16.0 OBJECTIVES

After studying this unit you should be able to:

- explain different payment terms used in international trade
- describe documents and procedures related to export-import trade financing
- highlight various financing techniques in international trade
- discuss problems of developing countries
- discuss government sources of export financing and credit insurance
- explain the concept of countertrade.

16.1 INTRODUCTION

Most international business firms are involved in foreign trade. Financing of trade requires large amount of money and financial services. The banks and financial institutions play vital role in providing the necessary help in this regard. There are uniform customs and rules for documentary credits followed all over the world in foreign trade. The goverment also plays an important role in regulation and financing of foreign trade. In this unit you will learn about the payment terms, documents and procedures relating to these documents in foreign trade. You will also learn about the government sources of export financing and credit insurance and the concept of countertrade.

16.2 PAYMENT TERMS IN INTERNATIONAL TRADE

Let us take an example of your walking across to a refrigerator dealer to buy a refrigerator. The deal is struck for an agreed price and you want the item to be delivered at your residence which, say for example is 10 km away from the dealer. The dealer hesitates a bit and says that the transportation costs will have to be borne by you as the price agreed upon do not include the carriage costs.

Whenever a sale of goods takes place in addition to the cost of the goods themselves there may be a number of other costs which must be paid by the buyer or the seller or shared between them. In internal or inland trade the contracting parties will normally agree a price based on mutual understanding since it would be possible for buyer or seller to arrange all formalities involving the movement of the goods from one place to another in the same country. In international trade these arrangements are codified so that the international trading community can be sure of defining respective responsibilities, simply and safely. In so doing, they eliminate any possibility of misunderstanding and subsequent dispute. The International Chamber of Commerce (ICC), Paris, published a code of shipping terms to identify responsibilities of buyers and sellers, entitled "INCOTERMS (International Commercial Terms). Incoterms were first published in 1935 with subsequent revisions addition made in 1953, 1967, 1980, 1990 and most recently in 2000.

Incoterms 2000 are internationally accepted commercial terms defining the respective roles of the buyer and seller in the arrangement of transportation and other responsibilities and clarify when the ownership of the merchandise takes place. They are used in conjunction with a sales agreement or other method of transacting the sale. These are protected by ICC copy right. Let us now explain them.

EXW — Ex Works : Title and risk pass to buyer including payment of all transportation and insurance cost from the seller's door. Used for any mode of transportation.

FCA — Free Carrier : Title and risk pass to buyer including transportation and insurance cost when the seller delivers goods cleared for export to the carrier. Seller is obligated to load the goods on the buyer's collecting vehicle; it is the buyer's obligation to receive the seller's arriving vehicle unloaded.

FAS — Free Alongside Ship : Title and risk pass to buyer including payment of all transportation and insurance cost once delivered alongside ship by the seller. Used for sea or inland waterway transportation. The export clearance obligation rests with the seller.

FOB — Free On Board : Title and risk pass to buyer including payment of all transportation and insurance cost once delivered on board the ship by the seller. Used for sea or inland waterway transportation.

CFR — Cost and Freight : Title, risk and insurance cost pass to buyer when delivered on board the ship by seller who pays the transportation.

CIF — Cost, Insurance and Freight : Title and risk pass to buyer when delivered on board the ship by seller who pays transportation and insurance cost to destination port. Used for sea or inland waterway transportation.

CPT — Carriage Paid To : Title, risk and insurance cost pass to buyer when delivered to carrier by seller who pays transportation cost to destination. Used for any mode of transportation.

CIP — Carriage and Insurance Paid To : title and risk pass to buyer when delivered to carrier by seller who pays transportation and insurance cost to destination. Used for any mode of transportation.

DAF — Delivered at Frontier : Title, risk and responsibility for import clearance pass to buyer when delivered to named border point by seller. Used for any mode of transportation.

DES — Delivered Ex Ship : Title, risk, responsibility for vessel discharge and import clearance pass to buyer when seller delivers goods on board the ship to destination port. Used for sea or inland waterway transportation.

DEQ — Delivered Ex Quay (Duty Paid) : Title and risk pass to buyer when delivered on board the ship at the destination point by the seller who delivers goods on dock at destination point cleared for import. Used for sea or inland waterway transportation.

DDU — Delivered Duty Unpaid : Title, risk and responsibility of import clearance pass to buyer when seller delivers goods to named destination point. Buyer is obligated for import clearance. Seller fulfills his obligation when goods have been made available at the named place in the country of importation. Used for any mode of transportation.

DDP — Delivered Duty Paid : Title and risk pass to buyer when seller delivers goods to named destination point cleared for import. Used for any mode of transportation.

You should note here that EXW, CPT, CIP DAF, DDU and DDP are commonly used for any mode of transportation. FAS, FOB, CFR, CIF, DES, and DEQ are used for sea and inland waterway. The terms can be grouped as group E, F, C, and D.

Most contract made after 1st January 2000 will refer to the latest edition of incoterms which came into force on that date. Unless the parties decide otherwise, earlier version of incoterm like incoterms 1990 are still binding if incorporated in contract that are unfulfilled and entered before 1 January 2000.

ICC recommended that incoterm 2000 be referred to specifically whenever the terms are used, together with a location. For example, the term "Delivered at Frontier" (DAF) should also be accompanied by a reference to an exact place and frontier to which delivery is to be made. Example of correct use of incoterm:

FCA Kuala Lumpur incoterm 2000

FOB Mumbai incoterm 2000

Having learnt about the trade terms, now let us look at how a transaction settlement takes place. When it comes to payment, various arrangements are possible, with the form of payment chosen often depending on how well the buyer and seller know each other. If the amount involved is fairly small and mutual trust exists between the two parties to the transaction, the business may be carried out on an open account basis. Alternatively, the seller, depending upon the product he sells, can demand an advance payment.

Payments in advance

Payment in advance, as the name suggests, is the payment of funds by the importer to the exporter prior to shipment. This is quite secure for the exporter. If the payment does not arrive he does not ship the goods.

Open account

This is a simple means of settlement in which the buyer pays the exporter after the exporter has shipped the goods or performed the agreed services. However, open account terms leave exporters open to risks in the event of non-payment.

Between the advance payment and open account terms there are variety of settlement procedures. We will learn about them as we go along.

16.3 SPECIAL DOCUMENTS IN INTERNATIONAL TRADE

An export shipment is always evidenced by various documents that are collectively known as "shipping documents". The word shipping is generic and covers carriage not only by sea but also by air or parcel post.

In facilitating international trade, banks do not normally become involved with the physical merchandise, in fact this only happens when things have gone badly wrong. Rather, banks handle the shipping documents.

There are numerous shipping documents, some of which are common to all shipments, (for example, an invoice), and some of which specialised documents that are rarely seen, (for example, a "photo sanitary certificate" which is required for shipment of plants and seeds).

