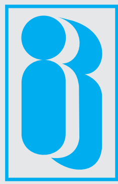

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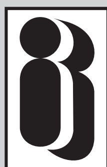

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editorial

Trade finance is an important element of financing the international business. Trade finance is the oldest method of financing receivables, claimed to have originated even before Europeans settled in America, and long before the world's stock markets were born. Trade finance also has traces in the early days of evolution of the Silk Route, involving China, Mesopotamia and Europe. Over a period, new and innovative mechanisms have evolved, and at present, it is estimated that trade finance caters to over 90% of world trade, though no precise data on this account is available. As the world trade is involved with more and more goods and services, more and more banks and financiers are involved with new products, lending money for trade transactions.

Most trade finance instruments, such as letters of credit, are simple forms of lending, some dating back hundreds of years. They are also among the safest for the banks involved, because they are short-term, the banks know the exporters and importers, and the goods covered can be used as collateral for the deal. The article 'Trade Finance : Genesis and Developments' highlights the origin and evolution of trade finance; and discusses briefly the various tools and instruments. This article is broadly segmented into : a) tools for raising finance; b) various terms of payment; and c) instruments that are used to mitigate risks.

As many emerging economies face the challenges of limited foreign exchange holdings, counter-trade has been used to overcome this challenge. In historical days, this used to be a simple barter, which has now evolved into other arrangements like buy-back, and counter-purchase. A brief write-up on counter-trade has been covered in this issue. Exim Bank of India's lead role in promoting India's international trade through multiple trade finance mechanisms like buyers' credit, suppliers' credit, lines of credit, guarantees, and the coordinating role played in promoting India's project exports among others, has also been highlighted in this article.

The global financial crisis, which has resulted in slowdown in economic growth, has also impaired the access to trade finance. There were estimates, in the early days of the crisis that the magnitude of shortage in trade finance was to be about US $25 billion, which was eventually estimated to have crossed US $100 billion. International Chamber of Commerce is of the view that exporters in general are seeking confirmed letters of credit, where they had exported on the basis of open account or cash against delivery. The banks' perception of risk has also led to tightening of liquidity, and therefore greater difficulty in getting confirmed letters of credit. Bankers' Association for Finance and Trade (BAFT) has opined that in addition to cost escalation, due to financial turmoil, and low level of risk appetite, increased capital costs under BASEL-II is also expected to increase the cost of trade finance for developing country exporters.

World Trade Organisation (WTO), even when the signals of crisis were visible, warned of the alarming situation on the trade finance front and its consequences on world trade. WTO constituted an expert committee to discuss the trade finance crisis and the means to tackle the crisis. Other organizations are also expressing concerns on the shortage in trade finance and closely monitoring the developments. I was personally present and contributed to the discussions held amongst various export credit agencies on this issue in a meeting convened under the auspices of UNCTAD. The recent G-20 meet also laid significant importance on this issue, which eventually agreed to provide a package of US $ 250 billion to fund trade finance.

Individually, multilateral institutions, export credit agencies, and national governments have taken up various measures to address the challenge of shortage in trade finance. The article on 'Global Financial Crisis: Shortage in Trade Finance' highlights such developments, including the measures taken by India.

As a prescription to the trade finance crisis, multilateral institutions may expand the provision of technical assistance / advice on trade finance policy, support for creation of finance related infrastructure and strengthening of institutions in developing countries. Rules setting organizations like WTO may consider setting up of flexible policies for developing countries that encourages concessional trade financing. Bank for International Settlements (BIS) may be persuaded to build suitable models that treat trade finance differently under Basel-II, which focuses on counter-party risk.

At national level, it is important to review our trade finance policies in the context of changing international environment. Constraints in securing trade finance, especially for exporting to developing or least developed countries would make Indian exporters look at business opportunities only in mature markets, leaving aside the emerging opportunities in developing or least developed countries. In this context, it may be important for India to strengthen its lines of credit activities, and thereby continue to pursue the developmental role played in other developing regions of Africa, Latin America and Caribbean, East Europe and CIS, and in Asia. This issue also has an article in detail on 'Exim Bank's Lines of Credit : A Unique Trade Financing Mechanism for South-South Cooperation'.

Exchange of information and institutional cooperation are the two important strategies for enhancing trade finance and trade amongst the trading partners. In this context, I may like to mention that Exim Bank of India mooted the idea of forging a stronger link among select export credit agencies in Asia. This informal forum seeks to provide a mechanism for participating countries and provides opportunities for cooperation in trade finance. Extending the similar concept at global level, Exim Bank took the initiative of setting up a Global Network of Exim Banks and Development Finance Institutions (G-NEXID), under the auspices of UNCTAD, with the objective of supporting rapidly increasing trade between developing countries with expanded financial services that can spur and stabilize economic growth.

The role of Export Credit Agencies (ECAs) in enhancing the trade finance is significant. With increasing globalisation of the world economy, ECAs now not only perform their traditional role of providing export credits but also offer a range of other products. An article on 'Trade Finance: Institutions, Activities and Practices at Global Level' presents a comparative illustration of the role of select ECAs.

The article on 'Musings on Trade Finance' discusses the need for an exclusive trade finance department in Indian commercial banks. The author has viewed that, in general, other departments like foreign exchange department, foreign business department, foreign department or international division, look after the trade finance portfolio. The article has also proposed a model structure of an exclusive trade finance department, which may be contemplated further by the readers.

As the Guest Editor of this 'Bank Quest' special issue on 'Trade Finance', I find significant value in these articles, which I strongly recommend for reading and preserving by the subscribers. I hope the readers also find the articles useful.

(T. C. Venkat Subramanian)

We are privileged that this special issue of 'Trade Finance' is edited by Shri. T. C. Venkat Subramanian, CMD, Export-Import Bank of India. In addition to the selected articles on trade finance, the issue also carries two book reviews : 'Dynamics of Ascent : A Centenary History of Bank of Baroda' by Dwijendra Tripathi and 'Handbook on Lending to Micro, Small and Medium Enterprises : A Practical Guide' by D. P. Sarda.

Exim Bank's Lines of Credit : A Unique Trade Financing Mechanism for South - South Co-operation

Prabhakar Dalal *

In the wake of the worst global economic crisis since the Great Depression of 1929, Indian economy, which registered a robust growth rate of 8-9% over the previous five years, witnessed moderation in 2008-09, not only driven by the knock-on effects of the Crisis but by the cyclical factors, as well. It is hoped that the worst is over. In fact, green shoots of recovery have started surfacing.

International trade is a major driver of growth and sound financial support structure is a *since-qua-non* for promoting international trade and economic development. National export credit agencies, such as, Exim Bank in India, play a crucial role in financing, promoting and facilitating flows of international trade and investment.

Exim Bank of India, as the country's premier export finance institution, has played a pivotal role in financing, promoting and facilitating India's export of projects, goods and services. Even in the period of current global downturn, Exim Bank's Lines of Credit (LOCs) portfolio has catalyzed exports at a rapid pace. Exim Bank proactively endeavours to enhance the competitive edge of Indian companies in their internationalisation efforts through a comprehensive range of financing programmes and advisory and support services at all stages of export cycle. Additionally, the Bank is also engaged in promoting two-way trade and investment flows between India and its trading partners across the globe.

Lines of Credit (LOCs) is a unique trade financing mechanism operated by Exim Bank. As a special mechanism to finance India's exports of non-traditional items, especially to emerging markets, Exim Bank, since its inception in 1982, has been extending export Lines of Credit to foreign governments, overseas financial institutions, regional development banks, commercial banks and other overseas entities, to enable buyers in those countries to import Indian projects, technology, equipment, and services, on convenient credit terms. Exim Bank's LOC programme has gained considerable recognition in the recent years, in developing countries of Africa, Asia, Latin America and the CIS, as it enables the LOC recipient countries to import developmental and infrastructural projects, equipment, goods and services from India, on a medium to long term credit terms. The financing programme has also enabled India demonstrate project execution capabilities in the emerging markets as has also proven as an effective market entry mechanism for Indian exporters with particular focus on small and medium enterprises. Acting as a catalyst for trade promotion, Lines of Credit offer a safe mode of non-recourse funding for Indian exporters. Indian exporters get their payment upfront upon shipments of goods and rendering of services under the Lines of Credit.

Lines of Credit are usually extended in US Dollars. Exim Bank, at present, extends two types of Lines of Credit. The first type of LOCs is where the Bank extends LOCs to overseas financial institutions, regional development banks and commercial banks on commercial terms, on its own, without any support of Government of India (GOI). The second type is where the Bank extends LOCs, at the behest of and with the support of Government of India to developing countries, as part of bilateral economic cooperation programme of GOI, called IDEAS (Indian Development & Economic Assistance Scheme). These Lines of Credit are extended to foreign Governments or their nominated agencies such as central banks, parastatal organizations, and national development financial institutions. Under the Lines of Credit, usually, a minimum of 85 per cent of the contract value

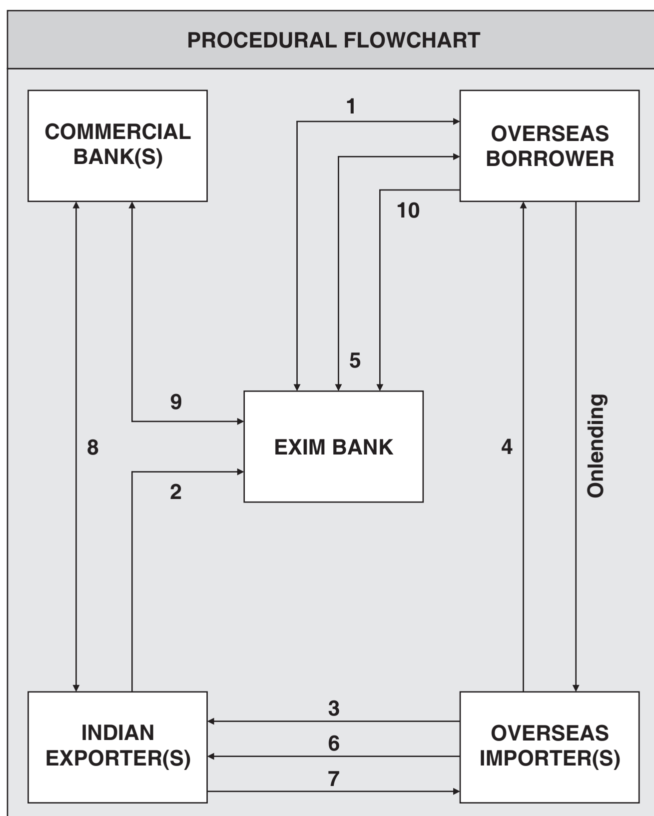
* Chief General Manager, Export-Import Bank of India.

must be sourced from India and the balance 15 per cent of the contract value can be sourced locally or from third country.

To promote India's trade and economic relations with developing countries, Government of India launched the India Development Initiative (IDI), in its General Budget for the fiscal year 2003-04. GOI has also launched region specific programmes such as "Focus Africa", "Focus LAC" (Latin America and the Caribbean), NEPAD (New Partnership for Africa's Development) and Team-9 (Techno-Economic Approach for Africa-India Movement). GOI, under these programmes, extends Lines of Credit to friendly developing countries for financing India's exports to those countries as well as for promoting India's economic interests in those countries. In its budget for the fiscal year 2003-04, GOI decided to route these GOI-supported Lines of Credit through Exim Bank. Since then, the Government Lines of Credit are funded, operated and monitored by Exim Bank.

Operational Procedure

Steps involved in LOC programme are enumerated below :



1. Exim Bank signs agreement with Borrower and announces when effective.
2. Exporter checks procedures and Service fee with Exim Bank and negotiates contract with Importer.
3. Importer consults Borrower and signs contract with exporter.
4. Borrower approves contract.
5. Exim Bank approves contract and advises Borrower and also exporter and his commercial bank, in India.
6. Importer establishes LOC in favor of Exporter.
7. Exporter ships goods.
8. Commercial bank negotiates shipping documents and pays exporter.
9. Exim Bank reimburses commercial bank on receipt of claim and debits LOC account of the Borrower.
10. Borrower repays EXIM Bank on due date.

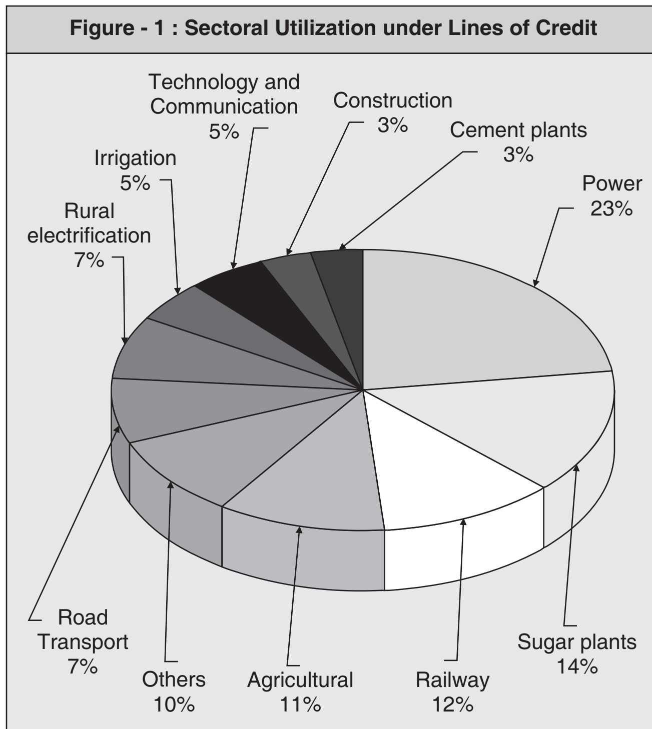
Exim Bank has a menu of 115 operative LOCs spread across 94 countries in Africa, Asia, CIS, Europe and Latin America, with credit commitments aggregating US $3,784 million, as on March 31, 2009, available for financing exports of projects, goods and services from India. Out of these, Africa enjoys the lion's share of 68 Lines of Credit, spread across 47 countries, cumulatively valued at US $2,310 million, followed by Asia with 24 Lines of Credit across 9 countries amounting to US $1170 million; Latin America & the Caribbean (LAC) with 15 Lines of Credit, across 23 countries, cumulatively valued at US$ 168 million; Commonwealth of Independent States (CIS) countries with 5 Lines of Credit across 12 countries amounting to US $65 million; Europe with 2 Lines of Credit across 2 countries with value aggregating US $20 million and Oceania with a Line of Credit of US $50.40 million to Fiji. These LOCs have been provided to developing countries of Africa, Asia and Latin America, to enable them to set up developmental projects with Indian technology.

