UNIT 7 EXPORT FINANCE AND INSURANCE

Structure

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7.0 OBJECTIVES

Export finance provides businesses a way to procure their working capital, especially for overseas transportation, which otherwise takes periods. These types of finances are particular and tailored to suit the financial demands of a wide variety of companies engaged in export trades. After studying this Unit you should be able to

- Explain export finance
- Categorize different types of export finance along with the terms used in the export finance
- Identify types of export finance systems followed in India
- Explain export promotion councils and their varied forms

7.1 INTRODUCTION

Finance can be termed as the livelihood of any business. Export finance refers to the financial mechanisms that facilitate and support international trades. During the early stages of the export process, funds that are received through financing channels are preliminarily used for incurring capital expenditures. However, the day-to-day capital for working and production requirements or unforeseen contingencies must be handled with the excess funds or from different sources.

7.2 EXPORT FINANCE REQUIREMENT

Export finance can be obtained through different sources to meet the requirement for capital and the smooth flow of goods and services. Financing sources are selected so that a long-term benefit can be obtained

through them and should be a reliable source to fit all the business's financial needs.

The first step before obtaining export finance is the need for such funds and how the expenditure is planned. There are several reasons why investments are needed, which are given in the detailed description below:

1. **Setting Up a New Export Business:** Financial support is required to start or set up a new export business. Although some acquire the existing business such as manufacturing units, which are in dire need of renovation or equipment up-gradation and modernization, in some cases, the business owners look up to expand their existing business in the international market, thus requiring financial aid.

2. **Business Expansion:** While expanding the businesses, one may require additional funds, thus arising a need for large-scale finance. For example, suppose a company business decides to grow itself in the export market or expand its existing business to cater to a new export line. In that case, the need for export finance arises.

3. **Working Capital:** Apart from export finance, working capital is most needed in export. Often businesses have to accommodate the buyer's credit period and have to choose to go through loans such as pre-shipment finance. During some critical conditions, there will also be to compete with the market, it is essential to muster some financial clout to help businesses to pursue new ventures.

7.2.1 Need for Export Finances

As discussed, finance is needed at various stages of business cycles, such as during pre and post-shipment finance against the collection of invoices during the multiple stages of the working cycles and financial aid against the suspension or removal of export subsidies and benefits due to any cause.

7.2.2 Types of Export Finances

Depending on the requirements of various firms, several types of financing are available which can be both long-term and short-term, with additional credits. Some of the common types of export finances are discussed below:

1. **Pre-shipment finances:** These types of finances are provided to the exporters who need funds before shipping the products or goods. In this case, funds will be mostly utilized to purchase the raw materials, produce goods, process raw materials into a good or product, packaging, etc. Pre-shipment finance is provided for up to 180 days as it is used as a form of working capital. In some cases, there is some unfortunate experiences or circumstances, the period of 180 days can be further extended up to 90 days, thus making a total of 270 days.

2. **Post-shipment finances:** This type of finance is provided when the goods are dispatched to the importer. Exporters make a bill that has to be paid by the importer, which takes about 3-6 months before the amount reaches the exporter. These time gaps impact the exporter's

production, so to reduce this financial stress or strain, the exporter presents the bill to a financing institute that provides the finance to the exporter. The bank or the financer can purchase the bill or collect the bill and also give a discount on the bill. Mostly this type of financing system has opted as a means to pay wages, cargo shipping, advertising overseas, etc. This finance is provided for 90 days and can be extended based on the individual's financial situation.

3. **Export finance against bills collection:** This type of finance can be obtained by the exporters based on the bills of the purchase which the importers or overseas companies made. In case of any malfunction or default, the finance company will provide compensation up to 80% of the default amount. This type of financing can also be considered post-shipment finance.

4. **Deferred export finance:** Apart from the financing to exporters, financing is also available to the importers or the overseas buyers to facilitate an easy and smooth import of goods; this can be broadly classified into two types.

   1) **Supplier Finance**: The finance is provided to the exporters by the exporter's bank to sell goods on an installment basis. For example, if the exporter is from India, Indian banks will provide financial aid to the industry.

   2) **Buyer's Finance:** The finance is provided to the overseas buyer by the exporter's company which helps in enabling the buyer to pay for equipment or machinery for the exporter's company.