The most commonly seen documents are :

16.3.1 Transport Documents

These are defined as "documents indicating loading on board or despatch or taking charge". They cover transport by sea, air and parcel post.

The universal document for transport by sea is the marine bill of lading, explained below. But with the advent of containerisation and combined transport, different styles of documents covering carriage by sea have evolved. These are also described below.

Shipping bill

This is used by custom authorities by which permission is given to export in three forms. These are (a) dutiable (b) free (c) duty draw back. It contains all details about goods and shipment. 'MATE Receipt' from Captain of the ship and certificate of measurement are also transport documents.

Bill of lading

A bill of lading is a formal receipt given by the shipowners or their authorised agents stating that the goods mentioned therein (quantity, quality, description etc.) are shipped to a specified destination mentioned in the document on a specified date and vessel and are deliverable to the person mentioned therein or to his order after payment of all dues of the shipping company.

This document fulfils three functions:

1) A receipt given by the shipping company for goods accepted for carriage by sea from one port to another.

2) A document of title to goods; these will only be released to the importer at the port of discharge against production of a signed original bill of lading.

3) A contract of carriage, called contract of affreightment.

An important concept is that a bill of lading is a document of title. By retaining control over the bill of lading, the holder retains effective control over the goods, but without being in physical possession of them. Depending on the consignee, there are bearer bills of lading, straight bills of lading and bills of lading made out to the order of a party. Depending on the form of shipment there are short form bill of lading, liner bill of lading, container bill of lading, charter party bill of lading etc. It is called "clean" if goods are in good condition and "claused" or "dirty" if it contains a qualified statement.

Bills of lading are issued in sets of two or three originals, all of them signed and any one of which can be used to obtain release of the goods. A bank seeking to retain effective control over the goods, must control the full set of original bills of lading.

Combined transport document

It is increasingly customary for a 'unit load', housed in a container, to be shipped on one contract of carriage from a place of taking in charge to a place of delivery. This is called 'combined' or 'multi modal' transport, and is evidenced by a 'combined transport bill of lading', which takes the place of the traditional port-to-port bill of lading described above.

A combined transport document quite frequently will not specify the ports of loading or discharge. The issuer is responsible for the whole combined transport being completed, by land and/or sea and/or air.

The standard document often seen is that developed by FAITA - the International Federation of Forwarding Agents Associations. The FAITA combined transport bill of lading, which is a document of title, should not be confused with the FAITA forwarders certificate of receipt.

Air waybill

It is also called an 'Air Consignment Note', a receipt for goods to be carried by air. Unlike a bill of lading , it is only a receipt and not a document of title. Since an air waybill (AWB) is not a document of title to the goods it is not necessary for a consignee to possess the AWB for taking delivery of goods. Thus, for shippers the AWB is not as safe a document as a bill of lading. Further, in the case of AWB it is obligatory on the part of the airlines to notify the consignee on arrival of goods and they will normally deliver the goods to the consignee or his order on proper identification.

Parcel post receipt

This is issued by the post office of the exporting country but is not a document of title.

16.3.2 Invoices

These take the following forms:

Pro-forma Invoice : a "quotation" issued to a potential buyer; often required by the authorities of an importing country before an import licence is granted.

Commercial Invoice : gives full details and description of the goods shipped.

Consular Invoice : certified by the diplomatic representatives of the importing country located in the exporter's country; intended to protect the importing country against overpricing of imports.

16.3.3 Insurance Policy

Although banks do not become involved with the physical movement of merchandise, they have to be satisfied that it is properly insured. Insurance policy is a contract of insurance. It is an undertaking given by the insurers promising to pay or secure payment of money as compensation in case the goods under movement or otherwise are subjected to loss, theft, damage etc. In international trade marine insurance is the most common document obtained either by exporter or importer for the safety of the goods. Many types of marine insurance policies are available with insurers e.g. open, floating, valued, unvalued, time and voyage policies. Fire policy is also included in marine policy.

The exporter must identify the risks involved with the transaction and insure against them. Broadly the main risks are:

a) Commercial

b) Transportation (usually marine)) e.g. Perils of the sea

c) Buyer refusing delivery or not paying

d) Political, for example, an overnight coup in the country, or government restrictions imposed on foreign exchange transfer

e) Interest rate fluctuations, especially in long-term capital projects; and

f) Fluctuations in the exchange rate between the exporter's and the customer's currency.

Insurance policies provide actionable evidence of a contract of insurance. Full details of the risks covered are shown on the policy. The right to claim from insurers may be assigned by the insured in the first instance to someone else, usually the overseas buyer or a bank, by endorsement and delivery. Marine risks that may be covered include:

a) 'perils of the sea' covers accidental loss or damage that are caused by sea water, storms, stranding collisions, etc.

b) 'fire' covers smoke damage as well but does not cover goods which by their nature are likely to self-ignite.

c) 'jettison' covers an act of the master of throwing the goods overboard, usually to lighten the vessel in time of emergency.

16.3.4 Certificate of Origin

Evidences the origin of the goods. Often required by the customs/exchange control authorities of the importing country. It can be obtained from Chambers of Commerce, Export promotion council or authorised trade associations.

16.3.5 Bills of Exchange

The bill of exchange is not in itself a shipping document but it is important in the sense that it is the legal document upon which many methods of bank financing are based.

A bill of exchange or 'draft' is normally attached to a set of shipping documents. It is a demand for payment, signed by the exporter (the drawer), addressed to the importer or his bank (the drawee).

It is drawn either "at sight" or at a fixed or determinable future time, when it is time bill, it is referred to as a "tenor" or "usance" or "term" bill, the three words have the same meaning.

A bill drawn at sight is payable by the drawee upon first presentation. A tenor bill required the drawee to "accept" it on first presentation, that is to undertake to pay on a future date. This is done by signing across the face of the bill, after which it becomes known as an "acceptance".

A "clean" bill of exchange is that bill which is not accompanied by shipping documents. If the documents are attached to it, it is called "documentary bill"

It then becomes a legal instrument evidencing an obligation of the drawee and enforceable in the courts. If the drawee happened to be a first class bank, the acceptance is in effect as good as cash and can be discounted. Thus a bill of exchange has the following important characteristics. It is:

a) an instrument in writing;

b) an unconditional order signed by the maker (drawer);

c) a direction given to a specific person (drawee); and

d) made payable to a certain person or to his order or bearer.

A bill of exchange serves as a means for collecting payment, demanding payment and extending credit.

To sum up, the documents related to goods are invoice, packing list and certificate of origin. Those related to shipment are mates receipt, shipping bill, certificate of measurement, bill of lading (air waybill). Letter of credit and bill of exchange relate to payment. Besides there are documents issued by Reserve Bank of India relating to foreign exchange.

Having learnt about the payment terms and some of the important documents in international trade, let us familiarise ourselves with the trade finance and procedures related to export-import trade financing.