Contracts / Projects Financed

As on March 31, 2009, Exim Bank has approved 585 export contracts amounting to US $2295 million, under the operative Lines of Credit. The largest beneficiary of Lines of Credit, Africa, contributes 65

per cent of total approved contracts with contracts approval of US $1485 million, followed by Asia with approved contracts of US $655 million (29 per cent). LAC countries, CIS & Europe and Oceania secured contracts amounting to US $87 million, US $19 million and US $49 million, respectively under the Lines of Credit. Sectoral utilisation of Exim Bank's LOCs is presented in a pie-chart given below (Figure 1).

Figure - 1 : Sectoral Utilization under Lines of Credit



Examples of Projects financed under the LOCs

A number of critically important projects in the key sectors of economies of developing countries have been financed under the LOCs, as per the following table :

Impact of Lines of Credit in Developing Countries

Increasingly, Lines of Credit are being extended for financing Indian project exports, which create, in the recipient countries, a greater visibility for Indian expertise and project execution capabilities, with downstream linkages. Established primarily to enhance India's exports to developing countries, the LOCs, today, have become an effective tool for market penetration and trade expansion. It has also created considerable goodwill and long-term economic interests for India in the developing countries of Africa, Asia, Latin America and the CIS countries. Just to cite an example, under an LOC to Senegal, an Indian company supplied and installed 2394 diesel engine driven pumpsets covering 64,000 hectare in Northern Valley and Casamance region of Senegal for enhancing irrigation for rice cultivation. As a result of this project, rice production in the region has more than doubled, meeting 40 per cent of rice demand locally, as compared to 19 per cent before the execution of the project.

Developing countries across the world, hitherto dependent on expensive technologies and equipments of developed countries, have now been able to import Indian technologies, projects, supplies and services at competitive price due to concessional interest rate and longer repayment period of LOCs. It helps the overseas governments / financial institutions in implementing their developmental projects in key sectors of economy like agriculture, industry, infrastructure, energy, telecom and transportation, using Indian technology and equipment.

Projects / Sectors financed		Countries Benefitted
Agricultural Projects	:	Angola, Burkina Faso, Chad, Cote d'Ivoire, Gambia, Ghana, Madagascar, Mali, Senegal, Sierra Leone, Sudan, Vietnam
Construction Projects - Housing, Seat of Government, Cricket Stadium	:	Gabon, Ghana, Guyana
Communication Projects	:	Honduras, Myanmar, Suriname
Irrigation	:	Angola, Jamaica, Lao PDR, Lesotho, Malawi, Mozambique, Senegal
Power - Generation, transmission and distribution	:	Cambodia, Ethiopia, Lao PDR, Mali, Mozambique, Myanmar, Niger, Sudan, Suriname, Vietnam
Rural electrification	:	Ghana, Mali, Senegal
Railway rehabilitation	:	Angola, Ghana, Mali, Myanmar, Senegal, Sri Lanka
Road Transportation	:	Central African Republic, Cote d'Ivoire, Ghana, Niger, Senegal
Technology (Parks and Training)	:	Cote d'Ivoire, D R Congo, Mozambique, Senegal
Sugar Industry - Rehabilitation	:	Ethiopia, Fiji Islands, Sudan

Transfer of technology and sharing of developmental experience have been the hallmarks of this LOC mechanism.

Such projects are meant to enhance local employment, build local capacity for growth of industrial activities and support private sector development in developing countries. Transfer of technology and sharing of developmental experience have been the hallmarks of this LOC mechanism. Indian technology is regarded in emerging markets, especially in Africa as "Triple A" technology; first "A" stands for "Appropriate", second for "Adaptable" and third for "Affordable". Indeed, Exim Bank's LOCs have emerged as a shining example of South-South Co-operation.

International Example of Forfaiting : Purchase of export claims without recourse to the exporter

Forfaiting
the exporter sells its claims from the supply of goods without recourse to the bank

Form
promissory notes or bills of exchange; letters of credit with deferred payment; book claims

Suitable for
small and medium sized transactions

Extent of financing
up to 100% of the contract value

Security
letter of credit with deferred payment; bankaval on promissory notes or bills of exchange (or separate bank guarantee); separate bank guarantee for book claims

Duration
medium term, i.e. up to 5 years

Currency
Swiss francs as well as USD, EUR and other currencies where refinancing is available for the respective durations

Risks
usually assumed by the bank

Rate of interest
refinancing costs of the bank plus a margin

margin : variable, depending on the standing of the borrower / the borrower's country / the guarantor

Fees

Commitment fee
until credit utilization (variable, depending on the transaction)

Disbursement
after delivery against presentation of the promissory notes or the bills of exchange, the agreed documents (delivery documents), and fulfilment of the formalities required

Countries
only selected countries

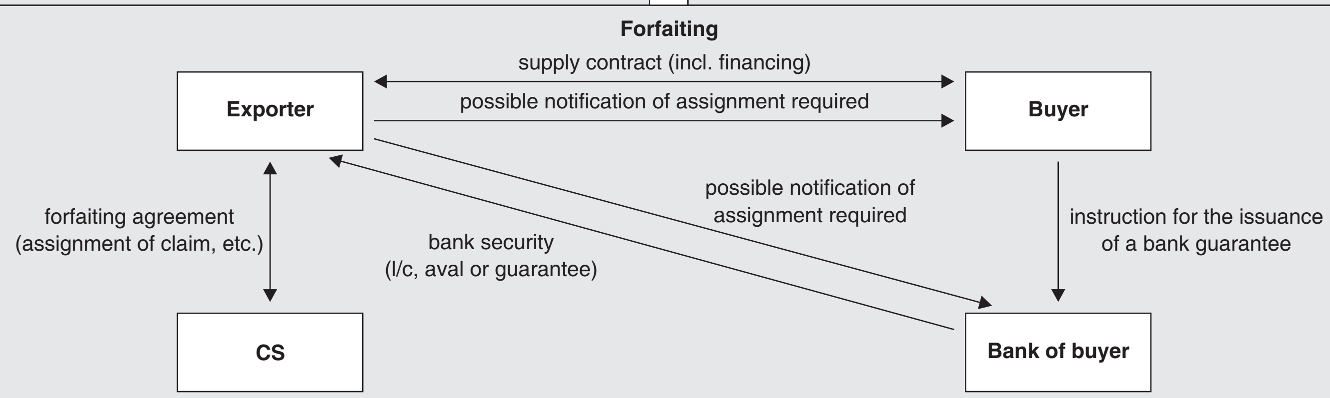
Preconditions
- availability of all authorizations required in the importing country for the supply contract, the taking up and the repayment of the loan
- assignment of the export claim (incl. security) to the bank

Advantages for the exporter

In general
- a credit transaction becomes a cash transaction
- no collection and "reminder"work for the exporter
- improvement of liquidity

Forfaiting
- discharge of the exporter from the risks
  - no commercial risk
  - no country risk
  - no currency risk
  - no interest fluctuation risk
- no limitation in the foreign content of the supply contract
- financing of up to 100% of the contract value possible
- no SERV / ECA premium
- quick and simple

Forfaiting



Source : Credit Suisse

Trade Finance Institutions in select countries, Activities and Practices

David Sinate *

BACKGROUND

Exports are a major driver of economic growth globally and Export Credit Agencies (ECAs), which include Exim Banks and Export Credit Guarantee / Insurance Organisations, play an important role in promoting the international trade of and investment flows to / from their respective countries. A typical ECA acts as an export financing institution, a commercial export insurer, a foreign investment catalyst and a project finance expert. ECAs globally differ in their role & function, resources, but are mostly owned by the state. All ECAs are generally backed strongly by the respective national governments, particularly for supporting exports on medium and long-term credit basis. With the backing of their governments, ECAs are able to take on longer tenors and higher risks than commercial banks. ECAs may be classified as : i) Those providing only export credit, with export credit insurance from another agency, and ii) Those providing both export credit and export credit insurance.

RANGE OF ACTIVITIES

With increasing globalisation of the world economy, ECAs now not only perform their traditional role of providing export credits but also offer a range of other products.

The US Exim Bank operates in the area of leasing of capital equipment and related services. To facilitate financing in partnership with other ECAs, US Exim Bank is active in setting up "One-Stop-Shop" co-financing facilities. "One-Stop-Shop" arrangements allow products and services from two (or more) countries to benefit from a single ECA financing package. Without co-financing, the importer would have to make separate financing arrangements with two (or more) ECAs to ensure their support for exports from their countries. The country with the largest share of the sourcing and / or the location of the main contractor, generally determines which ECA would lead the transaction. The lead ECA provides export credit support for the entire transaction (by arranging for support from the other ECAs).

> **The US Exim Bank operates in the area of leasing of capital equipment and related services.**

US Exim Bank's Environmental Exports Program provides enhanced levels of support for a broad range of renewable energy and other environmentally beneficial exports through direct loans as well as export credit insurance, loan guarantees and working capital loan guarantees, as US Exim Bank is committed to support US exporters of renewable energy and environmentally beneficial goods and services as well as exporters participating in foreign environmental projects.

Export Development Corporation (EDC), Canada provides export credit insurance, which is used by companies to acquire working capital from their banks that generate direct, export-related benefits to Canada. Through its Export Guarantee Program, EDC encourages Canadian financial institutions to advance pre-shipment loans to Canadian companies exporting goods or services (75 per cent of loan value is covered by EDC). EDC's program to invest in private equity and venture capital funds both at home and abroad is designed primarily to assist small- or mid-sized Canadian firms to innovate, commercialize their business and build contacts for gaining entry into the global arena.

* General Manager, Export-Import Bank of India.

> **Exim Bank of China administers concessional loans from the Chinese government and on-lends "foreign government loans".**

Japan Bank for International Corporation (JBIC) provides Natural Resources Development Facilities (NRDF) for projects in the form of loan and / or guarantee for import and / or development of energy and natural resources. NRDF loan is provided directly to overseas joint ventures (JVs) (project company). JBIC also provides loan to the overseas JV partner in case entire production of energy / natural resources is acquired by the Japanese company on long-term contract basis. JBIC's Overseas investment loans help to strengthen the domestic industrial structure by financing overseas business investments of Japanese companies. These investments bring economic benefits to the host countries, including increased employment, technology transfer and foreign currency earnings. JBIC's overseas investment loans are utilized not only for large-scale projects, but also by small and medium enterprises (SMEs) seeking to expand their business operations overseas.

Exim Bank of Korea has a 'Resources Development Credit Programme' under which credit is provided to Korean entities for investing and acquiring mining and other rights abroad. Overseas investment credit is provided to Korean companies in the form of capital subscription, acquisition of stocks or long-term credit. Through the EDCF (Economic Development Co-operation Fund), a bilateral ODA (Official Development assistance) loan program established by the Korean Government in 1987, and administered through Exim Korea, the latter seeks to facilitate industrial growth and improve the economic stability of developing countries, and thereby encourage a sound economic relationship between Korean companies and these countries. In 2008, Exim Korea has sought to broaden its scope of support to cover new growth industries of atomic energy, knowledge-based services and environment, developing them into full-fledged key export industries of the future.

Exim Bank of China administers concessional loans from the Chinese government and on-lends "foreign government loans". Foreign Government Loan refers to either the concessional loan or "mixed credit" provided by a foreign government to the Chinese government (mixed credit is a combination of a concessional loan from a foreign government, with an export credit or a commercial loan provided by a foreign bank).

Exim Bank of India (Exim India) provides finance to externally-oriented Indian Companies at all the stages of the export business cycle *viz.,* import of technology, export product development (including Research & Development), export production, export marketing, pre-shipment credit, post-shipment credit, project finance and Overseas Investment Finance. Exim India has been playing a key role in providing an impetus to the growing internationalisation of Indian companies, by extending funded / non-funded assistance to the latter for investments in their overseas ventures in diverse sectors (cumulatively till FY 2007-08, the Bank has supported 223 ventures set up by over 180 Indian companies in 61 countries, comprising both developed and emerging markets). Exim India has also played a pioneering role towards facilitating inclusive globalisation, through its innovative "Grassroots Business" initiative, a program that seeks to address the need of relatively disadvantaged sections (rural craftsmen and artisans for instance) to gain wider access to domestic markets and also entry onto overseas markets. This initiative is in line with GOI's focus on village and rural sectors. Besides, the Bank entered into a co-operation arrangement with International trade Centre, Geneva, for implementing a unique Enterprise Management Development Services (EMDS) Program an IT-based solution provider to enable SMEs prepare their business plans with the international market in focus.