5. **Export Finance Against Allowances and Subsidies**

During some conditions, there will be an unexpected rise in expenditure due to national and international changes. In such cases, the government provides allowances or subsidies to help the exporters, thus reducing the prices of exported goods, which will benefit the importers.

Check Your Progress I

Note: Use the space provided for your answer

1. Fill in the blanks:

   (a) ………… the type of finances that are provided to the exporters who need funds before shipping the actual products or goods.

   (b) The type of finance that can be obtained by the exporters based on the bills of the purchase which was made by the importers or overseas company..................

   (c) The type of finance is provided when the goods are dispatched to the importer...................

2. Define Export finance against bill collection.

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7.3 ROLE OF EXPORT CREDIT

Export finance is crucial in enabling exporters to accept and efficiently execute their export orders. Usually, export credit is required for a short period, such as before and after the dispatch of the shipment of any goods. The pre-shipment export finance will help to accomplish timely production, packaging, and shipment. The provision for export finance is different from the provision of finance in that when production is oriented towards the domestic market, export credit will not be associated with the exports. The standard credit risks included are if buyers do not pay the amount, buyer's financial insolvency, refusal of the receipt of the exported goods, unfair termination of the contract, and many more. A country needs to develop and maintain an efficient system that provides them with the bottleneck to win the export contracts, in such a way that it adds to the international competitiveness strength of the country's export.

7.3.1 Export Credits in India

In the Indian context, there are no direct or proper subsidies to the exporters; instead, India relies on a wide range of indirect measures, such as duty and tax concessions, export promotion, marketing assistance, and many more. Majorly commercial banks provide export finances at a lower rate than their prime lending rates. Keeping in view international practices, the scheduled commercial banks have provided more flexibility by introducing the Linked Prime Lending Rates (LPLRs) since April 1999. Later modifications were brought out in the scheme, and with effect from April 19, 2001, RBI has allowed commercial banks to lend at the sub-PLR for loans above rupees 2 lakhs.

7.3.2 Changing role of Export Credit Agencies

Export Credit Agencies (ECA) are crucial international trade and investment flows. The traditional role of any agency is to encourage exports by supporting them, and providing insurance; in some cases, trade finance is being delivered directly. The export credit ensures goods and political as well as commercial risks of the exports.

7.3.3 Providers of Export Finance in India

There are several export financers in India, such as banks, non-banking financial corporations, foreign traders, etc., who offer financial aid or guidance to the exporters. A keen view into these topics to give ideation about the basics is an export-import Exim can be provided by the bank of India, which offers buyers credit, project-based finances, lines of credit, and corporate banking products. Some of the other banks which provide financing are nationalized banks, regional banks, foreign banks, private

sector banks, etc. The funding obtained covers pre and post-shipment finances along with certain terms and conditions.

Apart from banks, specific non-financial sectors and institutes offer export-specific financial services such as working capital loans, buyer's loans and bill discounting for their means of profits.

7.4 EXPORT PROMOTION COUNCILS AND EXPORT FINANCE

Export Promotion Council encourages exporters who are both old and new exporters to attend different types of workshops conducted throughout the year, addressing topics such as commercial terms, how to design a successful business plan, understanding finances, proper documentation, etc. These platforms provide the exporters with business solutions and advice that will be helpful throughout their businesses. These platforms also offer business developers with financial aid and financial procurement streams.

Export financing helps as a solution for cash flow for the exporters, thus facilitating the international commerce of goods and services. The three main points to consider for export financing are assessing financial needs (cash flow), type of financial aid required (short-term, medium, or long-term), financing through internal resources (such as reducing current assets, reducing fixed assets, increasing liabilities, and optimizing the equity structures) financing through external resources (such as special export credits).

Enumerating the working capital finance, which is produced by the banks, FEDA (Foreign Exchange Dealers Association) sets the rules and regulations and schedules the charges to be paid. Packaging credit or pre-shipment loan is provided to the exporters for a period of 180 to 360 days on the basis of disbursement (secured/ unsecured), later liquidation of credit was carried out if the exporters were unable to tackle the deadlines relaxations will be provided by the banks. Post-shipment finance is a credit loan or advance granted by a bank to exporters from the date of extending credit after the shipment of goods and services for meeting the working capital requirements. To acquire the credit amount from any financer, the amount should tally with the maximum permissible bank finance or the borrower's limit. Up to 10% margin is applicable under post-shipment credit. The main aim of post-shipment finance is to get financial aid without waiting for the number of sales from their respective overseas buyers.