Check Your Progress A

1 An Indian importer of chocolates from Belgium wishes to be quoted an all-inclusive price for the transaction. Which of the following terms would he ask for from the exporter?

   a) CIF (cost insurance and freight...named port of destination)

   b) EXW (Ex Works)

c) DDP (Delivered Duty paid ...named place of destination)

d) FOB (Free on Board ...named port of shipment)

2 What are Incoterms?

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3 State whether the following statements are True or False.

i) A clean B/L is one devoid of clauses that show a defect in the packaging or condition of the goods.

ii) Combined transport bills of lading cover goods carried from or to the ship via other modes of transport.

iii) Certificates of origin are always issued by a Chamber of Commerce.

iv) An air waybill is a document of title to goods.

v) A bill of exchange is a transport document.

16.4 TRADE FINANCE

Defined simply and narrowly trade finance involves the provision of funds to one or more parties involved in a trade deal so that the transaction can take place. Broader definition of trade finance involves a wide range of financial engineering tools, such as factoring, forfaiting, countertrade, joint ventures and various forms of private and official credit insurance.

In a straight forward trade deal, funds can be provided to the buyer of goods or services or to the suppliers so that the latter is able to grant the former credit in the form of an extended payment period. These are, respectively , buyer and supplier credits.

Trade finance for all forms of goods, services and also major capital projects, comes from a variety of sources. Obviously, banks play a central role in the provision of primary funds for all forms of business and many, particularly the larger banks, have specialist trade finance divisions. Secondary funding is also provided to exporters and importers by trading houses, import-export agencies, credit collection agencies or specialist trade finance houses within the structure of individual deals. Other sources of finance comprise the bilateral and multilateral development funds made available primarily from the World Bank and Regional Development Agencies.

Trade finance is provided in the short, medium and long terms. Short term usually means upto six months, but can run up to two years. Medium-term finance is generally regarded as extending upto five years and long term or extended term beyond five years.

Today trade finance has changed from the narrowly defined practice of providing finance to allow trade deals to perform. It represents a broader practice of considerable range of specialist financing and insurance tools designed to make deals perform, guarantee payments in a variety of ways and create marketing opportunities for goods and services.

Earlier we saw methods of settlement of an international trade transaction from advance payment to open account terms. Financial Institutions/ Banks facilitate the settlement process at various stages and even finance them when there is a need. Trade Finance is broadly classified into two categories, depending on what stage of trade activity the finance is extended namely:

1. Pre-shipment finance
2. Post-shipment finance

Financial assistance extended to the exporters prior to shipment or export of goods falls within the scope of pre-shipment finance. Financial assistance extended after the shipment of export goods falls within the scope of post shipment finance.

Pre-shipment finance is nothing but a working capital finance (mainly inventory finance) extended to an exporter in anticipation of his exporting the goods. Basic purpose of extending pre-shipment finance is to enable the eligible exporters to procure/process/manufacture/warehouse/ship the goods meant for export. Pre-shipment finance could be either funded or non-funded. Funded advances are granted by different banks under various nomenclatures depending upon the purpose, security, stage of advance etc. Non-funded facilities could be by way of opening Domestic letters of credit, Import letters of credit, Back to Back letters of credit or issue of various types of guarantees.

Post-shipment finance is extended after shipment of the goods to the date of realisation of export proceeds. Post-shipment finance can be classified as under:

a) Negotiation/payment/acceptance of export documents under letter of credit (L/C)

b) Purchase/discount of export documents under confirmed orders/export contracts etc.

c) Advances against export bills sent on collection basis.

d) Advances against exports on consignment basis.

e) Advances against retention money relating to exports

f) Financing of Projects exports and Services exports.

g) Advances against deemed exports etc.

Let us look at how exactly a buyer and supplier credit arrangements can be structured.

Let us take an example of a car manufacturer in India (Maruti) selling cars to an importer in Switzerland. Depending upon the terms of the sale contract and the mutual trust between the buyer and seller the transaction can be settled through an open account (where the Swiss buyer pays the Indian seller directly with a cheque, banker's draft or some form of bank transfer), payment in advance (where the Swiss buyer pays to the importer prior to shipment), collections and documentary credits (by centrally involving the banking system in the collection and payments procedure for the shipping documents).

Generally one might describe a documentary credit as a arrangement between banks for the international settlement of debts with a variety of degrees of security for each party and the provision of finance where required. This arrangement can bridge the conflicting problems in a trading transaction between buyer and the seller; the buyer is anxious to receive the goods he has ordered for, in good condition before a stipulated date and that he may be granted appropriate time to pay for them. The seller wants to ensure that the goods he is selling will be paid for and, particularly in the case of an international transaction, that he will receive such payments as soon as possible.

Trade finance today has grown to encompass broader practice of mobilising a considerable range of specialist financing and insurance tools. Let us look at some of them.

16.4.1 Letters of Credit

A documentary credit represents a commitment of a 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 documentary credit is an essential implement for conducting world trade today. It fulfils all the requirements for this role, provided the conditions regulating its use are stated in clear and unambiguous terms.

Strict requirements govern the composition of the documents used in the documentary credit. It is important for the beneficiary of a documentary credit to know that payment will be made only if the document are in absolute conformity with the required terms and that the bank has to divide on the basis of the documents alone. The Uniform Customs and Practice for Documentary Credits (UCP) prepared by the International Chamber of Commerce in Paris provide the basis for judging the conformity of the documents.

Documentary Credits serve the following purposes

a) They are a classic instrument for financing purchase/sale of foreign goods, services and foreign equipment.

b) They assist the issuing bank to grant finance to the importer and monitor its use.

c) They are an effective way of bringing confidence and security into the transactions of commercial parties.

d) They are a routine instrument for exporters to secure payment.

Now let us look at how documentary credits work. The buyer (importer), who applies for the credit, is known as the applicant. His bank which issues the letter of credit (L/C), is the issuing bank. The seller (exporter) is the beneficiary. The correspondent of the issuing bank, to which the L/C is sent for transmission to the beneficiary, is the advising bank. If the advising bank adds its "confirmation" (own undertaking to pay) to the L/C, it becomes the confirming bank. You should note here that such an undertaking by the advising bank is independent of the undertaking of the issuing bank.

L/Cs are issued in two main types:

1 The majority of L/Cs are irrevocable. These may not be cancelled or amended unless all parties agree. If the advising bank merely transmits the credit to the beneficiary, "handing-on", the L/C remains an irrevocable credit. But if the advising bank confirms the L/C by its separate undertaking, it becomes a confirmed irrevocable letter of credit.

2 The revocable credit is not often seen. It can be cancelled at any time by any party, usually the applicant. The danger for exporters of revocable L/Cs is that the credit may be cancelled after the goods have been dispatched, but before the documents are presented to the advising bank for payment.

3 It may be confirmed. when the correspondent bank abroad confirms it.

4 It may be with recourse or without recourse. In case of former the overseas bank has a recourse against the supplier or beneficiary if documents are not paid by the opening bank or importer, and in case of latter the bank has no such right.