RESOURCES

The major sources of funds of the 6 ECAs are paid-up capital, reserves and borrowings. With the exception of US Exim, ECAs in the industrialized countries depend more on borrowings from the international capital markets as compared with those in developing nations. To some extent, this reflects their greater ability to borrow in international markets on favorable terms.

- EDC Canada's debt instruments are obligations of the Government of Canada.

- JBIC's foreign notes and bonds are guaranteed by the Japanese Government.
- 97% of Exim USA's borrowings are from the US Treasury, the balance being marketable securities issued by Exim USA.
- Exim Bank of China is the policy bank of China and its business is completely underwritten by the Government of China.
- Exim India's access to funds from GOI / RBI has been low and it has been raising funds by way of private placements of rupee bonds / term loans from banks, at commercial rates. It also taps the international markets, using innovative structures to reduce cost. However, domestic borrowing at commercial rates and incidence of withholding tax on overseas borrowings restrict its ability to offer internationally competitive credit packages. Interest equalization support available under India Development Initiative of Government of India, enables Exim India to offer attractive credit packages to Indian exporters through extension of Lines of Credit, to support project exports from India.

ECAs are increasingly moving towards obtaining a credit rating for their resources. Exim India's domestic borrowings continue to enjoy 'AAA' rating indicating highest safety and a fundamentally strong position with negligible risk factors, for its medium / long term as also short term debt instruments, from three rating agencies *viz.,* ICRA, CRISIL and FITCH. Exim India also has international credit ratings for its overseas borrowings from international credit rating agencies *viz.,* Moody's (Baa3), S & P (BBB-), Fitch (BBB-) and Japan Credit Rating Agency (JCRA) (BB+). The ratings assigned are on par with sovereign ratings.

ECAs from OECD / Western countries generally have triple 'A' ratings on the back of their respective countries' triple 'A' ratings. An exception is US Exim, which is unrated; however as an agency of the US Government; it meets almost its entire resource requirement from US treasury and hence effectively carries US sovereign rating. Sovereign / quasi-sovereign ratings enable the ECAs to raise resources from the international capital market at very competitive rates.

MAJOR SECTORS ASSISTED BY ECAs

Some of the major sectors assisted by various ECAs are as follows :

ECA	Sectors Supported	Main Items of Export Basket of the country
Exim Bank, India	Major sectors supported by Exim Bank include textiles, engineering goods, construction, metals, chemicals, pharmaceuticals, agro based products, capital goods etc.	Petroleum products, gems & jewellery, textiles & clothing, Machinery and instruments, Medicines & pharmaceuticals, fine chemicals and Metals.
Exim Bank, USA	Air transportation, oil and gas, power projects and manufacturing were the most important sectors.	Capital goods, Industrial supplies, Consumer goods, Automotive goods, food, feed & beverages.
EDC, Canada	Major sectors financed include surface transportation, aerospace, energy & telecommunications.	Consumer goods and Energy products.
JBIC	About three fourth of the overseas investment loans, which is the most important financial programme offered by JBIC, went to the manufacturing sector.	Machinery & transport equipment, Office & telecom equipment, auto products, Chemicals, Iron & steel.
Exim Bank, Korea	Major sectors assisted include manufacturing, construction, finance & insurance, wholesale & retail and services.	Information & communication equipment, Machinery, Semi conductors, passenger card, chemical products.
Exim Bank, China	Mainly financing of overseas construction contracts & overseas investment projects, shipping exports, general mechanical & electronic products and exports of new-technology products.	Office machines and data processing equipment, Telecommunication, electrical machinery, apparel and clothing.

ECAs have been generally considered as institutions purveying export credits with a mission to promote national exports.

OBSERVATIONS

ECAs have been generally considered as institutions purveying export credits with a mission to promote national exports. They have also often had to compete with other national ECAs in terms of offering non commercial credit terms to their exporters. Both these factors have meant that almost all of the ECAs considered, are fully owned by the Government.

Barring some European ECAs which are in the private sector and primarily engaged in providing export credit insurance, most of the other ECAs are involved in funding activities, either receiving funding support from their governments or having government guarantees on their borrowings.

There is one major difference between the range of programmes operated by ECAs in developed countries (excluding Japan), by those in Japan / Korea and by those in developing countries. While European ECAs are mainly engaged in credit insurance and guarantees, (other than the non-fund based activities such as providing credit information, rating services, advisory services, etc.), ECAs in the developing countries have gone beyond the traditional export credit programmes and operate a much wider range of facilities including overseas investment finance, import finance and export promotion activities. Exim India has the widest product range on offer including activities such as finance for export product development, finance for R&D activities of EOUs, deemed exports, etc. Since ECAs have rich experience in efficient handling of global loans and credits (involving project appraisal, loan administration, follow-up, etc.) they are the appropriate vehicles for implementing other governmental loan and foreign aid schemes. For this reason, Exim Korea has been entrusted by its government to administer development assistance programmes. Of the export promotion facilities offered by ECAs, it is observed that some of the ECAs (for instance, JBIC of Japan and Exim Korea) are mainly involved in the promotion of overseas investment efforts of their companies, in line with the importance of such investments to their economies, whereas promotional activities of other ECAs, are basically oriented at enhancing exports.

The geographical pattern of assistance extended by various ECAs reflects the destination of national exports with Asia accounting for a major part of the assistance sanctioned by the Asian ECAs followed by Latin America. Main regions assisted by US Exim were Asia / Latin America and China respectively. While industrialised country ECAs were mainly involved in the medium and long term financing of capital goods, aircrafts, power sector and the telecom sector, the product distribution of ECAs in the developing countries showed a diverse range. The main sectors assisted by Exim India in FY 2007 included textiles, engineering goods, construction, metals and chemicals.

There can be no single role model in respect of ECAs. Depending on the stage of development of the national economy, the domestic and external environment and the specific priorities of policy makers, different ECAs have adapted their policies suitably to fulfill their respective national requirements. This is reflected in the differing emphasis on finance for exports, imports, overseas investment and other types of lending not only between ECAs but also for same ECAs over different time periods.

Global Financial Crisis : Shortage In Trade Finance

Prahalathan S. Iyer *

BACKGROUND

Trade financing provides fluidity to the movement of goods and services worldwide. It is estimated that the trade financing has been used in more than 90% of trade transactions (mostly short term credit) in the world.

The global financial crisis, which has resulted in slowdown in economic growth, has also impaired the access to trade finance. According to World Trade Organisation's (WTO) estimates, the market for trade financing has deteriorated as a fallout of economic recession in the world, and the shortage in trade finance liquidity is estimated to be US $100 billion. According to Dealogic, a leading firm analysing trade finance trends, global trade finance shrunk by about 40% in the last quarter of 2008 as compared to the corresponding period of the previous year. Dealogic estimates that only 116 trade finance loans (excluding aircraft and shipping) were signed in the last quarter of 2008, the lowest quarterly deal count since 2004.

It is estimated that developing and emerging economies are most vulnerable to the shortages in trade finance, whose trade expansion is requisite for sustaining the global trade growth in the context of slowdown in trade in developed economies. It is reported that there is also a general reassessment of risk caused by the financial crisis, which has tightened the trade finance availability to emerging market economies. As a result, the cost of finance has increased approximately by over 3-4% in international markets, even for exporters considered to be good.

The restrictions on the wheels of trade finance for developing countries would have repercussions on the world trade performance.

POSSIBLE REASONS

Various reasons have been cited as possible reasons for shortage in trade finance in international market, affecting the trade prospects of developing countries. These include :

- During the period of economic boom, trade (particularly when it takes place between associated companies in developed countries) was not financed by banks through letters of credit, but by general credit extended by the companies, usually secured on other types of collateral. This type of credit has certainly been badly affected by the financial crisis, due to the general pessimism about the prospects of the companies, and the prices of their assets.
- The shortages in general credit may have also caused a shortage in meeting the demand for trade credits in a time when the credit system went into a downturn.
- In a scenario of slowing down demand, the time between production and export realization increases, which diverts the existing working capital towards meeting the wages and other overhead costs. As a result, manufacturers are forced to seek trade finance, to meet the growing finance-gap;
- International banks, which used to extend credit to local banks (by way of LOC confirmations, bill of exchange endorsements or interbank loans, swaps, hedges and other treasury activities, which enable the local banks to offer trade finance denominated in foreign currencies), have started adopting a cautious approach, in the wake of financial market turmoil, and have reduced the 'bank limits' or 'country limits'. As a result, the cost of trade finance in developing countries has gone up by 3% to 4%.

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- It may be mentioned that the 'bank limits' were reduced because of weakening credit worthiness of banks due to growing NPAs, and the 'country limits' were reduced due to uncertainty in the financial market performance.
- Risk appetite of banks has come down, even while undertaking commercial risks, in view of financial sector meltdown in developed countries. As a result, banks are adopting cautious approach in accepting letters of credit (L/C) issued by other banks, even from established mature markets.
- Rapid fluctuations in commodity prices have also been cited as one of the reasons for cancellation of trade contracts, which eventually led to adoption of cautious approach by banking institutions, and increase in counter-party risk aversion, thereby spiking the risk prices;
- Risk appetite of exporters has also come down; exporters have started demanding L/Cs, which were hitherto being serviced based on open account or cash against delivery.

According to a study conducted by International Chamber of Commerce (ICC) in November 2008, exporters in general are seeking confirmed letters of credit, where they had previously exported on the basis of open account or cash against delivery (CAD). The banks' perception of risk is leading to tightening of liquidity, and therefore greater difficulty in getting confirmed letters of credit. Increase in credit default swap (CDS) rate may be considered as a barometer for low level of risk appetite in the international financial market. CDS rates, in some instances, have gone up 5-6 times following the financial crisis. Another study by Bankers' Association for Finance and Trade (BAFT), USA, reveals that in addition to cost escalation due to financial turmoil and low level of risk appetite, increased capital costs under Basel-II, is also expected to increase the cost of trade finance for developing country exporters.

IMPACT ON GLOBAL TRADE

The scarcity of trade finance is very likely to accelerate the slowdown in world trade and output, which is otherwise caused by recessionary conditions in most of the developed economies. It is reported that limited availability of trade financing is disrupting the supply chain operations of developing country exporters. In a meeting convened by the World Trade Organisation in November 2008, members felt that shortage of liquidity, especially the trade finance credit, have affected the operations of both the banks and traders in the emerging markets. It was further specified that while slowdown in world trade may not be significantly reducing the demand for trade finance, limited availability of trade finance might reduce the growth in world trade. A IMF staff paper prepared for the G-20 meeting has pointed out that corporates in the emerging markets are facing funding-risks, including with respect to trade credit, given the drying up of external bond and syndicated loan markets, which place them in a hostile environment. The restrictions on the wheels of trade finance for developing countries would have repercussions on the world trade performance.

The restrictions on the wheels of trade finance for developing countries would have repercussions on the world trade performance.

While the various studies on this subject have not clearly mentioned the magnitude of trade contraction due to trade finance squeeze, the fall in shipping rates could be considered as a general barometer to estimate the magnitude of such challenges. The Baltic Dry Index, which hovered around 12,000 in the month of May 2008, has fallen down to around 2000 in the month of April 2009.

According to World Trade Organisation, the slowdown in global demand will drive exports down by roughly 9% in volume terms in 2009, the largest contraction since the Second World War. IMF has estimated the volume growth in world trade in goods and services to be at (-) 11% in 2009.

MEASURES TAKEN

Multilateral Institutions

Various measures have been taken by multilateral institutions to enhance the trade financing, which include :

- World Bank / International Finance Corporation (IFC) has announced tripling of the ceiling of the trade finance guarantees available under the IFC's Global Trade Finance Programme (GTFP - a trade facilitation

measure introduced to support trade from developing countries), from US $1 billion to US $3 billion; IFC is also developing a program to provide funded support to major financial institutions with wide trade finance networks in emerging markets, and to increase engagement with export credit agencies. IFC has also proposed to create a Global Trade Liquidity Pool (GTLP), in association with multilateral / regional institutions that are active in trade finance, to fund trade transactions for upto 270 days, which is expected to be self liquidating once the conditions of trade finance improve;

Box - 1

Exim Bank and Global Trade Finance Programme of IFC

Bank has signed an agreement with IFC, Washington, a member of the World Bank group, under the Global Trade Finance Program (GTFP) of IFC. This arrangement will enable the Bank to confirm L/Cs, guarantees and other trade instruments issued by approved banks in more than seventy countries of Central Asia, Central and Eastern Europe, Latin America & the Caribbean, Middle East & North Africa, as also other regions of Asia and Africa. Under the program, IFC issues partial or full guarantees related to trade transactions on a per-transaction basis, covering the payment risk of local banks operating in IFC member countries. Bank partners IFC as 'Confirming Bank' under the GTFP.

- Asian Development Bank (ADB) has announced expansion of its Trade Finance Facilitation Programme (TFFP) from the existing US $150 million to US $1 billion. Under the TFFP, ADB provides guarantees to confirming banks, and revolving credits to issuing banks located in the developing member countries. The programme also enhances banks' ability to offer importers and exporters access to financial services, and works in partnership with the private sector to provide capacity, liquidity and stability in the trade finance system.
- African Development Bank (AfDB) intends to support trade finance through a US $1 billion trade finance initiative (TFI). To strengthen this initiative, AfDB has proposed to amend the legal agreements of Lines of Credit (LOCs) already approved, to specifically include the trade finance component. In addition, new LOCs would be offered to financial institutions catering to medium and long-term finance supporting trade. AfDB further proposes to provide apex revolving LOCs for trade finance through sub-regional DFIs, who would on-lend to local banks in the regions to support pre-shipment, post-shipment and working capital for trade finance. In parallel to these initiatives, AfDB is also preparing a business plan for launching a comprehensive trade finance programme (TFP) with more features.