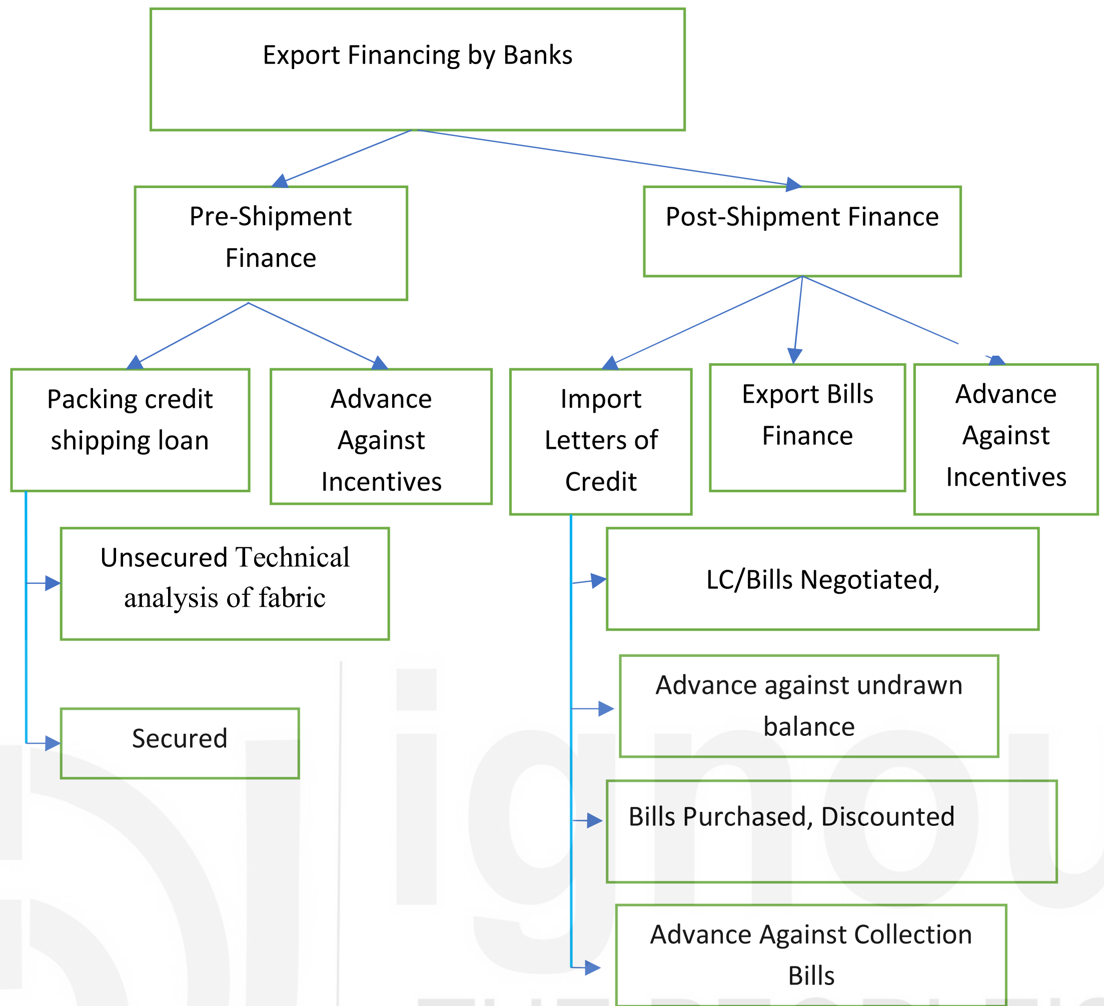
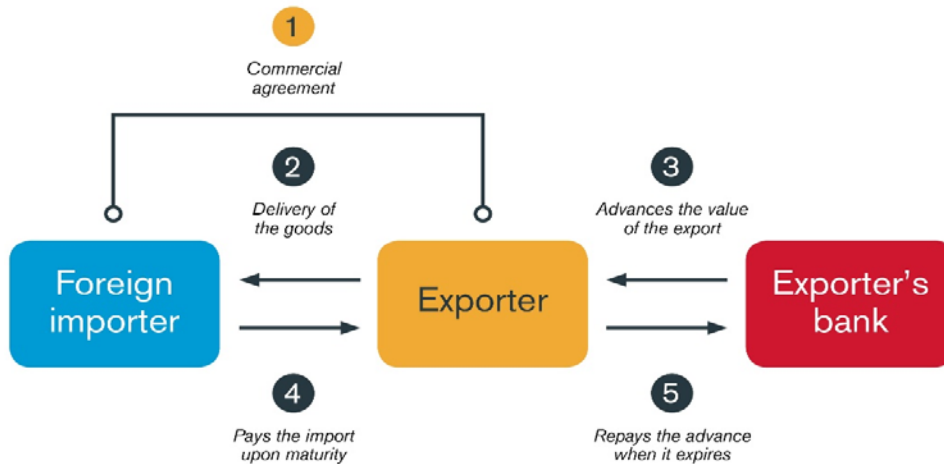