How a Letter of Credit is Set Up : Summary of Procedure

i) Buyer and seller conclude sale contract providing for payment by documentary credit.

ii) Buyer instructs the issuing bank to issue an L/C in favour of the seller.

iii) A detailed L/C application form is completed containing the actual terms of the L/C, as well as various terms and conditions which protect the issuing bank.

iv) Issuing bank asks another bank, usually in the country of the seller, to advise the credit and confirm the L/C if asked for by the applicant.

v) Advising bank informs the seller that the credit has been issued.

vi) As soon as the seller received the credit, and is satisfied that he can meet the terms and conditions of the credit, he starts the process of despatching the goods.

vii) Seller sends the documents evidencing shipment of goods to the bank where credit is available, usually the advising bank.

viii) Bank checks the documents against the credit, if the documents meet the requirements of the credit, the bank will pay/accept negotiate according to credit terms.

ix) Issuing bank effects payment in accordance with LC terms to the bank that has paid/negotiated/accepted under the credit.

x) The documents are released to the buyer (upon payment/acceptance of the draft), who sends the shipping documents to his clearing agents for clearance and delivery of the goods.

Settlement (making payment) under letters of credit usually take one of the following methods:

Sight L/Cs: Most of the credits provide for payment against sight drafts and/or upon presentation of documents. Under sight credits the issuing (or paying) bank is obliged to make payment to the beneficiary or negotiating bank as the case may be upon receipt of the documents in compliance with the terms of the credit. In turn, the account party (importer) is obliged to make payment to the issuing bank against documents.

Acceptance Credits: Acceptance credit provides for drawing a time (usance) draft under the letter of credit to settle payment. An acceptance credit is also known as a usance credit or documents against acceptance credit. As the issuing bank under an acceptance credit is committed to a longer period of time and the documents representing it's collateral would have to be released to the account party before maturity of the acceptance, banks should appraise the credit risk accordingly.

Documentary acceptance credits are primarily designed to provide finance for the applicant; but if term bills are discounted they will provide the working capital to finance the exporter too. The applicant may require the beneficiary to draw term bills of exchange on any one of the following:

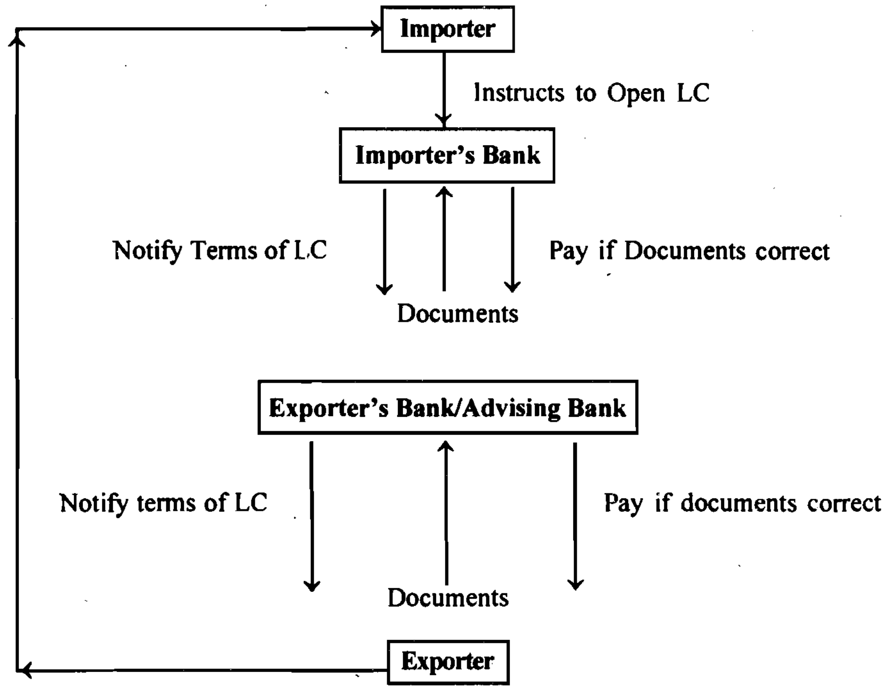
a) **The applicant himself :** If drafts are to be drawn on the applicant, the issuing bank upon receipt of documents from the advising bank will obtain the applicant's acceptance. These acceptances are either held till maturity or the exporter's bankers arrange for it to be discounted as a trade bill depending upon the availability of a local discount market.

b) **The issuing bank :** Where drafts are to be drawn on the issuing bank, the credit will usually authorise the advising bank to pay the beneficiary on a sight basis. When the issuing bank receives the correct documents they will accept the draft drawn on them by the beneficiary, discount it, and arrange for the discount proceeds to offset the reimbursement claim from the advising bank.

c) **The advising bank :** If an active discount market exists in the beneficiary's centre, the credit may call for the beneficiary to draw his drafts on the advising bank. In this case the finance for the importer is being provided in the exporter's country. The beneficiary may choose to hold the accepted bill until maturity, thereby financing the applicant himself. More usually the beneficiary discounts the bill, either with the advising bank or with his bankers. The bill will meet the acceptance of the advising bank, presumably well-known in the local discount market and should, therefore, attract the minimum discount charge from the purchaser of the bill because of the standing of the advising bank which has accepted to pay it at maturity. Drawing term bills of exchange on issuing or advising bank are also referred to as Bankers Acceptances in international trade terminology and are considered as best means of trade financing.

Deferred Payment Letters of Credit: Deferred payment credits are similar to acceptance credits except no drafts are required or presented. The issuing/confirming bank should notify the beneficiary/presenting bank upon proper compliance with the terms of the credit, when the payment will be made and will give an irrevocable undertaking to that effect.

How a Letter of Credit Operates



Uniform Customs and Practice for Documentary Credits

In its efforts to standardise the rules governing operation of documentary credits, International Chamber of Commerce (ICC), a non-government independent world organization, has codified a standard set of rules for operation of credits. These rules are known as "Uniform Customs and Practice for Documentary Credits"(UCP). These rules were first codified in the year 1933 and were adopted in the same year at the seventh congress of ICC in Vienna. They were subsequently revised from time to time with the latest UCP 500. UCP 500 has been adopted by banking association and individual bank in over 175 countries and came into effect by replacing UCP 400 on 1st January, 1994. International Chamber of Commerce publication No.500 sets out manner in which documentary credit work will be conducted for the mutual benefit and understanding of all the parties involved. It is not legally binding unless the parties specify under the credit (which banks incorporate invariably in all the letters of credit) that they will be bound by such terms. UCP 500 represent changes over the past 10 years in the law and practice relating to documentary credit usage. These changes address developments in the transport industry and technological applications. One of the development in UCP 500 is to provide a detailed list of the elements of acceptability for each category of transport document. Students are advised to read this publication for an enhanced understanding of the documentary credit operations. Students are also advised to read their publication URC 522 - uniform rules for collection and URR-525 uniform rules for bank to bank reimbursements under documentary credits.

