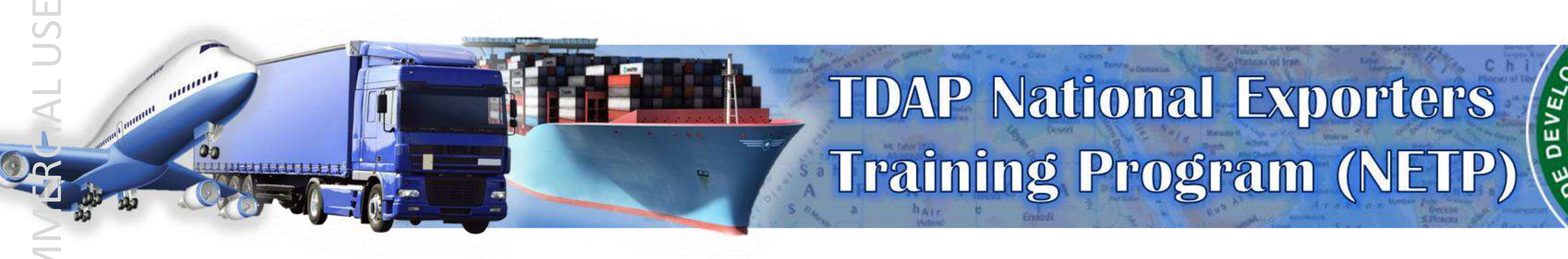



# Export Financing, Payment Methods, and Terms

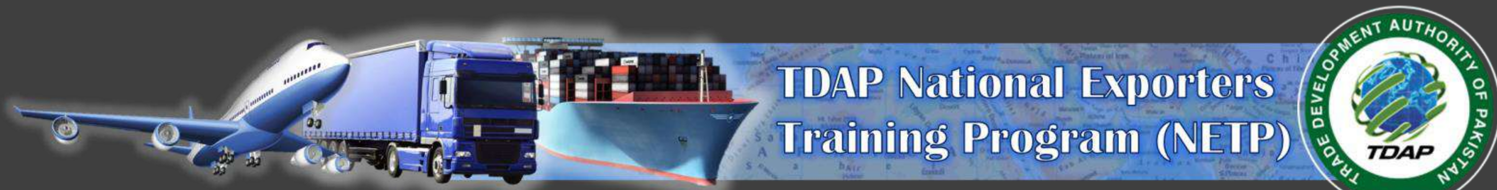
**LEVEL II**

**Instructor's Name**

Institute of
Business Administration
Karachi
*Leadership and Ideas for Tomorrow*

# Instructor’s Introduction

- Profile section 1
- Profile section 2
- Profile section 3



# Module Objectives

After studying this module, participants would be able to understand:

- Different forms of payments available in financing international trading activities
- The advantages and disadvantages of different forms of payments
- State Bank of Pakistan's Export Finance Scheme for exporters
- Other financing options such as through domestic banks as well as financing to support the purchase of plant and machinery, such as the Long-Term Financing Facility.



# Introduction

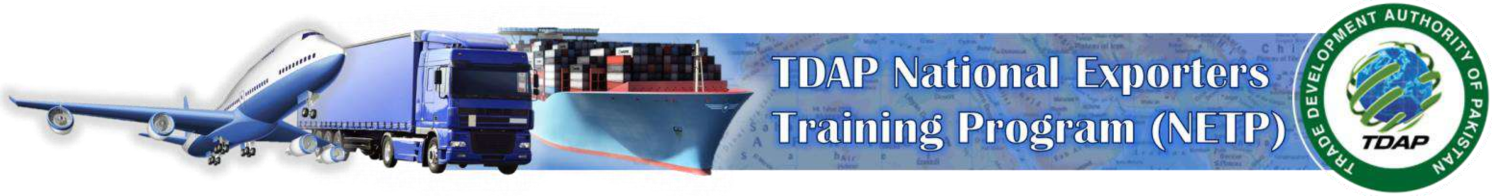
- We will focus on letter of credit as an important method of payment for exporters as well sources offered by SBP.
- The topics include a discussion on the advantages and disadvantages of L/Cs, risks associated with L/Cs, and different schemes offered by State Bank of Pakistan to exporters