Figure 7.1 A Theoretical Flow Chart Explaining Export Financing

Some of the other trade options for international trade finance if forfaiting and counter trade arrangements. Forfaiting is a method adopted by trade finances that allow exporters to obtain a cash flow by selling with medium or long-term foreign accounts which are receivable at a discount to a forfeiter. When the export trade documents are exchanged, the forfeiter pays the exporter for their goods/ services.

EXIM (Export-Import Bank of India) bank financing is one of the trade options which the government of India provided as an Act of Parliament in 1981. EXIM is fully operated by the government of India with board directions consisting of banks of India such as RBI, Export Credit Guarantee Corporation of India (ECGC), and some business entities. The export credits were regularly provided to the exporters, which includes investments and subsidies as well to the Indian companies who were exporting abroad. This was developed keeping in view the increasing potential of the country's exports.



Intext Activity1

Explore how different export finances can be explored and obtained by the business personnel to achieve success in the export business and write down your experience in 500 words.

7.4.1 Export Credit Insurance

An Export Credit Insurance (ECI) is protection from a seller at the risk of non-payment by a foreign buyer. Mostly the goods have insurance which covers commercial risks such as buyer insolvency, bankruptcy, etc., some of the political issues covered were terrorism, riots, revolution, currency inconvertibility, etc. thus providing sellers protection against things both within and outside the buyer's control.

Export Credit Insurance (ECI) is a similar form of trade credit insurance. The main focus of export credit is focused on increasing trade relations with customers overseas. One of the main risks for export credit is that the companies need to become more familiar with the local laws, customs, and political situations thus making it difficult to operate at a rapid level and sometimes sudden increase in the tariffs makes the trade difficult. In simpler terms, an ECI accounts for protecting the business from unpaid invoices, which are caused due to several reasons.

Advantages that business owners can claim are as follows:

- **Risk reduction** helps safeguard against the losses from non-payment from the buyers. The export credit covers up to 95% of the total sales invoices.
- **Improve liquidity**, including foreign receivables. When the inventory of the receivables is insured, automated access is provided to the additional financing and improving the cash flow.
- **Increased competitiveness** is often seen in today's expanding and trending new markets. Credit terms are sometimes necessary to boost the existing customer base and increase the diversity of the product range.

- **Credit management expertise**, by using different credit risk management leverages such as EXIM, one can manage the credit using reliable sources.
- **Flexible coverage** is for those with multiple customer databases such as single, multiple or few buyers. EXIM and export credit insurances have policies that can fit each one of them aptly.

7.5 TERMS OF EXPORT CREDIT FACILITIES

Rules and regulations were drawn out by the government to provide whatever support they saw fit in order to promote their local domestic exports. Exports are more focused on by the government; as the exports increase there will be an increase, in job opportunities and an increase in domestic production, which will benefit the national economies.