G-20 has announced a US $250 billion trade finance package to be available over a period of 2 years.

- European Bank for Reconstruction and Development, which expects the demand for trade finance from the member countries, proposes to hike the budget for its trade facilitation programme, from the present €800 million to €1.5 billion for the year 2009, to boost the trade with and within eastern Europe, Central Asia, Russia and Ukraine.
- Inter-American Bank for Development (IADB) has also announced increased limit for its Trade Finance Facilitation Programme (TFFP) from US $400 million to US $1 billion. Under this programme IADB will also add loans to its current offering of guarantees, and support non-dollar denominated trade finance transactions to address the growing demand of transactions denominated in other currencies such as Euro. The enhancement of the programme are designed to complement the IADB's US $6 billion liquidity programme, which is aimed to alleviate the impact of global financial crisis on this region.
- G-20 has announced a US $250 billion trade finance package to be available over a period of 2 years. The core of this package is a pool of money which international institutions and national governments contribute 40%, and commercial banks, the remaining 60%.
- Berne Union proposes to strengthen its network and various means of coordination among members, to

share the experiences in tackling the previous financial crises in Asia and Russia, and real-time knowledge exchange, to enhance export credit, credit insurance and reinsurance.

Box - 2

G-20 Package on Trade Finance

G-20 member countries have agreed on the following :

- to treble the resources available to the IMF to US $750 billion;
- to support a new SDR allocation of US $250 billion;
- to support at least US $100 billion of additional lending by the MDBs;
- to ensure US $250 billion of support for trade finance;
- to use the additional resources from agreed IMF gold sales for concessional finance for the poorest countries; and
- to constitute an additional US $1.1 trillion programme of support to restore credit, growth and jobs in the world economy.

The G-20 package on trade finance does not involve US $250 billion of new money. Because of the short-term nature of trade finance, G-20 plans to mobilise that amount of funding over two years with about US $50 billion. Of this package, international institutions and national Governments are expected to contribute about 40%, and the remaining 60% by the commercial banks.

It is reported that already IFC-Washington, China and Japan have collectively contributed US $5 billion, which if considered as the 40% of the public component, would mobilize another US $7.5 billion from private sector commercial banks, making the kitty reach US $12.5 billion. Further, it is reported that USA, UK, the Netherlands and some other EU members, African Development Bank, and the Inter-American Development Bank are expected to contribute, taking the public component to US $10 billion, making the total kitty to US $25 billion. Assuming that the trade finance instruments run for an average of 180 days, the US $25 billion kitty is expected to fund about US $100 billion trade over the two years.

National Governments / Export Credit Agencies

National Governments have been supporting the trade finance activities, some of them through the respective export credit agencies or developmental institutions. For example :

- USA through US-Exim Bank is making additional resources available to increase access to affordable trade finance. US-Exim Bank, has already announced a programme to provide US $4 billion in new short term trade finance facilities and US $8 billion in medium and long-term trade finance facilities to support export of US goods to emerging markets. Similarly, China, through the China-Exim Bank, is providing short, medium and long-term trade finance facilities for export of Chinese goods and services to emerging markets. These programmes will be implemented through bilateral export credit agencies in the form of direct loans, guarantees or insurance to credit worthy banks. Both the countries would also coordinate with the multilateral institutions and regional development banks to complement the existing emerging market liquidity efforts;
- US-Exim Bank has also announced US $2.9 billion insurance cover to help meet the growing demand to insure US lenders' confirmation of letters of credit issued by 11 Korean financial institutions. According to US-Exim Bank's survey, there was considerable gap in commercial capacity available to support letters of credit issued by Korean banks and financial institutions, which necessitated announcement of such scheme;
- US-Exim Bank also modified the working capital loan guarantee programme, which enables indirect exporters (small and medium suppliers to export oriented units) to be eligible under this scheme; Earlier, these companies were only eligible for 10% of the working capital guaranteed by US-Exim Bank. On case by case basis, US-Exim Bank would also consider reducing the collateral requirements for letters of credit to 10% (from 25%), which otherwise has been 100% in the private sector;
- Federal Reserve, USA, has announced currency swap facilities with European Central Bank, and central banks in various other countries, such as

Bank of England, Swiss National Bank, Bank of Japan, Reserve Bank of Australia, Bank of Canada, Bank of Sweden, Bank of Norway, National Bank of Denmark, Bank of Korea, to keep the foreign currency liquidity into the international financial system;

- The UK Government has announced plans to guarantee as much as £ 20 billion of bank loans to small and medium companies ensuring flow of credit. 50% of the plan would be targeted to support short-term finance; and the plan is designed to allow banks to lend to business that would normally be turned away because of deterioration in trading conditions and decline in value of their assets, which are often taken as security;
- Germany has announced a financial sector rescue package of €480 billion (US $672 billion), under which the Government extends guarantees for inter-bank lending to secure confidence and liquidity in to the banking system;
- France has enacted the French Bank Relief Act, thereby creating a Refinancing Company (Société française de refinancement del'économie or SFRE) and a Recapitalisation Company (Société de prise de participation de l'Etat or SPPE) and further proposed to provide direct guarantee to French banks and other such entities to underwrite the debt issued by them;
- Central Bank of Russia has announced schemes to lend to commercial banks without requisite collateral for upto six months. In addition, the Central Bank has granted a credit line of US $50 billion, to Vnesheconomobank, drawing from its foreign exchange reserves, to lend to Russian banks and corporates to help meet their foreign liabilities, until the end of 2009;
- Chinese Guangdong Province has announced setting up of two funds worth Yuan 1.9 billion (approximately US $280 million) to support exporters in the Guangdong province. A Yuan 900 billion fund will be used to boost export of technology intensive branded products, and traditional labour intensive products; while another Yuan 1 billion fund will be used to meet the financing needs of the processing industry;
- The Government of Hong Kong SAR has proposed to extend the maximum guarantee period for working capital loan for SMEs from 2 years to 5 years, increasing the indicative ceiling of guarantee exposure for each participating lending institution from HK $1.25 billion to HK $1.5 billion. The Government also proposes to allow SMEs to recycle the guarantee once it has fully paid up the loan backed by the guarantee. The Government has already increased the overall grant ceiling for each SME HK $100,000 to HK $150,000, to be disbursed from the Export Marketing Fund;
- Japan has proposed the establishment of an Asia-Pacific Trade Insurance Network to facilitate intra- and extra-regional trade flows and investment through reinsurance cooperation among export credit agencies in the region. Japan's Nippon Export and Investment Insurance (NEXI) have proposed itself to be the leader and main underwriter of this collective re-insurance system.
- The Japanese government has announced US $1.0 billion trade finance facilitation initiative, to be developed in close cooperation with IFC and ADB. This follows the earlier initiative of Japanese Government to contribute US $2 billion, through the Japan Bank for International Cooperation (JBIC) to IFC's Bank Recapitalization Fund, which would help the banks from emerging markets to recapitalise;
- Bank of Korea, South Korea's Central Bank, since November 2008 allowed commercial banks to borrow upto US $10 billion, for lending foreign currency loans to small and medium exporters; the scheme has been extended (since December 2008) to large companies and can be availed until the end of the year 2009. Earlier (in October 2008), Export-Import Bank of Korea injected US $5 billion into commercial banks, in order to facilitate them to discount the export bills of Korean exporters;
- Banco Nacional de Desenvolvimento Economico e Social (BNDES), the export credit agency of Brazil has announced R$6 billion working capital credit facilities for Brazilian companies (to be disbursed through accredited financial institutions). Under this scheme, which is available till June 30, 2009, firms can avail loans upto R$50 million, with a repayment term of 13 months, of which five months will be grace period.

- Brazilian Central Bank announced that it would use its foreign reserves to increase credit lines for exporters who have been finding it hard to access trade finance instruments. As a follow-up, Brazilian Central Bank auctioned US $1 billion to banks (who will use them for trade credit lines) with repurchase clauses.
- Colombia and Venezuela have jointly pledged US $100 million each for creation of a special fund in order to boost cross-border trade between the two countries. In addition to meet the trade finance requirements of small businesses and exporters from these two countries, the fund would also support infrastructure projects along the border to boost trade.

IMPACT ON INDIA

Scarcity in trade finance was a result of pressures from both demand-side and supply-side. In the initial months of crisis, Indian credit market faced credit squeeze, which was led by net capital outflows, as international investors withdrew capital from India to compensate their losses incurred in exotic derivatives trading. This eventually affected the Indian firms as there was lending restraint shown by the banks. Further, there was contraction in trade credit extended by supplier firms, as also increase in demand for trade credit by the end-user firms, affecting the working capital liquidity of exporters. To combat the working capital liquidity, Indian companies turned to trade financing.

During the business boom, exporters have access to multiple trade financing channels like overdrafts, invoice discounting and factoring, which becomes increasingly harder and expensive during the days of crisis. It is also reported that buyers credit extended by overseas banks to Indian importers, which used to be a trade finance mechanism with extended credit period, has also dried up. Indian firms / exporters, who were using such facilities, have also turned towards conventional trade finance products, increasing the demand for such products. On the supply-side, it is reported that the commercial banks, on the lines of international banks, preferred to adopt a cautious approach, due to the threat of industrial slowdown and the resultant growth in non-performing loans.

It is reported that in general, when there is a trade boom, exporters seek to collect their payments through the open account or cash against delivery. But, following the crisis, Indian exporters started demanding letters of credit, even with established importers, as the buyers were taking longer time to pay, which exceeded the normal credit limits. The slowdown in demand in developed countries, as also the order book cancellations, are the main reasons for increasing demand for letters of credit. Non-acceptance to the buyers' demands of payment terms, such as longer tenor and cash against delivery, made the Indian exporters less competitive than others from competitor countries, who are being supported by their national Governments with various measures including credit guarantees. It may be mentioned that the late payment terms, and fear of cancellation of export orders caused threat to the business prospects of the Indian firms.

There are also reports that even developed country buyers / banks, in the guise of intense scrutiny, have been rejecting / delaying the processing of trade documents on the basis of minor discrepancies. In such a situation, the acceptability of letters of credit from least developed markets, as also from some of the developing markets, is being scrutinized by the banks critically, which has been restricting the wheels of trade finance. Another issue, which raises concerns among the Indian exporters, is the cost of credit. Exporters are also reporting challenges of liquidity in foreign currency, and high cost of foreign currency, especially for pre-shipment credit, where they need to source raw materials to service an export order.

The shortage of availability of trade credit, following the financial crisis, could be viewed from the decline in short-term trade credit inflows into India, as reflected in India's overall Balance of Payment statistics. During the period April-December 2008, net capital inflows under the head 'short term trade credit' have shrunk to US $0.5 billion, as compared to US $10.7 billion received during the corresponding period of the previous year. Short-term trade credit to India witnessed a net outflow of US $3.1 billion in the third quarter of 2008-09 (as against inflows of US $4.1 billion during the same period of 2007-08), mainly due to lower disbursements reflecting tightness in the overseas market and increased repayments as roll over was difficult.

MEASURES TAKEN BY INDIA

Various measures have been taken by the RBI / Government of India to address the liquidity challenges faced by the exporters, as also to enhance the availability of trade finance. The measures taken so far include :

- Interest subvention of 2% has been announced as a temporary measure for the period December 1, 2008 to September 30, 2009 to the labour-oriented sectors such as Textiles (including Handloom), Handicrafts, Carpets, Leather, Gems and Jewellery, Marine Products, and Small & Medium Enterprises (as defined by GOI). However, the total subvention will be subject to the condition that the interest rate, after subvention, will not fall below 7 per cent, which is the rate applicable to the agriculture sector under priority sector lending.
- Period of pre-shipment credit eligible for concessional rate of interest has been increased from 180 days to 270 days. Period of post- shipment credit eligible for concessional interest has also been increased from 90 days to 180 days in view of delay in realization of export proceeds in the current situation.
- RBI has already notified the extension of period of realization of export proceeds from six months to twelve months, from the date of export, in view of prevailing external environment.
- RBI has raised the ceiling on export credit in foreign currency from LIBOR + 100 basis points to LIBOR + 350 basis points, subject to the condition that the banks will not levy any other charges, i.e., service charge, management charge, etc. except for recovery towards out-of-pocket expenses incurred.
- The eligible limit of export credit refinance (ECR) facility has been enhanced from the existing level of 15 per cent of the outstanding rupee export credit eligible for refinance as at the end of the second preceding fortnight to 50 per cent.
- Government has expanded the lendable resources available to the Bank through a refinance facility by RBI. The refinance facility of Rs.5000 crore provided to Exim Bank was aimed at mitigating the pressures on account of the recent developments on loan disbursements to Indian exporting companies;
- Back-up guarantee has been extended to Export Credit Guarantee Corporation (ECGC) to the extent of Rs.350 crores to enable Indian exporters in getting more orders; funding for ECGC has also been provided from the National Export Insurance Account (NEIA) for providing higher risk cover to MSME exporters and select export sectors.

LESSONS LEARNT AND SUGGESTED MEASURES FOR ENHANCING TRADE FINANCE

Global Level

Multilateral / regional development finance institutions should play a pivotal role in rebuilding confidence amongst member governments, banks and financial institutions in the region, through provision of well-targeted credit enhancements, policy support, and capacity building initiatives. These may include technical assistance / advice on trade finance policy, loans for creation of finance-related infrastructure, and support in creation and strengthening of institutions that support trade finance transactions.

