Chapter 5 - Pre Shipment Trade Finance

Pre Shipment Finance is issued by a financial institution when the seller want the payment of the goods before shipment. The main objectives behind pre-shipment finance or pre-export finance is to enable exporter to:

1. Procure raw materials.
2. Carry out manufacturing process.
3. Provide a secure warehouse for goods and raw materials.
4. Process and pack the goods.
5. Ship the goods to the buyers.
6. Meet other financial cost of the business.

Types of Pre Shipment Finance

1. Packing Credit
2. Advance against Che-ques/Drafts etc. representing Advance Payments.

Pre-shipment finance is extended in the following forms :

1. Packing Credit in Indian Rupee
2. Packing Credit in Foreign Currency (PCFC)

Requirement for Getting Packing Credit

This facility is provided to an exporter who satisfies the following criteria

1. A ten digit importer exporter code number allotted by DGFT.
2. Exporter should not be in the caution list of RBI.
3. If the goods to be exported are not under OGL (Open General License), the exporter should have the required license /quota permit to export the goods.

Packing credit facility can be provided to an exporter on production of the following evidences to the bank:

1.Formal application for release the packing credit with undertaking to the effect that the exporter would be ship the goods within stipulated due date and submit the relevant shipping documents to the banks within prescribed time limit.
2. Firm order or irrevocable L/C or original cable / fax / telex message exchange between the exporter and the buyer.
3. License issued by DGFT if the goods to be exported fall under the restricted or canalized category. If the item falls under quota system , proper quota allotment proof needs to be submitted.

The confirmed order received from the overseas buyer should reveal the information about the full name and address of the overseas buyer, description quantity and value of goods (FOB or CIF), destination port and the last date of payment.

Eligibility

Pre shipment credit is only issued to that exporter who has the export order in his own name. However, as an exception, financial institution can also grant credit to a third party manufacturer or supplier of goods who does not have export orders in their own name.

In this case some of the responsibilities of meeting the export requirements have been out sourced to them by the main exporter. In other cases where the export order is divided between two more than two exporters, pre shipment credit can be shared between them

Quantum of Finance

The Quantum of Finance is granted to an exporter against the LC or an expected order. The only guideline principle is the concept of Need Based Finance. Banks determine the percentage of margin, depending on factors such as:

1. The nature of Order.
2. The nature of the commodity.
3. The capability of exporter to bring in the requisite contribution.

Different Stages of Pre Shipment Finance

Appraisal and Sanction of Limits

1. Before making any an allowance for Credit facilities banks need to check the different aspects like product profile, political and economic details about country. Apart from these things, the bank also looks in to the status report of the prospective buyer, with whom the exporter proposes to do the business. To check all these information, banks can seek the help of institution like ECGC or International consulting agencies like Dun and Brad street etc.

The Bank extended the packing credit facilities after ensuring the following"

1.The exporter is a regular customer, a bonafide exporter and has a goods standing in the market.
2.Whether the exporter has the necessary license and quota permit (as mentioned earlier) or not.
3.Whether the country with which the exporter wants to deal is under the list of Restricted Cover Countries(RCC) or not.

Disbursement of Packing Credit Advance

2. Once the proper sanctioning of the documents is done, bank ensures whether exporter has executed the list of documents mentioned earlier or not. Disbursement is normally allowed when all the documents are properly executed.

Sometimes an exporter is not able to produce the export order at time of availing packing credit. So, in these cases, the bank provide a special packing credit facility and is known as Running Account Packing.

Before disbursing the bank specifically check for the following particulars in the submitted documents"

1.Name of buyer
2.Commodity to be exported
3.Quantity
4.Value (either CIF or FOB)
5.Last date of shipment / negotiation.
6.Any other terms to be complied with
The quantum of finance is fixed depending on the FOB value of contract /LC or the domestic values of goods, whichever is found to be lower. Normally insurance and freight charged are considered at a later stage, when the goods are ready to be shipped.

In this case disbursals are made only in stages and if possible not in cash. The payments are made directly to the supplier by drafts/bankers/che-ques.

The bank decides the duration of packing credit depending upon the time required by the exporter for processing of goods.

The maximum duration of packing credit period is 180 days, however bank may provide a further 90 days extension on its own discretion, without referring to RBI.

Follow up of Packing Credit Advance

3. Exporter needs to submit stock statement giving all the necessary information about the stocks. It is then used by the banks as a guarantee for securing the packing credit in advance. Bank also decides the rate of submission of this stocks.

Apart from this, authorized dealers (banks) also physically inspect the stock at regular intervals.