However, due to unfortunate conditions, international trades ultimately fail, thus resulting in losses to taxpayers and the government. Therefore, the risk associated with credit facilities is being recognized by the government agencies in an orderly manner, and set up rules which aim to ensure support with fewer risks. Rules were formulated in 1978 and are officially known as the "arrangement of guidelines for officially supported export credits" or "the consensus rules". Some of the essential conditions are summarized to wholly understand the consensus rules are given as follows:

- **Cash payments:** Export Credit Agencies (ECA) usually will only fund up to 85% of the total eligible content of an exported good. The remaining 15% must be funded by the importer or the business itself.
- **Repayment terms:** As per the consensus rules, various repayment methods can be opted to cover the loans. A special rule only applicable for project finance transactions is that the covered loans are to be made for tenors for up to 7.5 years of average life.
- **Eligible contents**: The term used by ECA that determines what content is eligible for the cover. The export contract should be related to the goods and services from the government are provided under the cover.
- **Interest rates:** CIRR (Commercial Interest Reference Rate) is a fixed rate that is the ECAs follows. But due to several changes and reasons, the ECA-covered loans are now provided with variable interest rates.
- **Premias:** Premia are subjected to consensus rules. ECA charges insurance and guarantees premia for a financial year to cover the calculated interests.

But, one of the main contexts to understand is eligibility. Those considered eligible are provided cover for their suitable content for an export contract. Several eligibility criteria ensure that the ECA is covering the goods which are originated from their homelands. For example, due to agreements and globalization, several consortiums of contracts from different countries are involved under a single contract, thus making it different from the local content.

Check Your Progress II

Note: Use the space provided for your answer

1. Elaborate on different forms of export finances.

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2. Define EXIM.

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7.6 LET'S SUM UP

To sum up the Unit, export credit insurance (ECI) is a protection from a seller at the risk of non-payment by a foreign buyer. Export finance can be obtained through different sources to meet the requirement for capital and the smooth flow of goods and services. Depending on the needs of various firms, several types of financing are available, which can be both long-term and short-term with additional credits. Apart from the financing funding to exporters, financing is also available to the importers or the overseas buyers to facilitate an easy and smooth import of goods such as supplier's finance and buyer's finance. In the Indian context, there are no direct or proper subsidies to the exporters, instead; India relies on a wide range of indirect measures, such as duty and tax concessions, export promotion, marketing assistance, and many more. But, rules and regulations were drawn out by the government to provide whatever support they saw fit to promote their local domestic exports. However, due to deplorable conditions, some international trades are ultimately fail, thus resulting in losses to taxpayers, the government, and so on.

7.7 KEYWORDS

Export Finance: Export financing is a cash-flow solution for exporters. Export Finance facilitates the commerce of goods internationally. The seller agrees to the payment terms of the cross-border buyer. Thus, there is a cash flow issue. The supplier ships the goods overseas, while the payment will be received later.

Working Capital: Working Capital Financing is when a business borrows money to cover day-to-day operations and payroll rather than purchasing equipment or investment. Working capital financing is a common practice for

companies with inconsistent cash flow.

Subsidies: A subsidy is a direct or indirect payment to individuals or firms, usually through a cash payment from the government or a targeted tax cut. In economic theory, subsidies can be used to offset market failures and externalities to achieve greater economic efficiency.

Export Credit: Export credits are government financial support, direct financing, guarantees, insurance, or interest rate support provided to foreign buyers to assist in the financing of the purchase of goods from national exporters. An export credit agency offers trade finance and other services to facilitate domestic companies' international exports. Most countries have ECAs that provide loans, loan guarantees, and insurance to help eliminate the uncertainty of exporting to other countries.

Insurance: Insurance is a way to manage risk. When company buy insurance, they purchase protection against unexpected financial losses.

7.8 REFERENCES AND SUGGESTED READINGS

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7.9 CHECK YOUR PROGRESS- POSSIBLE ANSWERS

Check Your Progress I

1. (a). Pre-Shipment Finances

   (b). Export finance against bills collection

   (c). Post-Shipment Finance

2. This type of finance can be obtained by the exporters based on the bills of the purchase which was made by the importers or overseas company. In case of any malfunction or default, the finance company will provide compensation of up to 80% of the default amount. This type of financing can also be considered post-shipment finance.

Check Your Progress II

1. Packaging credit or pre-shipment loan is provided to the exporters for a period of 180 to 360 days on the basis of disbursement (secured/ unsecured), later liquidation of credit was carried out if the exporters were unable to tackle the deadlines relaxations will be provided by the banks. Post-shipment finance is a credit loan or advance granted by a bank to exporters from the date of extending credit after the shipment of goods/ services for meeting the working capital requirements. The main aim of post-shipment finance is to get financial aid without waiting for the number of sales from their respective overseas buyers. Some of the other trade options for international trade finance if forfaiting and counter trade arrangements.

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