Banks / financial institutions / export credit agencies in developed countries should focus on extending direct support for trade financing rather than addressing this challenge only through guarantees. The institutions from developed countries should also extend credit lines to Governments / institutions in developing countries with the objective of enhancing trade financing. Banks and financial institutions, taking advantage of such programmes, or taking advantage of risk mitigation products, such as political risk insurance cover, should minimize the cost of L/C confirmations and inter-bank debt.

Rules-setting organizations, like WTO, may have to provide necessary comfort to banks and financing institutions (that are providing finance and guarantees), especially from developing countries, and set flexible policies for developing countries that encourages concessional trade financing; it may be appreciated that the priority task would be to enhance the capacity in developing countries to mitigate the effects of increased perception of risks and to provide the market with earmarked liquidity for trade finance. It is also necessary to persuade the Bank for International Settlements (BIS) to build suitable models and treat trade finance differently

under Basel-II. Unlike Basel-I, where the focus is on trade finance performance risks, Basel-II focusses on counter party risk, despite a perceived low risk level in trade finance activity.

National Level

There is a need for periodic review and change in our policies related to trade finance, to reflect the changing international environment (where competitor countries are introducing new support policies), as also in the context of changing business climate (recessionary trends).

Box - 3

Role of Exim Bank in Strengthening Institutional Cooperation for Trade Financing

Exchange of information and institutional co-operation are the two important strategies for enhancing trade finance and trade amongst the trading partners. Exim Bank mooted the idea of forming the Asian Exim Banks Forum, in 1996, in order to forge a stronger link among the member institutions. ECAs from Australia, China, Indonesia, Japan, Korea, Malaysia, Philippines, and Thailand, along with the Bank are members of this Forum. The forum seeks to provide a mechanism for participating countries to enter into a process of dialogue while providing an opportunity for cooperation in areas that transcend trade and investment. Representatives from regional and international organizations such as ADB, OECD, participate in the deliberations as observers. The forum facilitated signing of bilateral L/C confirmation facility among the members. The forum is also exploring the possibility of setting up a regional ECA with the support of multilateral funding institution like ADB.

Extending the similar concept at global level, Bank took the initiative of setting up a Global Network of Exim Banks and Development Finance Institutions (G-NEXID), under the auspices of UNCTAD, with the objective of supporting rapidly increasing trade between developing countries with expanded financial services that can spur and stabilize economic growth. G-NEXID is intended to boost bilateral and multilateral agreements of all kinds among Export-Import (Exim) banks and development-finance institutions (DFIs) based in developing countries. Such cooperation is expected to reduce the costs of trade for the developing countries, spurring investment across borders and making financing more readily available to new and innovative businesses and enabling the growth of "niche markets." The network would also facilitate developing countries to learn from each other and share effective financing practices, and establishing risk-sharing methods for investments.

Constraints in securing trade finance, especially for exporting to developing or least developed countries would make Indian exporters to look at business opportunities only in mature markets, leaving aside the emerging opportunities in developing or least developed country markets. Negotiating exports on the basis of cash terms would make Indian exporters, especially from the small and medium segment, less competitive, when compared to a similar exporter in another country that has access to trade finance. Considering such situations, India needs to intensify its lines of credit activities, and continue to pursue its developmental role in developing countries of Africa, Latin America and Caribbean, East Europe and CIS, and in Asia.

Institutional Level

Timely and continuous exchange of credit information is essential. Thus, greater level of institutional co-operation among the developing countries is required for closely monitoring payment delays and sharing of information on credit risks; such cooperation would be collectively beneficial to enhance trade finance and cope with the financial crisis.

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special feature

Trade Finance : Genesis and Developments

Prahalathan S. Iyer *

Introduction

Since in historical ages people have traded across the borders. In those days, the preferred ways of settling the payments might have been through barter, cash or bill of exchange. The expansion of international trade, which supported growth in incomes following the World War-II, had been accompanied by dramatic transformations in the economies of most of the nations. The conventional system of international settlements of trade failed to meet the needs of new generation export contracts, the volume of which started growing exponentially. Thus, traders and bankers have had to devise new and sophisticated financing instruments to deal with this evolution. Governments around the world have been supporting cross-border trade by coordinating the rules that govern the trade. In 1993, the Uruguay Round negotiations of the GATT (General Agreement on Tariff and Trade) was concluded establishing free trade principles and expanding worldwide trade by reducing tariffs and other trade barriers, including export subsidies and regulations. Also, there came into existence many other trade blocs like EU, NAFTA, ASEAN, which created large trading markets globally. With the growth in international trade, the importance of trade finance has also increased, since the success of a nation's export program depends on the availability of trade finance, which facilitates the transfer of commodities and manufactured goods among countries.

Definition and Evolution

Trade finance refers to innovative, custom engineered financial products and services that meet a country's import and export needs. It is completely different from regular and commercial bank lending, mortgage lending and insurance. Importers and exporters look for any competitive advantage that would help them to increase their sales. For example, flexible payment terms make a product more competitive, when there are similar products from different countries. Similarly, the cost of finance (interest rate and other fees) has a strong effect on price and can make product very uncompetitive in the international market. These factors are therefore to be adjusted to reflect the country's trade objectives. While international trade is a two-way traffic, countries in the development of their trade finance schemes have placed a lot of emphasis on exports, which generate earnings for the country, and make it possible for the country to purchase any imports of its choice.

Trade Finance Tools and Instruments

A successful trade-financing model may include diverse tools and instruments, some of which are explained briefly, and pictorially represented below :

Tools for Raising Finance

1. Export finance

Export finance may be classified into two categories, namely, the stage at which the financing is provided, and its duration.

Classification by stage includes :

- **Pre-shipment finance** is defined as any loan or advance granted, or any other credit provided by a financial institution to an exporter for financing the purchase, processing or packing of goods, on the basis of a confirmed export order received in the exporter's favour from an overseas importer.
- **Post-shipment finance** refers to the provision of finance for export of goods from the stage of shipment to the date of realisation of the export proceeds. Exporters who sell goods abroad usually have to wait for some time before payment is received from overseas buyers. The period of waiting may

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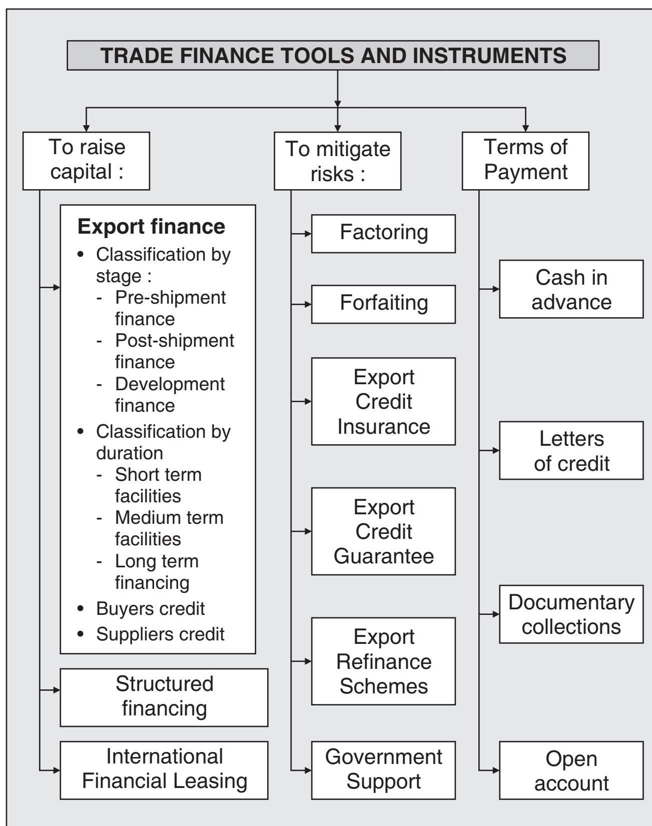
depend upon the terms of payment; the need for post-shipment finance to strengthen the financial position of the exporter varies accordingly. Post-shipment finance may take different forms including the involvement of factoring or forfaiting (discounting of receivables).

- **Development finance** refers to finance that is provided towards the development of exportable products and the addition of value to these products. This form of financing is long-term in nature. In general, export credit agencies / specialized institutions provide such products.



Classification by duration includes :

- **Short-term facilities** that are extended with a maximum duration of up to one-year; usually such credits are given for specific periods of 90 days or 180 days to meet specific export durations. Both pre-shipment and post-shipment finance fall under short-term financing.
- **Medium-term facilities** are given from 13 months to a period of up to three years. While the short-term facilities are usually specific in nature, the medium-term facilities are usually of a general nature and are mostly utilised for purposes that are with extended duration of working capital cycle.
- **Long-term financing** has to do with the provision of credit for development purposes. Such facilities are usually given with duration of more than three years. They are given for the setting up of factories, establishments of farms and such other long-term objectives that are intended to increase the production and processing of export commodities.

In all instances, whether long-term, medium-term or short-term, such facilities are given on very advantageous terms at various stages of the export cycle, by many countries. Such concessionary access to credit is especially important in periods of high interest rates, so is the timeliness of delivery, without which execution of export contracts may not be feasible.

Export finance also includes buyers credit and supplier's credit :

- ***Buyer's Credit :*** A financial arrangement whereby a financial institution in the exporting country extends a loan directly or indirectly to a foreign buyer to finance the purchase of goods and services from the exporting country. This arrangement enables the buyer to make payments due for the supplier under the contract.
- ***Supplier's Credit :*** A financing arrangement under which an exporter extends credit to the buyer in the importing country to finance the buyer's purchases.

2. Structured financing

Structured Financing is a technique where certain assets with more or less predictable cash flows can be isolated from the originator and used to mitigate risks (e.g. transfer of foreign exchange, contract performance and sovereign risk), and thus secure a credit. Structured trade finance is the art of transferring risks in trade financing from parties less able to bear those risks to those more equipped to bear them in a manner that ensures automatic reimbursement of advances from the underlying assets. Structured financing is essentially transaction-based lending (independent of the balance sheet). In this system, the lender finances the entire chain of pre-sold trade deals, or hedged, with effective control over goods /

title documents. Such a system of financing is on better terms as commodity risk is standardised and other assets are let free. It also enables quick settlement of liquid security.

3. International Financial Leasing

Leasing is a method of financing assets that is internationally being used. Financial leasing consists of one party (lessor) acquiring assets from one or more suppliers at the instructions of another party (lessee), and in granting to the lessee the use, but not the ownership of these assets for an agreed length of time in return for the payment of agreed rentals.

Different laws, depending upon the segment of a lease operation, may govern the leasing agreements. If it is supply agreement, the law of the suppliers' place of business should be taken into consideration; in terms of lease agreement, the law of lessor's place of business should be taken into consideration; in view of the securities, the law of the place where collateral is located should be taken into consideration; and in the event of bankruptcy, the law of the principal place of business of each of the parties should be taken into consideration. In a nutshell, the legal risks associated with a leasing operation are complicated when the parties involved are from different countries and with divergent laws. International Institute for Unification of Private Law (UNIDROIT), thus has drafted a convention that formulates uniform rules on international financial leasing, called the Ottawa Convention on International Financial Leasing, signed on May 28,1988.

Terms of Payment

Most transactions in international trade entail an agreed amount (the price) being paid by the purchaser to a supplier located in another country for delivery of goods or services. However, when the parties agree on a monetary payment, it is possible for settlement of agreed payment without the amount paid having to leave the country. The payment is usually made through a credit transfer that will cross borders. The challenge of mitigating or sharing of the risks involved in such credit transfer is left to the contracting parties, who may agree on the terms, date, method, extent and modality of payment.

1. Cash In Advance

Pre-payment happens generally when the suppliers are not in a position to finance from their own funds the manufacturing of the goods, prior to delivery. Exporters can also avoid credit risk through this payment method, since payment is made prior to the transfer of ownership of the goods. However, requiring payment in advance is the least attractive option for the buyer, as this method creates cash flow problems. Foreign buyers are also concerned that the goods may not be received if payment is made in advance. To protect their own interests, purchasers might consider obtaining an advance payment bank guarantee, or security over the goods manufactured, or obtain ownership of raw materials and components to be used in the manufacture of the intended exportable goods, or obtain a third party finance (usually a bank) by way of non-recourse credit. Exporters who insist on this method of payment as their sole method of doing business may find themselves losing out to competitors who may be willing to offer more attractive payment terms.

2. Deferred Payment

Due to lack of equity capital or cash flow, the purchaser is not able to pay for the goods or services upon delivery from his / her own funds. Sometimes, the seller may agree to wait till the goods bought by the buyers are sold to the end-users, with the price of the downstream transaction funding the upstream transaction. In such instances, the supplier will deliver goods to the buyer before receiving payment.

3. Payment Upon Delivery

Suppliers in general may not get payment without delivery of goods to the purchasers to the place agreed upon. On the other hand, the purchasers will get the goods when they make the payment. Geographical distances combined with the increasing complexities of international trade transactions and the incidence of numerous deliveries in contracts with continuity, make it difficult for simultaneous payment and delivery of goods. Also the delivery may not assure the requisite quality and quantity sought from the suppliers. Thus, the buyers need to ensure adherence of quality and quantity by the sellers, before making payment. Thus, it becomes important for exchanging the goods against payment to

> **Letter of Credit (LCs), also known as documentary credit, is among the most secured instruments available to international traders.**

be made through the third party with an acceptable financial standing, usually a bank.

Letter of Credit (LCs), also known as documentary credit, is among the most secured instruments available to international traders. An LC is a commitment by a bank on behalf of the buyer that payment will be made to the exporter provided that the terms and conditions have been met, as verified through the presentation of all required documents. The buyer pays its bank to render this service. An LC is useful when reliable credit information about a foreign buyer is difficult to obtain, but the seller is satisfied with the creditworthiness of the buyer's foreign bank. An LC also protects the buyer since no payment obligation arises until the goods have been shipped or delivered as contracted.