16.4.2 Forfaiting

Meaning

Forfaiting is the purchase of a series of notes, usually bills of exchange, promissory notes, or other freely instruments, on a non-recourse basis. (This means that there is no comeback on the exporter if the importer does not pay). The Forfaiter deducts interest (in the form of discount), at an agreed rate for the full credit period covered by the notes. The debt instruments are drawn by the exporter (seller), accepted by the importer (buyer), and will bear an aval (name of the guarantor bank) or unconditional guarantee of the importer's bank.

In exchange for the payment, the Forfaiter then takes over responsibility for claiming the debt from the importer. The Forfaiter either holds the notes until full maturity (as an investment). Or sells them to another Forfaiter, again on a non-recourse basis. The holder of the notes then presents each receivable to the bank at which they are payable, as they fail due.

How should forfait be used?

Traditionally, Forfaiting is fixed rate, medium term (three to five years) finance, but Forfaiting have become flexible about the terms a forfaiting house will accept.

Some houses will accept paper with tenors up to ten years; nd in other cases for shorter periods, down to 180 days. The market for paper generally ranges between one and ten years, depending upon the country/import financed by the guarantor.

Payments will normally be made semi-annually in arrears, but most Forfaiters will accommodate payments, which are made quarterly, semi-annually, annually, or on a bullet basis. These can include capital and interest repayments holidays. There is no need to have a ready-made transaction to sell the Forfaiter. Many houses structure deals themselves, and will advise on credit terms, which debt instruments to ask for, and help price the deal.

International investment and Forfaiting corporation (IIF) is a finance company mainly mediating between imports and financial institutions as well as private investors in financing global trade related assets and working capital loans.

IIF has a major trading presence in the Forfaiting market, acting as a principal between the banks and institution who wish to buy and sell trade related assets and working capital loans. The company generates most of its business volume through its well-established customer relations, which is in turn placed in the secondary markets.

What information does a forfaiter need?

The forfaiter needs to know who the buyer is and his nationality, what goods are being sold; detail of the value and currency of the contract; and the date and duration of the contract, including the credit period and number and timing of payments (including any interest rate already agreed with the buyer). He also needs to know what evidence of debt will be used (either promissory notes, bills of exchange, letters of credit), and the identity of the guarantor of payment.

The documents are required by the Forfaiter from the exporter are:

1. Copy of supply contract, or of its payments terms
2. Copy of signed commercial invoice
3. Copy of shipping documents including certificates of receipt, railway bill, airway bill, bill of lading or equivalent documents
4. Letter of assignment and notification to the guarantor
5. Letter of guarantee or aval, the aval is the forfaiters' preferred form of security of payment of a bill or note. The buyer's (impoter's) banker's co-acceptance is called avalisation. For an aval to be acceptable, the avalising bank must be internationally recognized.

The aval may be placed on the face of the note. Sometimes a guarantee is issued instead of an aval, particularly in some countries, which may not recognise the aval as legally binding. Usually it is provided in a separate letter. Alternatively, the Forfaiter may be happy to accept a blank endorsement by the guarantor.

The most important point to remember is that any guarantee should be irrevocable, unconditional, divisible and assignable.

Once a forfaiter has all this information, indications or quotations can be given immediately by phone or fax. A commitment can be given prior to contract or delivery, and options can be given to assist the exporter negotiation of the contract.

The most commonly used debt instruments

The promissory notes and the bill of exchange (or draft) are the most commonly forfeited debt instruments. Under a Forfaiting agreement, a promissory note or bill of exchange/

draft is issued for each installment of the suppliers credit, thus documenting the existence of a claim of the exporter on the importer that is totally abstract, that is, it is, unconditional, irrevocable, and divorced from the underlying trade transactions.

In some cases, importers may prefer to open a letter of credit to cover their debts under a supplier's credit. It is possible to discount the deferred payment draft arising under these letters of credit. For Forfaiting purposes an irrevocable letter of credit is issued by the importer's bank in the import's country. The letter of credit does not have to be transferable, or confirmed by the advising bank in the export's country but it must be subject to the uniform customs and practices of documentary credits of the International Chamber of Commerce, Paris.

Advantages to the exporter

i) Payment is received at a known time and hence cash flow is guaranteed.

ii) Payment is guaranteed.

iii) It is off-balance sheet.

iv) Frees the exporter from any risk.

v) 100% Finance is possible.

16.4.3 Bankers Acceptances

Earlier we saw a bill of exchange as a fundamental document to trade, both domestic and international. A bill of exchange represents written evidence of a debt and is drawn in a set. It is the earliest type of trade financing instrument and has evolved through centuries of trade and is now covered by both statute and case law. The legal definition, under the negotiable instruments act ,1881 is - "a bill of exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument."

There are three main parties to a B/E. The drawer (exporter), drawee (importer, or person to whom it is addressed), and payee (person the drawee must pay). In addition, during the life of a B/E other parties are involved who enjoy particular rights and, on the other hand, liabilities. These include the acceptor, holder, bearer, holder for value, holder in due course, discounter, endorser and endorsee.

B/E and other types of trading instruments are used to finance various types of trade transactions.

Let's take a simple example:

Trader A $\xrightarrow{\text{exporting goods}}$ Trader B

Payment by trader B is often financed by a Bill of Exchange.

B/E are drawn on one trader by another to finance the import or export or inland sale of goods.

They are self-liquidating (money is generated by the sale of the goods) and are readily negotiable in the secondary market. In the secondary market they are discounted and sold to investors and are redeemed at par at maturity.

Under normal trade, the exporter makes out and signs the bill either at sight (cash on demand) or term(usance). If at a term, the customer accepts it, by signing across its face, as payable at a fixed future date. Of course, the buyer could dishonour the bill by neither paying nor accepting. In addition to the drawer's and drawee's names and addresses, a B/E will show the date drawn, the amount in both figures and words, terms (sight or usance) and the payee (or to order or to bearer). It is more often payable to specified persons rather than bearer. Specimen of a bill of exchange is annexed.

Bills of exchange are increasingly being used to obtain trade finance. They can be discounted, negotiated and forfaited. Advances can be obtained against bills as well as acceptance credits. Acceptance credits are a very popular form of finance and they are referred to as Bankers Acceptances (BAs) in the United States.

Bankers Acceptance is (a) a bill of exchange (b) an order to pay a certain sum of money on a specified day (c) always drawn on and accepted by a bank (d) accepting bank is obliged to pay the BA at maturity.

The bank accepts the B/E drawn upon it by its customer and then sells it into a secondary market at a discount, including an acceptance commission, passing the proceeds to its client. The bank then pays the bill at face value at maturity.