# SLIDE NAVIGATOR

Letter of Credit

Export financing methods

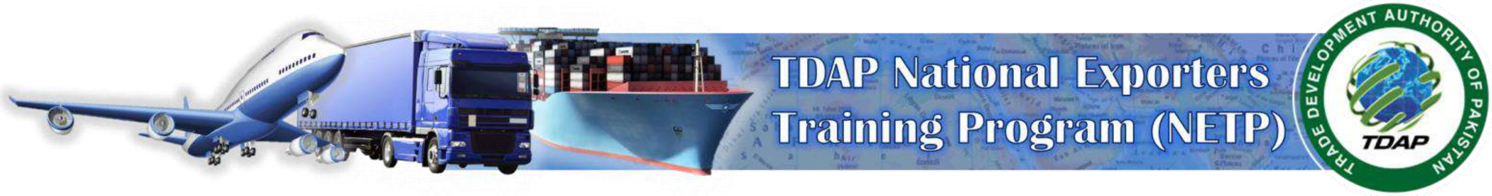




# Letter of Credit / Documentary Credit Method

- It is the most common method adopted by SMEs all over the world.
- It provides a guarantee to the exporter of the payment being made and allows the importer to make a payment at a later date.
- L/Cs involve transactions between the exporter's bank and the importer's bank.
- Once the sale contract between the exporter and the importer has been issued, the importer requests a L/C .
- Once the shipment has been made and the importer has received the goods, payment is made to the exporter.





# Important Terms related to L/C

**Sales contract/commercial agreement:** A legal binding document to describe the responsibilities of the buyers and the sellers.

**Applicant** (importer) and **beneficiary** (exporter)

**Issuing bank:** This is the bank that the importer requests to open a L/C, the importer's bank.

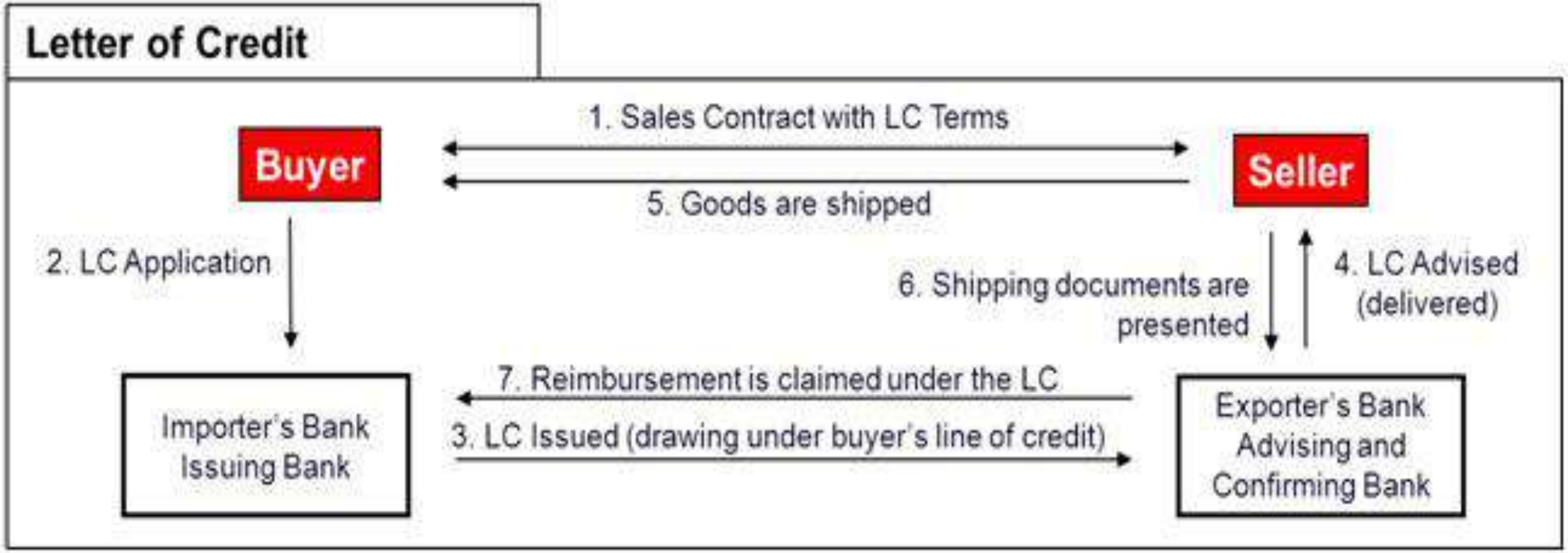
**Advising bank:** Its responsibility include the authentication of the L/C and transfer it to the beneficiary.