There are various types of letters of credit. These are briefly explained below :

- A **revocable** letter of credit can be amended or cancelled at any time without the beneficiary's agreement (unless documents have been taken up by the nominated bank). Little protection is offered to the beneficiary with a revocable credit and they are rarely seen;
- An **irrevocable** letter of credit can neither be amended nor cancelled without the agreement of all parties to the credit;
- An **unconfirmed** letter of credit is forwarded by the advising bank directly to the exporter without adding its own undertaking to make payment or accept responsibility for payment at a future date, but verifying its authenticity;
- A **confirmed** letter of credit is the one in which the advising bank, on the instructions of the issuing bank, has added its confirmation that payment will be made as long as compliant documents are presented. This commitment holds even if the issuing bank or the buyer fails to make payment. The added security of confirmation needs to be considered in the context of the standing of the issuing bank and the current political and economic state of the buyer's country. A bank will make an additional charge for confirming a letter of credit.
- A **standby letter of credit** is used as support where an alternative, less secure, method of payment has been agreed. Should the exporter fail to receive the payment from the buyer, he may claim under the standby letter of credit. Certain documents are likely to be required to obtain payment including : the standby letter of credit itself; a sight draft for the amount due; a copy of the unpaid invoice; proof of dispatch, and a signed declaration from the beneficiary stating that payment has not been received by the due date and therefore reimbursement is claimed under the terms of the standby letter of credit.
- **Revolving Letter of Credit :** The revolving credit is used for regular shipments of the same commodity to the same buyer. It can revolve in relation to time or value. If the credit is time revolving once utilized, it is re-instated for further regular shipments until the credit is fully drawn. If the credit revolves in relation to value, once utilised and paid, the value can be reinstated for further drawings. The credit must state that it is a revolving letter of credit and it may revolve either automatically or subject to certain provisions. Revolving letters of credit are useful to avoid the need for repetitious arrangements for opening or amending letters of credit.
- **Transferable Letter of Credit :** A transferable letter of credit is one in which the beneficiary has the right to request the advising or paying, or negotiating bank to make either part, or all, of the credit value available to one or more third parties. This type of credit is useful for those acting as middlemen, especially where there is a need to finance purchases from third party suppliers.
- **Back-to-Back Letter of Credit :** A back-to-back letter of credit can be used as an alternative to the transferable letter of credit. Rather than transferring the original letter of credit to the supplier, once the letter of credit is received by the exporter from the opening bank, it is used as security by the exporter to establish

a separate letter of credit in favour of his supplier. Many banks are reluctant to issue back-to-back letters of credit due to the level of risk to which they are exposed - a transferable credit will not expose them to higher risk than under the original credit.

- **Sight letter of credit** states that the payments would be made by the issuing bank at sight, on demand or on presentation. In case of usance letter of credit, draft is drawn on the issuing bank or the advising or paying bank at specified usance period. The credit will indicate whether the usance draft is to be drawn on the issuing bank or in case of confirmed credit on the confirming bank.

4. Open Account

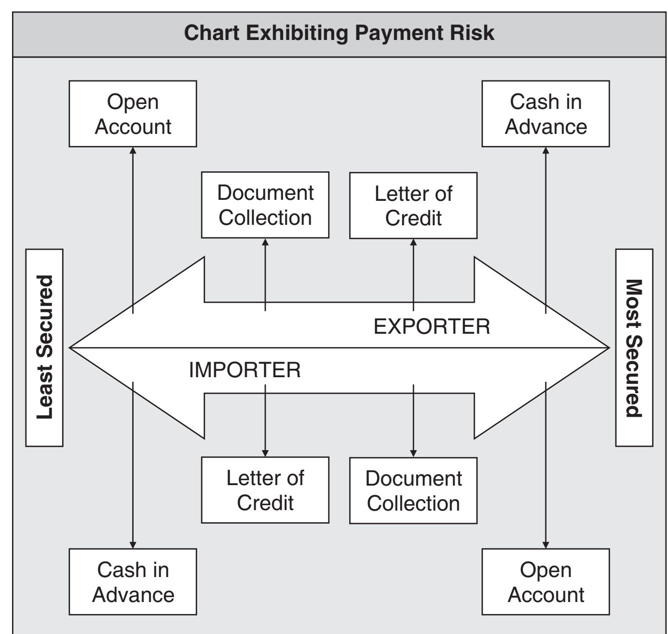
An open account transaction means that the goods are shipped and delivered before payment's due, usually in 30 to 90 days. Obviously, this is the most advantageous option to the importer in cash flow and cost terms, but it is consequently the highest risk option for an exporter. Due to the intense competition for export markets, foreign buyers often ask exporters to export in open account terms since the extension of credit by the seller to the buyer is common abroad. Therefore, exporters who are reluctant to extend credit may face the possibility of the loss of the sale to their competitors. However, with the use of one or more of the appropriate trade finance techniques, such as export credit insurance, the exporter can offer open competitive account terms in the global market while substantially mitigating the risk of non-payment by the foreign buyer.

5. Documentary Collection

A transaction, whereby the exporter entrusts the collection of a payment to the remitting bank (exporter's bank), which sends documents to a collecting bank (importer's bank), along with instructions for payment is called Documentary Collection. Funds are received from the importer and remitted to the exporter through the banks involved in the collection in exchange for those documents. Documentary collections involve the use of a draft that requires the importer to pay the face amount either on sight (document against payment-D/P) or on a specified date in the future (document against acceptance-D/A). The collection schedule lists instructions that specify the documents required for the transfer of title to the goods. Although banks do act as facilitators for their clients under collections, documentary collections offer no verification process and limited recourse in the event of nonpayment. Documentary collections are generally less expensive than letters of credit.

Risk Mitigation

International trade involves risks associated with transactions; managing such risks is harder now than before. However, there are several risk mitigation mechanisms available which needs to be considered in international trade transactions. Some of them are discussed briefly below :



1. Factoring

Factoring is a financial option for the management of receivables. In simple definition it is the conversion of credit sales into cash. In factoring, a financial institution (factor) buys the accounts receivable of a company (client) and pays up to 80% (rarely up to 90%) of the amount immediately as per agreement. Factoring company pays the remaining amount to the client when the buyer pays the debt. Collection of debt from the customer is done either by the factor or the client depending upon the type of factoring. The account receivable in factoring can either be for a product or service. Factoring differs from a bank loan in three main ways. First, the emphasis is on the value of the

receivables (essentially a financial asset), not the firm's credit worthiness; secondly, factoring is not a loan it is the purchase of a financial asset (the receivable); finally, a bank loan involves two parties whereas factoring involves three.

Box 1

Exim Bank and Trade Finance

Export-Import Bank of India (Exim Bank) is the premier export finance institution in India, set up in 1982, under the Export-Import Bank of India Act, 1981. Government of India launched the institution with a mandate, not just to enhance exports from India, but also to integrate the country's foreign trade and investment with the overall economic growth. Since its inception, Exim Bank has been both a catalyst and a key player in the promotion of cross border trade and investment. Commencing operations as a purveyor of export credit, like other Export Credit Agencies in the world, Exim Bank has, over the period, evolved into an institution that plays a major role in partnering Indian industries, particularly the Small and Medium Enterprises, in their globalisation efforts, through a wide range of products and services offered at all stages of the export cycle. Exim Bank concentrates primarily on medium to long-term export finance, and provides finance for production equipment, and working capital. Exim Bank also provides refinance and rediscounting facilities to commercial banks.

Exim Bank, being the focal point of the Working Group Mechanism for clearance of project and services exports and deferred payments exports, works in close coordination with commercial banks. Exim Bank has a range of export credit programmes for Indian companies executing contracts overseas for projects, products as well as services. These would typically include the pre-shipment and post-shipment credit, supplier's credit, buyer's credit and lines of credit. The Bank also extends guarantee facilities to facilitate Indian companies in executing export contracts.

The Bank pioneered the concept of international factoring and forfaiting in India, and established and nurtured an Indian entity through which international factoring and forfaiting services were extended to the Indian exporters.

Depending upon the terms of the agreement between the factor and the supplier, factoring may fall into one of the following types :

Disclosed factoring : In disclosed factoring, client's customers are notified of the factoring agreement. Disclosed type can either be recourse or non-recourse.

- *Recourse factoring :* In recourse factoring, client undertakes to collect the debts from the customer. If the customer doesn't pay the amount on maturity, factor will recover the amount from the client. This is the most common type of factoring. Recourse factoring is offered at a lower interest rate since the risk by the factor is low. Balance amount is paid to client when the customer pays the factor.
- *Non-recourse factoring :* In non-recourse factoring, factor undertakes to collect the debts from the customer. Balance amount is paid to client at the end of the credit period or when the customer pays the factor whichever comes first. The advantage of non-recourse factoring is that continuous factoring will eliminate the need for credit and collection departments in the organization.

Undisclosed factoring : In undisclosed factoring, client's customers are not notified of the factoring arrangement. The client himself undertakes sales ledger administration and collection of debts. Client has to pay the amount to the factor irrespective of whether customer has paid or not. But in disclosed type factor client may or may not be responsible for the collection of debts depending on whether it is recourse or non-recourse.

2. Forfaiting

Forfaiting is a method of trade finance that allows exporters to obtain cash by selling their medium term foreign account receivables at a discount on a “without recourse” basis. A forfaiter is a specialized finance firm or a department in banks that performs non-recourse export financing through the purchase of medium term trade receivables. Similar to factoring, forfaiting virtually eliminates the risk of non-payment, once the goods have been delivered to the foreign buyer in accordance with the terms of sale. However, unlike factors, forfaiters typically work with the exporter who sells capital goods, commodities, or large projects and needs to offer periods of credit from 180 days to up to seven years. In forfaiting,

receivables are normally guaranteed by the importer's bank, allowing the exporter to take the transaction off the balance sheet to enhance its key financial ratios.

The forfaiter also gains important benefits from the transaction. He will deduct a discount fee from the amount to be paid (normally based on a refinance rate clubbed with a commercial hedge rate). Further, exporter also assigns a commitment fee, which will cover the time until remittance of the receivable.

In most cases, the forfaitor will not keep the receivable in his books until maturity, but will in turn assign it, totally or partially, if it can be divided, to other forfaitors on a very active secondary market.

3. Export Credit Insurance

The purpose of export credit insurance is to mainly offer offshore protection to exporters of goods and services who sell their products on credit terms. The exporter is insured against losses arising from a wide range of risks, which may be conveniently categorized into either commercial risks, or political risks.

The presence of an export credit insurance scheme in a country, as can be seen, provides exporters of goods and services with a significant degree of financial security, thus allowing companies to pursue bolder export practices by accepting new purchasers, and venturing into new overseas markets, but with a smaller impact from the risks of non-payment and political instability.

Commercial Risks arises due to :	Political Risks arises due to :
- The insolvency of the purchaser; - The default on payment by a buyer following an unforeseeable event; - Non-acceptance of goods delivered to the purchaser, where such goods comply with any contracts in existence.	- Cancellation or non-renewal of an insured's export licence after a contract has been entered into; - War and other such disturbances in the purchaser's country of domicile which affect the fulfillment of the contract; - Transfer risks, where one country can freeze the assets and bank accounts of another country held locally. - Any action of a foreign government which hinders the enactment of the contract; including, import / export restrictions, the confiscation or expropriation of goods, and the nationalisation of corporations and industries.

4. Export Credit Guarantee

An export credit guarantee is a commitment provided by an Export Credit Agency (ECA) to reimburse a lender if the borrower fails to repay a loan availed for export. It is basically an indemnity against loss and not a security for a loan. It is a mean to provide a cushion to financial institutions on times of business failures and credit default. The purpose of export credit guarantee schemes is to mitigate the risk of non-payment by borrower and enhance the opportunities available to exporting countries in accessing credit, if the lending institutions have confidence in the ability of the ECA to deliver. For this to happen the guarantee scheme should be backed by sovereign Government or Government agencies.

The objectives of an export credit guarantee schemes include :

- To encourage banks to extend facilities to borrowers who may have inadequate or no collateral;
- To enable industries (both large enterprises and SMEs) to get access to institutional credit;
- To assist exporters to expand into new markets.

Box 2

Counter Trade

Many emerging economies face the challenge of limited foreign exchange holdings. One way to overcome this challenge is through promotion and encouragement to counter-trade. Counter-trade is one of the oldest payment methods in international trade and has been used in about one-fifth of world trade transactions, and the share is growing. Though today's modern counter-trade appears in so many forms, generally, it involves exchange of goods and / or services as a condition of purchase, or as financing of purchases. Some of the forms of counter-trade include:

- **Barter -** is the traditional type of counter-trade involving the exchange of goods and services against other goods and services of equivalent value, with no monetary exchange between exporter and importer;
- **Counter-purchase -** is an undertaking by an exporter to buy goods from the importer, or agrees to arrange for the purchase by a third party. The

value of the counter-purchased goods is an agreed percentage of the prices of goods originally exported.

- **Buy-back -** is an arrangement between a buyer and seller of an item (usually capital goods) with the condition to accept products manufactured using the equipment towards payment.

Counter-trade agreements involve complications not normally found in contracts governing the sale of goods for cash between private parties, viz.,

- Agreements and actions for their breach can get extremely complicated because each party is both buyer and seller of goods and is potentially entitled to the full range of both buyer's and seller's remedies;
- Agreements are often entered into with a Government or a Governmental agency. The exporting company, therefore needs to be aware of the possible effects of sovereign immunity.