Acceptances have the advantage of enabling an exporter to give credit to an importer, while receiving cash up front. Also, by accepting a bill, the bank is adding its guarantee that it will be met in full at maturity and so the acceptance can then be sold at a rate which reflects the bank's credit rating. BAs are highly liquid and are actively traded, usually in round lots, in the secondary markets.

16.4.4 Guarantee/Bond

Bonds and Guarantees are an important part of international trade. They give a buyer certainty over receiving pre-agreed payments if a supplier fails to meet his contractual obligations.

If an exporter fails to complete a contract on time or according to specification, the importer will suffer various losses as a result. Seeking compensation directly from the exporter could be a lengthy and costly exercise with an uncertain outcome. To avoid such losses the importer, as a condition of the contract, could require the exporter to provide a bond or guarantee for an agreed amount through an acceptable bank or other financial institution. If a problem occurs the importer would simply demand that the guaranteed amount be paid immediately.

A guarantee (or bond) is a written instrument issued to an overseas buyer by a bank or financial institution (acceptable third party) guaranteeing that the exporter or contractor will comply with his obligations under the contract. If he fails to do so, the overseas buyer will be indemnified for a specific amount.

These bonds, issued by banks or financial institutions, are provided only on the basis that there is full recourse to the exporter in the event of the bond being called. The issuer i.e. the bank or financial institution will therefore require a counter indemnity/ guarantee from the exporter that he will be able to fulfil his obligations.

Now let us look at the various types of guarantees in the international trade scenario:

1. **Tender (Bid) Guarantees :** Given in support of a client's tender, an assurance that the client will sign the contract if his tender is accepted. It assures the buyer that he will not be wasting time and effort in evaluating tenders from potential suppliers who will not follow through. In the event of default, i.e. The client declines to sign the contract or does not do so within the time stipulated, the bank agrees to pay a fixed amount stated in the guarantee.

2. **Performance Bonds :** Given in support of a client's obligation to fulfil a contractual commitment. It is normally issued before the cancellation of a tender guarantee. It covers non-completion or faulty completion of the contract.

3. **Advance Payment Bonds :** This is a safeguard whereby the seller arranges for his bank to give the beneficiary, the buyer, its undertaking to refund any advance payment or progress payment if the goods are not shipped or the contract not complied with. Quite common where the export of "capital goods" is involved, for example, a power station or ship.

4 **Retention Bonds** : Where a contract calls for, say, 10% of each payment to be withheld until the project is completed and accepted, a guarantee may be issued which enables the contractor to receive the full amount while assuring the buyer that the issuing bank will refund the retention percentage if necessary.

5 **Customs Guarantees :** These are issued where goods are imported temporarily. If the goods are not re-exported, the guarantee will be implemented and duty paid to the customs authorities.

6 **Bill of Lading Indemnities :** Given to shipping companies in the absence of negotiable bills of lading, so that the importer can clear the goods without delay. When the bills of lading are received and delivered to the shipping company, the indemnity is cancelled. If, on the strength of the indemnity, the shipping company delivers to the wrong party, the issuing bank must make good any loss.

As in the case of the documentary credit and the documentary collection, the International Chamber of Commerce in Paris has issued "Uniform Rules for Demand Guarantees" (ICC NO..458...) to formulate a code of practice intended to secure a fair and consistent approach towards bonds and guarantees.

16.5 PROBLEMS OF DEVELOPING COUNTRIES

Most of the developing countries import more goods and services than they can export. This develops a gap to finance for which loans from external sources are needed. This is only one side of the picture. The other side is the gap between domestic savings and investments. Most of the developing countries are poor and have low per capita incomes. With low income, the savings too are low and many of these countries tend to get trapped into the vicious circle of low savings, low investment, to low productivity and, therefore, continued poverty. If they are to break the vicious circle and to reach a path of sustained growth, they need to use the savings of other countries to finance the investment needed for improving GDP growth rate. Hence the need for external funds. These can come in the form of grants, loans or equity investments.

One of the main sources of external finance for the developing countries is the export credit offered by the industrialised countries to finance export of capital goods to the developing world.

The expanding volumes of trade and the growing number of importers and exporters has also brought with it higher political and commercial risks. As governments in the exporting countries came increasingly to value the role of the exporter and of the banks who provided trade finance, so a range of official aids to exporters evolved. Foremost amongst these came the export credit agencies (ECAs), whose primary function is to provide insurance against the commercial and political risk of non-payment for the exports.

Some governments have restricted the role of their export credit agencies to providing insurance cover only; while others provide both insurance and medium and long term finance for capital goods. In nearly all cases, ECAs are required to operate on a commercial basis, funding their operations and the cost of loss settlements partly from premium income.

In addition to their insurance activities, ECAs are also the means by which governments formally administer official export credit lending. Let's now look at some of the ECAs of the industrialised countries and how they really help promote exports.

16.6 GOVERNMENT SOURCES OF EXPORT FINANCING AND CREDIT INSURANCE

The export credit insurance, funding and guarantees programme for the US revolves around the Export-Import Bank(EXIM Bank). Created in 1934 and established under its present law in 1945, EXIM bank is an independent US Government agency directed by

Congress to aid in financing and to facilitate the exports of US goods and services. This is accomplished in two principal ways:

a) **Direct Financing :** By lending directly in its own name individually or in cooperation with US Commercial banks (which include the US agencies and branches of foreign banks) to foreign buyers of US goods and services in excess of US$5 million and eligible foreign financial institutions (cooperative institutions) which finance various small buyers in its country. EXIM bank is bound by its statues not to compete with US commercial banks in their lending function and it therefore acts primarily in a supportive role. However if international competition dictates EXIM bank will match terms and if necessary take responsibility for funding the full amount of the loan.

b) **Guarantees :** By furnishing guarantees to US commercial banks and the Foreign Credit Insurance Association (FCIA) against all political risks, and substantial portions of commercial risks taken on by FCIA under its insurance programmes, and US Commercial banks when extending lines of credit to foreign financial institutions in "non-industrialised" countries.

Additionally from time to time, financial guarantees for part or all of the lending done by US commercial banks in cooperation with an EXIM Bank direct lending operation may be obtained.

It should be noted that EXIM Bank can and does lend funds directly to foreign buyers. This is the major difference between Exim Bank and the majority of the European export credit agencies.

UNITED KINGDOM - EXPORT CREDITS GUARANTEE DEPARTMENT (ECGD)

Established in 1919 ECGD is a government department which assists exporters of goods and services in two principal ways:

a) Insurance: By insuring them against commercial and political risks of not being paid, whether through the default of the buyer or through such causes as restrictions on the transfer of currency, cancellation of valid import licences, political/economic action outside the UK preventing the transfer of payments, etc. Additionally ECGD insures new investment overseas against the risk of war, expropriation and restriction of remittances. As with other credit insurers, it is mandatory for the policy holder, under supplier credit insurance, to carry a small part of any loss arising for his own account.. The percentage normally insured by ECGD is 90% for commercial risks and 90-95% for political risks. Through the assignment of their rights under these policies to their bankers, exporters are able to maximise their borrowing capacity.

b) Bank guarantees: By furnishing interest rate subsidies and unconditional guarantees of 100% repayment to banks, on the basis of which the latter provide finance to exporters at preferential fixed interest rates (except for intra-RRC trade where variable rates apply) under both buyer and supplier credit schemes.