Liquidation of Packing Credit Advance

4. Packing Credit Advance needs be liquidated out of as the export proceeds of the relevant shipment, thereby converting pre-shipment credit into post-shipment credit.

This liquidation can also be done by the payment receivable from the Government of India and includes the duty drawback, payment from the Market Development Fund (MDF) of the Central Government or from any other relevant source.
In case if the export does not take place then the entire advance can also be recovered at a certain interest rate. RBI has allowed some flexibility in to this regulation under which substitution of commodity or buyer can be allowed by a bank without any reference to RBI. Hence in effect the packing credit advance may be repaid by proceeds from export of the same or another commodity to the same or another buyer. However, bank need to ensure that the substitution is commercially necessary and unavoidable.

Overdue Packing

5. Bank considers a packing credit as an overdue, if the borrower fails to liquidate the packing credit on the due date. And, if the condition persists then the bank takes the necessary step to recover its dues as per normal recovery procedure.

Special Cases

1 - Packing Credit to Sub Supplier

Packing Credit can only be shared on the basis of disclaimer between the Export Order Holder (EOH) and the manufacturer of the goods. This disclaimer is normally issued by the EOH in order to indicate that he is not availing any credit facility against the portion of the order transferred in the name of the manufacturer.

This disclaimer is also signed by the bankers of EOH after which they have an option to open an inland L/C specifying the goods to be supplied to the EOH as a part of the export transaction. On basis of such an L/C, the subsupplier bank may grant a packing credit to the subsupplier to manufacture the components required for exports.

On supply of goods, the L/C opening bank will pay to the sub supplier's bank against the inland documents received on the basis of the inland L/C opened by them.

The final responsibility of EOH is to export the goods as per guidelines. Any delay in export order can bring EOH to penal provisions that can be issued anytime.

The main objective of this method is to cover only the first stage of production cycles, and is not to be extended to cover supplies of raw material etc. Running account facility is not granted to subsuppliers.

In case the EOH is a trading house, the facility is available commencing from the manufacturer to whom the order has been passed by the trading house.

Banks however, ensure that there is no double financing and the total period of packing credit does not exceed the actual cycle of production of the commodity.

2 - Running Account facility

It is a special facility under which a bank has right to grant preshipment advance for export to the exporter of any origin. Sometimes banks also extent these facilities depending upon the good track record of the exporter. In return the exporter needs to produce the letter of credit / firms export order within a given period of time.

3 - Preshipment Credit in Foreign Currency (PCFC)

Authorised dealers are permitted to extend Preshipment Credit in Foreign Currency (PCFC) with an objective of making the credit available to the exporters at internationally competitive price. This is considered as an added advantage under which credit is provided in foreign currency in order to facilitate the purchase of raw material after fulfilling the basic export orders.

The rate of interest on PCFC is linked to London Interbank Offered Rate (LIBOR). According to guidelines, the final cost of exporter must not exceed 0.75% over 6 month LIBOR, excluding the tax.

The exporter has freedom to avail PCFC in convertible currencies like USD, Pound, Sterling, Euro, Yen etc. However, the risk associated with the cross currency truncation is that of the exporter.

The sources of funds for the banks for extending PCFC facility include the Foreign Currency balances available with the Bank in Exchange, Earner Foreign Currency Account (EEFC), Resident Foreign Currency Accounts RFC(D) and Foreign Currency(Non Resident) Accounts.

Banks are also permitted to utilize the foreign currency balances available under Escrow account and Exporters Foreign Currency accounts. It ensures that the requirement of funds by the account holders for permissible transactions is met. But the limit prescribed for maintaining maximum balance in the account is not exceeded. In addition, Banks may arrange for borrowings from abroad. Banks may negotiate terms of credit with overseas bank for the purpose of grant of PCFC to exporters, without the prior approval of RBI, provided the rate of interest on borrowing does not exceed 0.75% over 6 month LIBOR.

4 - Packing Credit Facilities to Deemed Exports

Deemed exports made to multilateral funds aided projects and pro-grammes, under orders secured through global tenders for which payments will be made in free foreign exchange, are eligible for concessional rate of interest facility both at pre and post supply stages.

5 - Packing Credit facilities for Consulting Services

In case of consultancy services, exports do not involve physical movement of goods out of Indian Customs Territory. In such cases, Preshipment finance can be provided by the bank to allow the exporter to mobilize resources like technical personnel and training them.

6 - Advance against Che-ques/Drafts received as advance payment

Where exporters receive direct payments from abroad by means of che-ques/drafts etc. the bank may grant export credit at concessional rate to the exporters of goods track record, till the time of realization of the proceeds of the che-ques or draft etc. The Banks however, must satisfy themselves that the proceeds are against an export order.