Conclusion

Trade finance plays an important role in facilitating trade by securing finance in order to :

- Manage cash flows, risks and costs;
- Raise funds and capitals; and
- Help in trade expansion.

Almost every country that has successfully traveled the path of export-led growth placed significant priority on ensuring that appropriate structures and schemes are put in place, providing specialized and custom-designed trade finance services. The role of government in trade financing is crucial, especially in emerging economies, as in such countries, there may be underdeveloped financial and money markets, with exporters having restricted access to financing. Governments may either pay a direct role like provision of trade finance or credit guarantee or indirectly by facilitating the formation of trade financing institutions as developmental agencies. In most of the instances ECAs or Exim Banks have been established as developmental institutions with 100 percent government shareholding to provide the needed support to the export sector. Proactive role of such institutions in trade finance increase the access to trade finance in emerging economies and contribute to trade expansion and facilitation. The commercial legal system must be transparent and must be integrated with the financial infrastructure in order for it to be effective.

Box Item

CHARACTERISTICS OF A LETTER OF CREDIT

Applicability

Recommended for use in new or less-established trade relationships when you are satisfied with the creditworthiness of the buyer's bank.

Risk

Risk is evenly spread between seller and buyer provided all terms and conditions are adhered to.

Pros

- Payment after shipment
- A variety of payment, financing and risk mitigation options

Cons

- Process is complex and labor intensive
- Relatively expensive in terms of transaction costs

TIPS FOR EXPORTERS

- Consult with your bank before the importer applies for an LC.
- Consider whether a confirmed LC is needed.
- Negotiate with the importer and agree upon detailed terms to be incorporated into the LC.
- Determine if all LC terms can be compiled within the prescribed time limits.
- Ensure that all the documents are consistent with the terms and conditions of the LC.
- Beware of many discrepancy opportunities that may cause nonpayment or delayed payment.

Source : U.S. Department of Commerce, International Trade Administration.

MUSINGS ON TRADE FINANCE

R. N. Vadivelu *

Surprisingly many of the venerable treatises on banking terms had not defined the term 'trade finance' until the later part of the last century. Trade finance differs fundamentally from trade credit. While trade credit is a business to business credit, trade finance means and includes, funded and non-funded facilities extended by banks and financial institutions to carry out trade, more specially cross-border or international trade, both in goods and services. Trade finance will essentially include mostly short term funded and non-funded facilities extended both to importers and exporters. For the purpose of an analytical study of trade finance in our country, we can broadly classify the providers into the following broad categories.

A. Direct Finance

B. Facilitators

a. Export Credit Guarantee Corporation of India

b. General insurance companies who provide marine and cargo insurance.

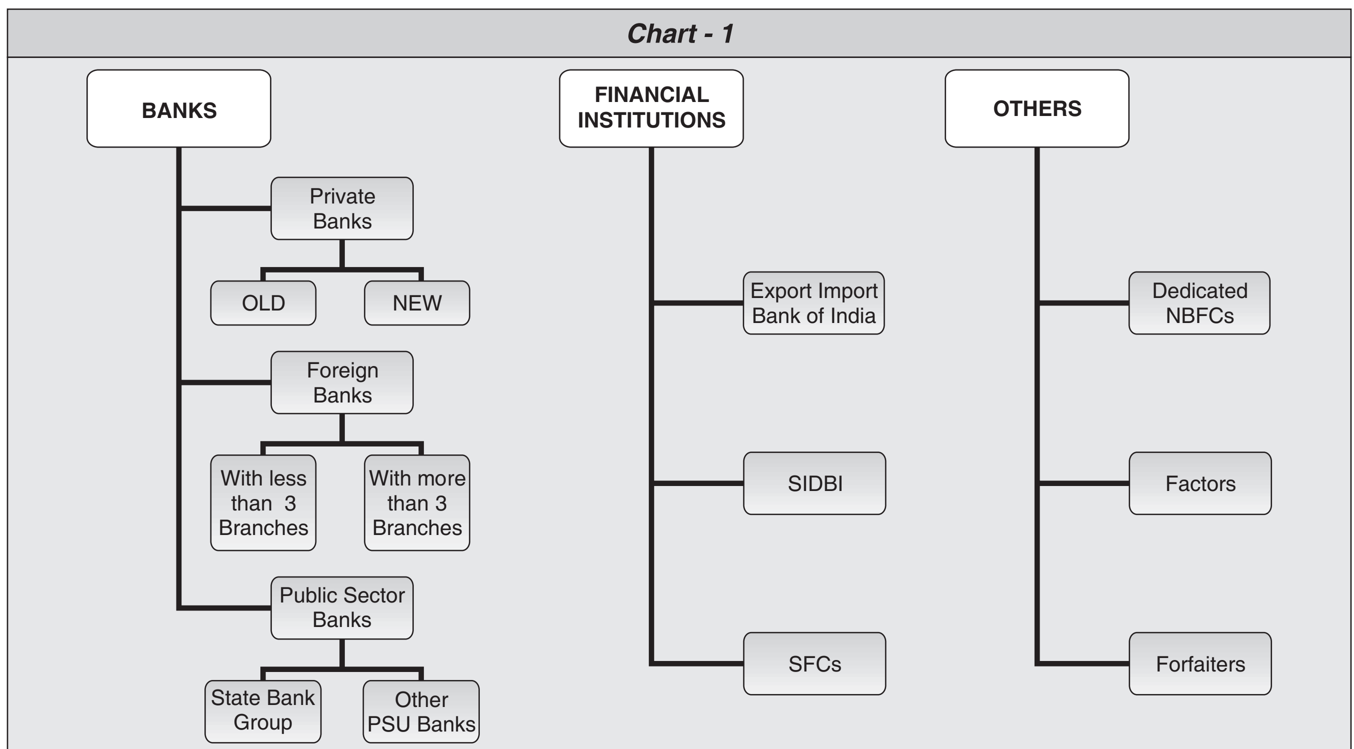
c. Credit Information Bureaus

d. Logistic providers

e. Other service providers

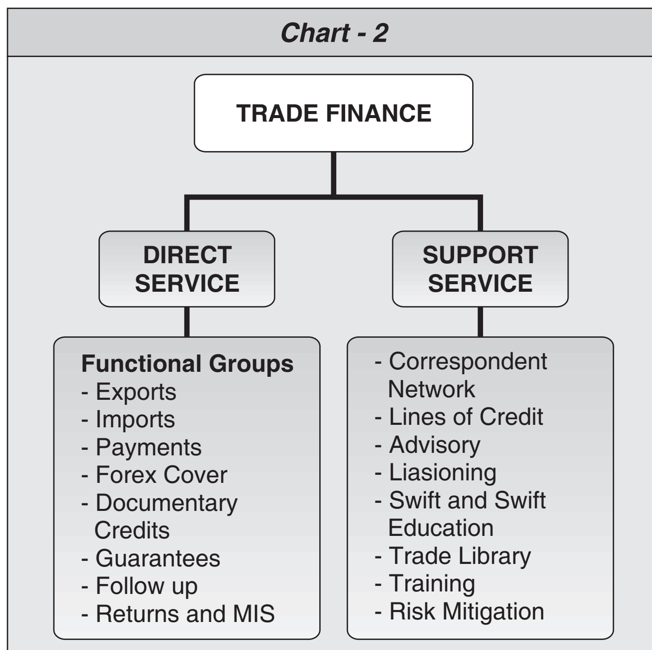
Trade Finance in Indian Banks

In many banks there is no separate or titled department exclusively for trade finance. Departments such as Foreign Exchange Department, Foreign Business Department, Foreign Department, International Division, generally look after certain aspects relating to trade



* Chief Executive, Foreign Exchange Dealers' Association of India, Mumbai.

finance. In several banks the head of the credit or advances departments doubles up as the head of the trade finance department without expressly so designated. In order to ensure that quality trade finance is extended, monitored and recovered, a full fledged trade finance team must be carved out in each bank and financial institution. The organization chart for the trade finance department is suggested below :



While the support services can be created and operated at enterprise level for the bank as a whole, direct services have to be made available at the branch level.

It is also suggested that the trade finance department should seamlessly co-ordinate with the credit department, risk management department and other operational departments normally situated at the branch to provide best possible services to the clients. This department should also have a strong working relationship with various export promotion councils and commodity boards. There should be a trade library which should receive documents on current policies and policy changes announced from time to time. The advisory group within the trade finance department should equip itself with the latest developments in trade and the opportunities available for their clients to expand their business and also possess minute knowledge on applicable regulations and international developments affecting trade. It should be ensured that the advisory group is not construed as a sales group for the bank's products and services.

It is very important that the bank or the financial institution providing trade finance, establishes a vast correspondent network in as many countries as possible, because opportunities in trade may stem from any country where the customer may not have any trade experience before.

Trade finance department with the help of its treasury department should ensure that confirmation limits for the letters of credit and guarantees are always made available with all the correspondent banks. Experience has proved that constant touch with the key correspondents and exchanging greetings for New Year, Easter and other festivals on a personal level always lead to increased business inflows and quicker resolution of queries and complaints.

Periodic personal visits abroad by the officials of the trade finance department help to enhance the name and image of the bank and often result in establishment of a single point contact for trouble shooting.

Nostro Accounts :

A time has come now with the advent of technology and implementation of core banking solutions, for the banks to revisit their nostro account relationships. Several nostro accounts in a single currency might have helped in a decentralized and stand alone set up for forex operations, more and more banks are now seen to reduce the number of banking accounts in a single currency aiming towards reducing the time lag in nostro reconciliation and speedy marking and disposal of credit and debit entries. Banks should carefully weigh the facilities offered, their experience on the turn around time taken for resolution of queries, lines extended for LC and guarantee confirmations, presence of representatives in India, online account viewing and payment ordering facilities, and of course the fee structure before selecting a single nostro correspondent.

If the bank selected for nostro account has a presence in India with an Authorised Dealer Category I licence issued by Reserve Bank of India, then it should be

It is also necessary to establish a dedicated institute for trade finance to train all personnel engaged in providing trade finance in all the directly or indirectly connected areas of trade finance.

ascertained and ensured that a firewall is in place to safeguard and ensure that the customer relationships are not passed on to their Indian operations even by human or technology oriented error. This relationship should be periodically reviewed taking into account reciprocal business made available either directly or from their Indian operations.

Dedicated institute for Trade Finance

It is also necessary to establish a dedicated institute for trade finance to train all personnel engaged in providing trade finance in all the directly or indirectly connected areas of trade finance. This institute can impart training on the various methods and products available for financing imports, exports and opportunities available for extending operations abroad in the form of joint ventures or wholly owned subsidiary. This institute can also impart training on various support services connected with trade finance including marine insurance, storage, warehousing, logistics and marketing. Knowledge on evaluating sovereign risks can also be imparted by this institute. Research on trade finance products discovery of innovative new products and such similar activities can be undertaken at the institute. Banks and financial institutions can come together and establish this institute.

Impact of Basel II on Trade Finance :

In the November 2008 WTO Expert Group meeting on Trade and Finance, concerns about the impact of capital adequacy requirements, as per Basel II norms, on the availability of trade finance were expressed and discussed. In fact, this Expert Group meeting was convened to discuss the shrinkages reported in trade credit, especially from developing and emerging economies.

The ICC Banking Commission (the Commission) is a leading global rule making body for the commercial banking industry. It is also a worldwide forum of trade finance experts. It has members in 70 countries, many of them are emerging economies.

The Commission had undertaken a survey of major international trade finance banks on the impact of Basel II on the availability and pricing of trade finance. The findings and conclusions from the survey were discussed in the Commission's March 2009 meeting held in Dubai.

Summary of these findings are :

a. While trade finance lending is generally short term in nature between zero to 180 days and are usually self liquidating, Basel II norms, when applied, warrants a one year maturity floor for all lended facilities. As capital requirements are thus artificially inflated, the cost of trade financing also stand increased.

b. There is lack of historical and performance related data to assist in validating the risk attributes. In the absence of such data, conservative risk weights for trade finance products were applied. In many economies, these weights are provided by their national regulators.

The Commission listed out several grounds for giving revised treatment for trade finance in allocating bank's capital.

A few of these grounds include :

a. over the past few decades banks have experienced relatively few losses in their trade financing areas.

b. historically low risk profile of the trade finance activity.

c. the trade finance products have fixed and short term maturities.