It should be noted that ECGD does not lend funds directly in its own name but enables UK banks to do this at competitive rates by providing them with the repayment guarantees referred to above, together with interest rate subsidies and refinancing facilities.

FRANCE - COMPAGNIE FRANCAISE D'ASSURANCE POUR LE COMMERCE EXTERIEUR (COFACE)

COFACE was established in 1946 by the French Government as a semi public company to provide insurance of French exports and to guarantee banks which provide finance to facilitate exports. Other aspects of COFACE services include insurance for new overseas investments, projects and certain exchange risks. COFACE's function, therefore, approximates to RCGD's in the UK, i.e. To facilitate the provision of export finance through the French banking system and not to lend directly for this purpose in its own name.

COFACE covers short term commercial risks for its own account within established ceilings as well as operating the credit insurance service on behalf of the government. In the latter case, final decisions are taken by the Office of External Economic Relations (known as "DREE") of the Ministry of Finance in liaison with COFACE. All COFACE operations over 5 years must be approved by the DREE.

GERMANY - HERMES / KFW

Export credit insurance is provided by a consortium led by HERMES. HERMES is a private company acting as an agent for the Federal Government, which authorises them to extend export credit guarantees on its account.

HERMES processes applications made by exporters or banks and issues the appropriate policy. HERMES covers both commercial and political risks for both pre and post-shipment periods. Official funding of German exports takes place via the Kreditanstalt Fuer Wiederaufbau (KFW) , established after the second world war as a channel for domestic reconstruction funding. It has a variety of roles, but in the export sector it is the means by which medium and long term finance is provided to the buyers of German goods in developing countries. This can take various forms including, for example, aid grants or soft funding. It is mainly funded by the Federal budget, but also raises funds from the capital markets.

ITALY - SACE

Official export credit insurance in Italy is provided by Sezione Speciale oer l'Assicurazione de Credito all'esportazione (SACE) and is backed by the government. The organisation covers a broad range of commercial and political risks associated with foreign sales and investments, and leasing and capital projects. Short-term transactions (defined as being up to two years) involve comprehensive or specific cover for both political and commercial risk. Medium-term cover is specific in nature and covers three categories: political risk only; political and commercial risk for private buyers with a bank guarantee; and similar cover without a bank guarantee. In most cases the extent of the cover is up to 90 percent. Official export finance support is provided by Instituto Centrale per il Credito a Medio Termine (Mediocredito) which facilitates re-financing of export loans and interest make-up. It also administers Italian aid supplied by the Treasury. Italian exports are also funded by the country's medium-term credit institutions, which are largely controlled by the state.

JAPAN - JEXIM / MITI

Credit insurance is provided by the Export-Import Insurance Division (EID) of the Ministry of International Trade and Industry (MITI). The basis premise of the scheme is to insure risks which would not normally be taken up on a commercial basis.

EID covers general export insurance, proceeds insurance, foreign exchange insurance and also cover against losses associated with bonds and the dishonouring of bills. Risks cover levels vary, but, for example, under general export insurance upto 95 percent cover is provided for political risk and upto 60 percent on commercial risk.

Finance focuses around the Japanese Export-Import Bank (JEXIM). JEXIM offers supplier credits, investment credits and import credits, as well as direct credits to international organisations providing untied loans or, alternatively, it can enter into co-financing arrangements with such organisations as the World Bank.

Japanese exporters can also mobilise substantial funds to back their sales from the Overseas Economic Co-operation Fund(OECF). These loans, from Japan's aid body, are at a highly favourable interest rates.

SOUTH KOREA - KEXIMBANK / KEIC

The Export-Import Bank of Korea (KEXIM BANK) is a special government financial institution whose purpose is to promote the development of the Korean economy and economic cooperation with foreign countries. To accomplish this, the bank supports export and import transactions, overseas investments projects, and the development of natural resources abroad through extending loans, providing relending facilities and issuing guarantees.

Korea Export Insurance Corporation (KEIC) was established much later to specialise in the export insurance business and to take over the export insurance business from KEXIMBANK. The export insurance scheme offered by KEIC covers broad spectrum of export credit insurance, bank guarantee and investment insurance.

All over the world, official export credit agencies share similar features providing insurance cover and the required impetus to exports of their countries. In India these services are extended by the Export Credit Guarantee Corporation of India (ECGC) and the Export-Import Bank of India (EXIM Bank). ECGC was named in 1964 of former Export Insurance Corporation set up in 1957. Its primary goal is to support and strengthen export promotion in India by providing a range of credit risk insurance covers and offering guarantees to bank and financial institutions. Insurance covers are of two types (a) standard policies (b) specific policies. Both may be further for covering all "comprehensive risks" or political risks. As regards financial guarantees, they are of six types (1) Packing credit (2) Export production finance (3) Post shipment (4) Export finance (5) Export performance (6) Export finance (overseas lending) guarantees.

EXIM Bank was set up in 1982. It is fully owned by government. Its operations are grouped into project finance, trade finance and overseas investment. The bank extends both funded and non-funded assistance for promotion of foreign trade. To Indian exporters, the bank promotes exports through a variety of lending programmes.

16.7 COUNTERTRADE

Countries facing balance of payment difficulties encourage countertrade as a means of financing imports. Under countertrade, imports are paid for, not in the form of convertible money, but in the form of goods. Countertrade is an umbrella term, encompassing various different types of trade transactions, in which payment is made either wholly or partly in the form of goods. Countertrade referes to the reciprocal and compensatory trade agreements involving the purchase of goods or services by the seller from the buyer of his product, or arraignments whereby the seller assists the buyer in reducing the amount of net cost of the purchase through some form of compensatory financing.

As both the volume of world trade and the number of participants have grown, countertrading techniques have become numerous and advanced. As stated by the UN commission on international trade law: "countertrade is now common between developing countries, between developed and developing countries and between developed countries. Moreover it is taking place irrespective of whether there exists an institutional framework, i.e. government agreements, for it or not."

Countertrade activities fall into three main categories

1) **A means of financing** - often where the buyer is short of foreign exchange- with no, or only a partial, exchange of money between the original buyer and the seller;

2) **A trading technique** aimed, perhaps, at developing a new export market or boosting existing volumes of export business;

3) **A means of balancing trade** for either economic or political reasons - this was most frequently the case with the east European countries.

