Introduction to international banking

Meaning of international banking

- **International banking that enables people who live or work abroad to manage their finances in one central location. By keeping the money in one place, it allows to make transfers and payments in several currencies from stable and secure offshore jurisdictions**

Definition of international banking

- All banking transactions crossing national boundaries that lend all claims of domestic banks offices on foreign residents, claims of foreign claims of foreign bank offices on local residents

Functions of International Banks

1. Linking the savers and borrowers of different countries.
2. Helping in foreign currency exchange rate
3. Holding the inventories of foreign currencies
4. Accepting deposits from savers
5. Lending the borrowers
6. Lowering transaction cost by reducing information cost and reducing the risk of investments
7. Stimulating financial innovation by creating new financial instruments
8. Facilitating imports and exports of their clients and arranging for foreign exchange

Export financing

- Export or perish is the modern mantra
- In India imports are more than exports, every wholesaler and retailer should take necessary steps to increase their exports
- Government and RBI has taken necessary steps to increase the exports of the country

Sources of export financing

- **Commercial banks:** Commercial banks provides finance at concessional rate of interest and are re financed by the RBI.
- **EXIM banks:** Export import banks provides extended medium term loans to exporters
- **Reserve bank of india**, being the central bank of the country lays down the policy, procedures and provides frame work and provides guidelines. The RBI functions as refinancing for short and medium institution term loans respectively, provided by commercial banks.

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- **Export credit and guarantee corporation(ECGC):** It provides cover for financial and political risks involved in export trade

Forms of export finance

- Pre shipment finance
- Post shipment finance
- Factoring
- forfeiting

Meaning of pre shipment finance

- It refers to finance extended to purchase , processing or packing of goods meant for exports
- Pre shipment finance refers to the finance provided by financial institutions when the exporter wants the payment of the goods before shipment
- **Export finance** assistance is extended at various stages of **exports**. Loans or advances are granted by financial institutions to exporters for **financing** the purchase, processing, manufacturing or packing of goods prior to shipment which is known as pre-shipment credit.

Objectives of pre shipment

- To procure raw materials
- Carry out manufacturing process
- To provide a secure ware house of goods and raw materials
- To process and pack the goods
- Ship the goods to the buyer
- To meet other financial cost of business

Eligibility to obtain pre shipment credit eligibility

- Exporter should have a ten digit importer exporter code number allotted by DGFT(directorate general of foreign trade)
- Exporter should not be in the caution list of RBI for manufacturing restricted goods
- License is issued by DGFT If the goods fall under the restricted category

Pre shipment credit stages

- **Appraisal and sanction of limits:** here the banks check exporter profile, product profile, other external factors
- **Disbursement of packing credit assistance**: it includes free on board value, domestic value of goods, insurance and freight charges
- **Follow up of packing credit advances**: The exporter needs to submit stock statement giving all the necessary information about the stock.
- **Liquidation of packing credit advance:** packing credit advance need to be liquidated out of the export proceeds of the relevant shipment, thereby converting pre shipment credit into post shipment credit.

Post shipment credit

- Financial assistance is extended after the shipment of goods to the buyer
- Loans are provided at concessional rate of interest, to encourage exports

Types of post shipment credit

- Export bills purchased/discounted

Documents Against Payment (D/P) and Documents Against Acceptance (D/A) transactions.

- Export bills negotiated(bill under letter of credit)
- Advance against export bills sent on collection basis
- Advance against export on consignments basis
- Advance against undrawn balance
- Advance against claims of duty drawback

Forfeiting

- In trade finance, **forfeiting** is a financial transaction involving the purchase of receivables from exporters by a forfaiter. The forfaiter takes on all the risks associated with the receivables but earns a margin. The forfaiter may also be immunized from certain risks if the transaction involves payment by negotiable instrument. The forfaiting is a transaction involving the sale of one of the firm's transactions. Factoring is also a financial transaction involving the purchase of financial assets, but factoring involves the *sale* of any portion of a firm's receivables.

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- It refers to the non recourse discounting of export receivables
- Forfeiter pays exporter in cash and undertakes the risks associated with the export
- EXIM banks plays intermediary role between exporter and overseas forfeiting agency
- RBI has allowed authorised dealers to undertake forfaiting of medium term export receivables.

Benefits of forfeiting

- 100% financing
- Improved cash flows
- Reduced administration costs
- Advance tax refund
- Risk reduction
- Increased trade opportunity

Factoring

- It is an attractive way of providing export finance to exporters. In this system factor bears the complete credit risk. A factor is a special type of agent who offers a variety of services.
- These services include coverage of credit risk, maintenance of accounts receivable and advance of funds.
- The risk of non payment by the importer is to be borne entirely by the factor.
- In India, International Export factoring service on with recourse basis have been approved by the RBI.

INTERNATIONAL PAYMENT OR METHODS BY WHICH EXPORTER CAN RECIVE PAYMENT

I. **Open Account:** This method is usually avoided by the seller(exporter) as there is a greater degree of risk involved in it. Because the payment is made by the importer only after receiving the goods or on agreed future date. Indian exporters can export their goods under this method only by taking permission from the RBI. Usually this permission is given to foreign companies operating in India.

II. Cash in advance: the most secure method of trading for exporters and consequently the least attractive for buyers. Payment is expected by the exporter in full prior to goods being shipped.

III. Bill for Collection: the exporter documentation is sent from the seller country bank to the buyer’s bank. This invariably occurs after shipment and contains specific instructions that must be obeyed. The buyers bank will act on instructions provided by the exporter.

IV. Letter of Credit(L/c)or Documentary Credit(DC) : A bank to bank commitment of payment in favour of an exporter, guaranteeing that Payment will be made against certain documents. It is a guarantee by the bank to the suppliers of the goods that there bill will be honoured by the bank on behalf of the customer.

Types of Letter of Credit

- **Revocable letter of credit**
- **Irrevocable letter of credit**
- **Confirmed letter of credit:** Confirmed letter of credit is a special type of letter of credit in which another bank apart from the issuing bank has added its guarantee.

Stages of Export Process

1. **Preliminaries:** before commencing export process, the exporter should take 'Importer Exporter Number'(IEN) from the regional licensing authorities, as they have to show this number in every documents related to exports.
2. **Inquiry, offer and receipt of confirmed order**: Initially importer requests the exporter regarding his wish to import certain goods. It is called inquiry. If the exporter intends to export the goods then he submits a proposal, to export specific goods at specific price with specific terms and condition to the importer

3. **Regulations regarding exports:** if the goods to be exported are not available fully compared to confirmation order, then the exporter must produce it or procure the same from others.

Once the goods are arranged the next step is to arrange for packing and pre shipment inspection.

4. Shipment: As soon as the receipt of the conformation order the exporter has to contact shipping companies for space. The exporter has to get customs clearance from customs authorities.

5. **Payment Procedure:** Finally the exporter has to receive payment for the goods exported through his bank. By submission of relevant documents to the bank and the process of getting the payment from the bank by the exporter is called Negotiation of documents.

Import Procedures

1. Preliminaries
2. Enquiring and placing the indent
3. Obtaining foreign exchange
4. Arranging for payment
5. Method of payment