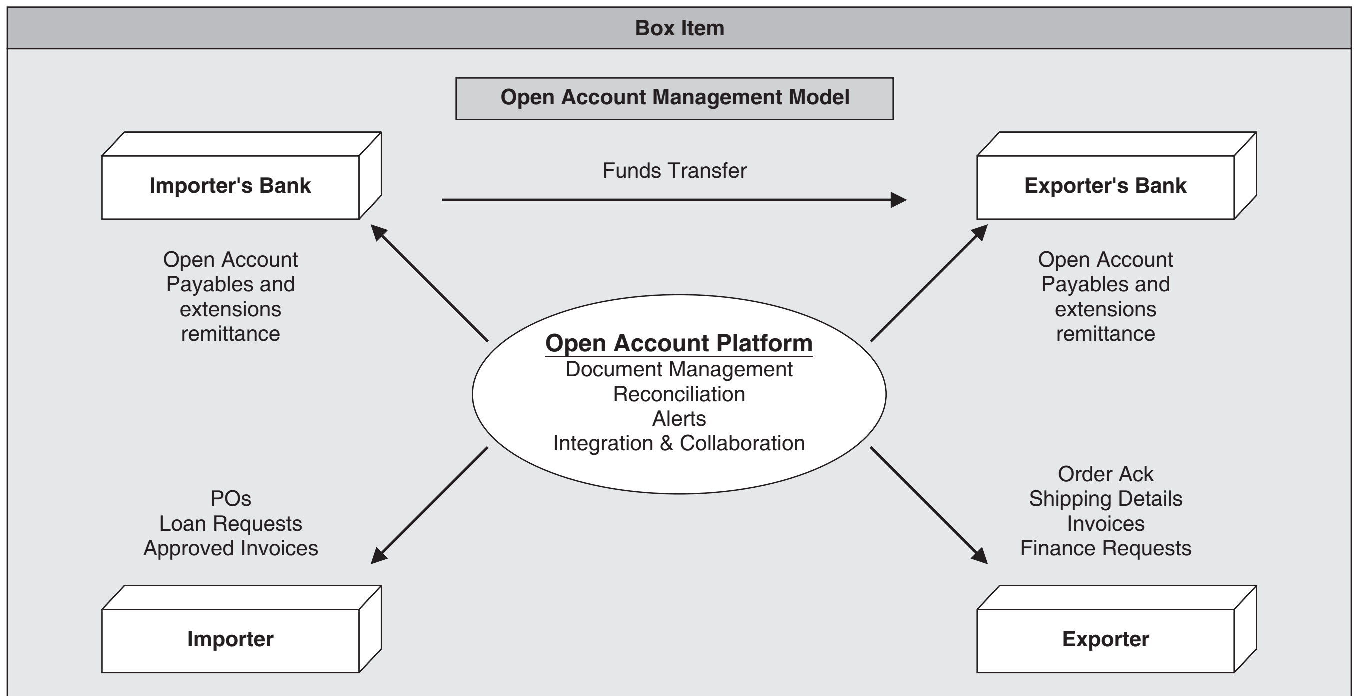
d. all the trade finance exposures are liquidated by cash on maturity.

e. many a times, each draw down under a trade finance facility warrants submission of underlying documentation.

f. the bank can refuse any draw down if the bank is not comfortable or satisfied with the documentation.

g. in debt-distressed economies, trade related instruments are generally the last forms of credit to be cut and the first to be re-established.

It is heartening to note that many of the national regulators have analysed and understood these factors and are discussing on the required steps that have to be taken so that capital cost on trade finance is brought down which will cascade down to reduction in cost of trade finance which will revive and enhance trade finance activities globally.



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R. Bhaskaran
Signature of Publisher

BOOK REVIEW

Name of Book : The Dynamics of Ascent - A Centenary History of Bank of Baroda

Author : Dwijendra Tripathi

Published by : Oxford University Press

Pages : 291

Reviewed by : Prof. R. D. Pandya

The Bank of Baroda Ltd., which become Bank of Baroda after its nationalization in 1969, was founded in July 1908 by the far-sighted and visionary ruler of the then Baroda State, Maharaja Sir Sayajirao Gaekwad - III. The bank completed 100 years of its life in July, 2008. In fact in the year 2007, the Bank was engaged in Centenary Celebrations all over the country in a befitting manner.

One would certainly agree that a period of 100 years is certainly long enough for a historian to sit back, look at the events that have gone by and indicate the direction in which the bank should move to scale greater heights of glory, progress and achievements.

Dr. A. K. Khandelwal, a distinguished and dynamic Chairman of the Bank thoughtfully decided to invite Shri. Dwijendra Tripathi to prepare a Centenary History of Bank of Baroda, as part of Centenary Celebration. Dr. Tripathi is, indeed, internationally known as a distinguished business historian who earlier wrote the history of the Bank covering 75 years of the Bank on the occasion of the platinum jubilee celebrations of the Bank.

After all it is generally known, History is a record of past events. But as Dr. Manmohan Singh, our Prime Minister said while releasing the third volume of the History of Reserve Bank of India, one has to go behind and beyond the events gone by to understand the real significance of history of any organization or institution. This is precisely done by Shri. Tripathi while preparing a Centenary History of Bank of Baroda. Shri. Tripathi has described the journey of the Bank in 15 (Fifteen) chapters. What emerges clearly from the study of this book is that the Bank has been greatly influenced by the developments taking place in the banking system or the banking industry over a period of last 100 years in the country. The Bank has, indeed, grown or declined with the growth or decline of the industry in the country.

If one goes through the history minutely, one really gets the impression that the Bank was influenced by the Baroda state administrators, the merger of the then Baroda State with the Old Bombay State, the emergence of the Imperial Bank of India in 1955, the creation of the Reserve Bank of India in 1935.

The Banking Companies Regulation Act 1949, Five Year Plans since 1951, nationalization of commercial banks in 1969, liberalization in the Indian economy, in 1980, economic reforms, particularly reforms in the financial sector since 1991-92 and more recently, the integration of the Indian economy with the global economy through the process of globalization. All these developments in the Indian economy provided challenges as well as opportunities for the growth and development of the Bank.

There was a time in 1955, when it was proposed that the Bank of Baroda Ltd., should become a State Associate Bank as it was started by the then Baroda State and it worked as a banker to the Baroda State. In the absence of the Imperial Bank of India or the Reserve Bank of India but,

BOOK REVIEW

fortunately, the Bank of Baroda Ltd., then made out a strong case for not taking over the Bank along with other State Associate Banks.

The Government of India was good enough to accept the arguments advanced for not taking over the Bank. If this had happened, the Bank of Baroda Ltd., or Bank of Baroda would not have existed today.

It emerges from the study of the history that every time there was a crisis in the Bank, it faced the situation bravely and emerged stronger from each crisis. This was possible, indeed, because of very prudent and competent management and leadership in the Bank. Over the last one hundred years many leaders have shaped the destiny of the bank through their vision, passion and leadership qualities. As Dr. Khandelwal says in his foreword, the Bank's journey has been a saga of enterprise, financial prudence and sound corporate governance.

The journey of the Bank over a period of 100 years was not smooth always. It had its troubles and tribulations / travails but as stated earlier, the Bank emerged stronger and stronger with passion for further growth and development. The Bank which started as a small bank confined its operations mainly to Gujarat and Bombay with limited resources and a small team of staff members has grown into an international bank with 70 branches operating in five countries. This growth of the Bank or ascent of the Bank can attributed to several factors over a period of 100 years. The main factors are as under :

1) The support of the Baroda State to the Bank.

2) The merger of then Baroda State with the Old Bombay State.

3) Nationalization of major commercial banks in 1969.

4) Globalization of banking & finance since 1991.

5) The prudent, shrewd and qualitative leadership provided by Shri. N. M. Chokshi, Shri. M. G. Parikh, Shri. R. C. Shah, Shri. C. P. Shah, Shri. V. D. Thakker and Dr. Anil Khandelwal, whose contribution to the growth and development of the bank has been richly acknowledged by Shri Tripathi in the History.

6) Emphasis on Foreign Exchange Business

This history of Bank of Baroda has been very comprehensive and rich in expression and coverage of the major events in the bank over a period of last 100 years. This book should be read by bankers, all stakeholders in the Bank of Baroda, economists and more importantly students of research in business history.

Shri. Tripathi deserves to be congratulated for writing such a comprehensive history of Bank of Baroda with clarity of though, lucidity of expression and analytical vigour.

BOOK REVIEW

Name of Book : Handbook on Lending to Micro, Small and Medium Enterprises - A Practical Guide

Author : D. P. Sarda

Published by : Govind Prakashan, 37, Natraj Nagar, Ton Phata, Jaipur - 302 015.

Pages : 188

Price : Rs. 530/-

Reviewed by : V. Raghuraman

The role of micro, small and medium enterprises (MSMEs) in an economy such as ours cannot be over emphasized. In fact, it would not be an exaggeration to say that small and medium industries form the backbone of the country's economy. Apart from contributing to national income, exports and employment opportunities, MSME sector has certain advantages : better utilization of local resources, low capital requirement, high employment generation, ability to cater to the local consumption needs and widening of entrepreneurial base. However, as is the case with all industries, providing timely and sufficient financial assistance at a reasonable rate of interest is of paramount importance.

Government has included financing to MSMEs as part of the mandatory priority sector finance. Banks and financial institutions are required not only to extend financial assistance to this sector at a lower rate of interest but also to convey their decision on finance proposals to the small and medium scale entrepreneurs within the shortest possible time. This, however, calls for having specially trained staff in the banks and financial institutions. Training, thus, assumes vital importance as the lending norms and other stipulations are revised frequently, keeping in view the prevailing economic condition.

It is in this context that the book under review assumes great significance. As indicated by the title, the book is a practical guide, providing valuable information regarding term loans and working capital loans to the MSME sector. Written by D. P. Sarda Advisor, Small industries Development Bank of India (SIDBI), and former Executive Director, RBI, the book has meticulously analyzed different aspects of the subject. Covering technical, commercial, financial and management appraisals, the author has devoted an exclusive chapter on the actual disbursement, supervision and follow-up of advances.

With his long experience in the banking field, Sarda has taken pains to provide valuable insights into many areas of lending not usually touched upon by many writers. For instance, he has even covered related subjects such as income recognition, asset classification and provisioning norms and thereby provided value addition to the publication. Besides, the book has some useful chapters on credit rating for risk management and special features for financing the MSME sector, which highlight, among others, its limitations.

Going through the various chapters, one is impressed by the author's simple but effective language whereby he succinctly conveys in no uncertain terms certain principles of sound and safe lending. At the same time, he is candid enough to admit that despite the best efforts of the financial institutions, some accounts could become NPAs and subsequently even bad. This does not mean that bankers should adopt a casual attitude about the defaulting account or lose heart but actually strive hard to ensure that such things are not repeated.

In this connection, one is tempted to follow his advice regarding management appraisal. According to him, this is of vital importance as the person or entrepreneur behind the project is what matters most from preventing even a sound project turning into an NPA account. He further adds that a second rate project run by a sound management team is better than a first rate project in the hands of a second rate management. The experience of sick industrial units indicates that many of them have become sick owing to inefficient and dishonest management.

The author has pointed out that while appraising entrepreneurs of established projects, their past record is available. But in the case of new projects, the past record of the entrepreneurs would not be either available with banks or useful for them. They have to judge their character and background on the basis of the performance of other units managed by them. The appraising officer while submitting his / her report has hence to be very cautious in evaluating the qualities of the promoter of new projects.

The wealth of information furnished in the book becomes both useful and handy as RBI guidelines stipulate that all loan applications from SSI units upto a credit limit of Rs.25000/- should be disposed off within two weeks and limits upto Rs.5 lakhs within four weeks, provided the loan applications are complete in all respects. Apart from detailing various techniques in appraising loan proposals from the SSI sector, the book has given check-lists that have to be scrupulously adhered to.

One cannot but agree with Mr. R. M. Malla, Chairman and Managing Director, SIDBI, when in the course of his foreword to the book, he mentions that "the publication will be useful not only for the staff and officers of banks / financial institutions but also to entrepreneurs for selecting suitable projects keeping in view their knowledge, experience and resources available with them".

The book would also be useful for bankers, consultants and students of banking and finance to understand the practical aspects of banks' lending to the MSME sector from different angles.

Books Added to the IIBF Corporate Library

No.	Title	Author	Publisher & Year Of Publication
1.	Agricultural Growth, Farm in Size and Rural Poverty Alleviation in India	C. H. Hanumantha Rao	Academic Foundation, 2005
2.	Beginner's Guide to the World Economy : Eighty-One Basic Economic Concepts that will Change the Way You See the World	Randy Charles Epping	Vintage Books, 2001
3.	Business Standard India 2009	Business Standard	BS Books, 2009
4.	Entrepreneurship: Growth and Economic Integration : a Linkage	V. B. Angadi & others	Himalaya Publishers, 2008
5.	Executive Guide to Information Security, Threats, Challenges and Solutions	Mark Egan & Tim Mather	Addison-Wesley, 2005
6.	Financial Sector in India : Emerging Issues	Rajesh Chakrabarti	Oxford University Press (India), 2006
7.	Handbook of Agriculture in India	Shovan Ray (Editor)	Oxford University Press (India), 2007
8.	How to Improve Trainer Effectiveness	S. Balachandran	Shroff Publishers, 2008
9.	How to Read a Balance Sheet : an ILO Programme Book with CD, 2nd edn.	ILO	Oxford & IBH, 2008
10.	Human Resource Management : a Case Study Approach	Michael Muller-Camen & others (Editors)	Jaico, 2008
11.	Imagining India : Ideas for the New Century	Nandan Nilekani	Penguin India, 2008
12.	India : Re-Energizing the Agricultural Sector to Sustain Growth and Reduce Poverty	The World Bank	Oxford University Press (India), 2005
13.	Indian Banking at a Glance, 2008	IBA	IBA, 2008
14.	India's Financial Markets: an Insiders' Guide to How the Markets Work	Ajay Shah & others (Editors)	Reed Elseiver India, 2008
15.	Infrastructure Development in India	Jayarama B. Bhat	Kuvempu University, 2008
16.	Macroeconomics Demystified	Madan Sabnavis	Tata McGraw Hill, 2008
17.	Operational Risk Management	S. K. Bagchi	Jaico, 2008
18.	Outliers : the Story of Success	Malcolm Gladwell	Penguin, 2008
19.	Performance Highlights of Foreign Banks in India, 2007-08	IBA	IBA, 2008
20.	Performance Highlights of Private Sector Banks, 2007-08	IBA	IBA, 2008
21.	Performance Highlights of Public Sector Banks, 2007-08	IBA	IBA, 2008
22.	Strategic Human Resource Management : Building Research-Based Practice	The Aston Centre for Human Resources	Jaico, 2008
23.	Technical Guide on Accounting for Microfinance Institutions	The Institute of Chartered Accountants of India	ICAI, 2008
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