The bilateral trade India had with the erstwhile Soviet Union and some East European Countries, for example, was a form of countertrade. Our imports from these countries were being paid in foreign non-convertible rupees which the exporting countries had to use for purchases of goods and services from India. Countertrade takes several forms other than the bilateral trade referred to above. Let us look at some of them:

a) **Counterpurchase:** The exporter has to undertake to purchase specified goods from the importing country of a value which is an agreed proportion of his exports. Obviously, the specified goods will be such as do not have a ready international market.

b) **Offset:** Compensatory, reciprocal trade agreements for industrial goods and services as a condition of military-related export sales and services. It is also used in the purchase of civilian aircraft and has become the norm in the aerospace/defense sector. Offset is divided into two categories, indirect offset and direct offset. **indirect offset** involves goods and services unrelated to the aerospace/defense material being sold. **Direct offset** involves compensation in related goods and usually involves some form of co-production, license or joint venture.

c) **Buyback:** The exporter of capital goods is obliged to buy a specified proportion of the production for which the importer is using the capital goods. A petrochemical plant may be imported and the seller of the plant has to buy a proportion of the output in payment of the cost of the plant. Another example:textile machinery against textile manufactured with it or gas pipelines in exchange for natural gas transported through them.

d) **Barter :** The exchange of goods or services of equivalent value without the use of currency.

e) **Technology Transfer :** The transfer of technology mandated as part of a countertrade or offset agreement, other than coproduction or license production. It may be in the form of research and development, technical assistance and training, or patent agreements between manufacturers. This is central to many Third World enterprizes, public and private, and is the focus of a large number of countertrade and offset deals.

The "reciprocity" which is a feature of virtually all forms of countertrade falls into several different categories, most of which are of greater benefit to the buyer or importer than to the seller or exporter. While countertrade provides a way of boosting trade between countries with non-convertible currencies and markets are opened up on both sides which otherwise would not have existed, it has its own disadvantages. The practice of countertrade impedes the functioning of a free market and has the potential to create severe economic distortions, for example, to prices. Countertrade involves lengthy and protracted negotiations, documentation is complicated, weighty and expensive, also driving the true "cost" of the transaction even higher. Countertrade is ultimately inflationary.

Check Your Progress B

1 What is countertrade? what are its forms?

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2 What do you mean by forfaiting? Name the parties involved in it?

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3 What is a guarantee?

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4 How does retention bond differ from performance bond?

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16.8 LET US SUM UP

When an international sales contract is negotiated both buyer and seller pay attention to the shipping terms go as to the sales price. To make it clear, an international set of trade terms (Incoterms) has been adopted by most countries that defines exactly the responsibilities and liabilities of both buyer and seller while the merchandize in transit. Incoterms make international trade easier and help trades in different countries to understand one another. These standard definition are protected by international chamber of commerce, Paris. There are 13 incoterms 2000. When it comes to arrangement of payment, it can be advance payment or open account terms. There are various types of documents used in international trade. There are (a) transport documents (b) invoices (c) insurance policy (d) certificate of origin (e) bill of exchange. In a trade transaction funds are needed. Trade finance involves provision of funds to one or more parties. Trade finance is provided in the short, medium and long terms. It can be pre-shipment finance and post-shipment finance. There are a wide range of financial engineering tools such as factoring, B.A., forfeiting, countertrade, joint venture etc.

ICC has codified a standard set of rules for operation of credits. These rules are known as uniform custom and practice for documentary credits. These rules are subsequently revised from time to time. The latest rules are called UCP 500. UCP 500 set out the manner in which documentary credit-work will be conducted. Documentary credit represents a commitment of a bank to pay the seller of goods or services a certain amount provided he presents stipulated documents evidencing the shipment of goods or performance of session within a stipulated period of time. Forfaiting means the surrender of rights. It is the purchase, without recourse to any provision holder of the instruments of debt instruments due to nature in near future and arising from the provision of goods and services. It has many advantages like payment is guaranteed and received in time, 100 percent finance is possible and it frees the exporter from any risk.

Countertrade means reciprocal and compensatory trade agreements between the countries facing balance of payment problems. It may take the form of counter purchase, barter offset, buyback and technology transfer. The government sources of export financing and credit insurance are US-(EXIM Bank), UK-(ECGD), France - (COFACE), Germany - HERMES/KEW, Italy - SACE, Japan - JEXIM/MITI South Korea - KEXIM Bank/KEIC and Indian EXIM Bank.

16.9 KEY WORDS

Assignment of policy: Transferring a policy from the exporter to a lender.

Bid Bond: A bond issued by a company tendering for a contract to assure the prospective buyer that he will comply with the terms of the tender should it be accepted.

Buyer Credit: A financial agreement in which a bank, other financial institution, or an export credit agency in the exporting country extends a loan directly to a foreign buyer or to a bank in the importing country.

Performance Bond: A guarantee to a buyer that the exporter will comply with the terms of contract.

Soft loan: A loan made at a concessional rate.

Supplier Credit: A financing arrangement under which the supplier(exporter) extends credit to the buyer in the importing country.

Acceptance Credit: An l/c which includes a term bill of exchange in its required documentation. The bill will be accepted by the drawee/bank on which it is drawn, discounted and the proceeds paid to the beneficiary.

Commercial Risk: The risk of non-payment by a non-sovereign or private sector buyer or borrower in his home currency arising from default, insolvency, and/or failure to take up goods that have been shipper, according to the supply contract .

Constructive Delivery: The process of handing over documents to an applicant in a documentary credit.

D/A: Document against acceptance. The commercial documents will be released to the drawee against acceptance of the term bill of exchange accompanying them.

D/P: Documents against payment. The documents will be released to the drawee against payment.

Political Risk: The risk of borrower-country government actions which prevent, or delay, the repayment of export credits. Many ECAs also include war, civil war, revolution, or other military or civil disturbances. Some also include physical disasters such as cyclones, floods or earthquakes.

Revolving Credit: A credit where the amount of available drawings is reinstated automatically after a stated period of time.

Transferable Credit: A credit which allows the beneficiary to transfer part, or all, of the credit rights to a third party, or parties , if part shipments are allowed.

Trust Receipt: A security document for goods, issued by a customer to his bankers.

FIATA: International Federation of Forwarding Agents Associations.

Incoterms: A code of shipping terms published by the International Chamber of Commerce which govern foreign trade contracts.

Irrevocable: An obligation which cannot be cancelled unless all parties concerned agree to cancellation.

Red Clause: A credit where the advising bank makes pre-shipment advance payments to the beneficiary.

16.10 ANSWERS TO CHECK YOUR PROGRESS

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3. (i) F (ii) T (iii) F (iv) F (v) F

16.11 TERMINAL QUESTIONS

1. You want to export pickles to your friend in the US. Contact a bank and summarise your conversation with them.

2. Discuss letter of credit?

3. Explain the characteristics of a Bankers Acceptance.

4. Documentary credits are synonymous with international trade. Discuss.

5. What is forfaiting, Explain the procedures of forfaiting. How does it benefit the exporter?