**Confirming bank:** A confirming bank can take over the responsibility of making payments instead of the issuing bank if the exporter is not satisfied with the risk associated with the issuing bank

**Nominated bank:** Bank chosen by the exporter to pay, exporter's bank.

**Carrier:** Contracted shipper, which will provide documents such as terms of carriage, receipt of goods. Bill of lading is a detailed list of ship's cargo, letting the bank know that goods have been received and is en-route to the importer.

# L/C – The Process



# L/C – The Process (contd)

1. The importer issues a letter of credit or L/C in their issuing bank in favour of the exporter.
2. The issuing bank sends the L/C to the advising bank for authorization, which informs the exporter.
3. The exporter then ships the goods. The exporter receives a bill of lading from the shipper and sends the document to the exporting bank (which is the nominated bank by the exporter).
4. Once the nominated bank confirms that the conditions have been met, the bank asks for payment from the issuing bank.
5. The importer's account at the issuing bank is credited and the documents are released to the importer. These documents can be used to collect the goods from the shipping line.



# Types of L/C

- Sight L/C
- Usance L/C
- Irrevocable L/C
- Confirmed L/C
- Transferable L/C
- Deferred payment L/C
- Red clause L/C
- Revolving L/C
- Standby L/C

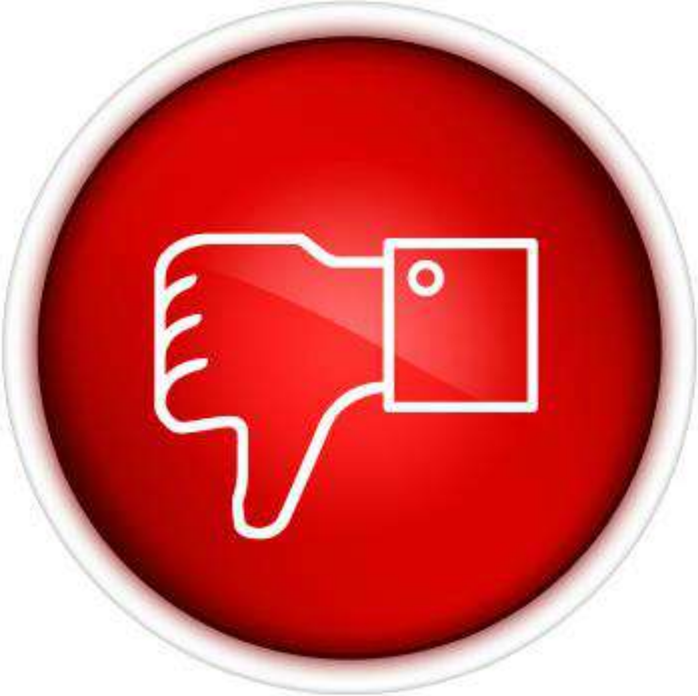


# Advantages of L/C

- Exporter is assured payment once the documents are honored.
- Exporters can secure payments earlier in the form of a post shipment and pre shipment advances.
- Credit facilities from the issuing bank are provided as they allow payments after a time lag once the products have been received.
- The importer is also assured of good quality products since the exporter is bound to the terms and conditions.

# Disadvantages of L/C

- Discrepancies in payments, vague terms and conditions of the L/C, delay in receiving documents and delay in transit.
- Falsified documents can be submitted to the bank.
- Process can be expensive due to bank fees, charges and commissions.
- Some importers may face challenges due to the lack of a suitable credit line as well as bottlenecks in production.



# Mitigation of risk

- In order to avoid risks of default payments by the issuing bank, L/Cs can be covered through a confirming bank:
  - They guarantee payment to the exporter in case the importer's bank defaults.
  - They covers the risk associated with political instability in the importing country.
- Typically, L/Cs are preferred forms of payment when the risks associated with the importer's country is low.

# SLIDE NAVIGATOR

Letter of Credit

Export financing methods

# Export Financing

- An exporter requires finance not only to produce and ship the goods but also to purchase inputs, hire labour and invest in machinery and equipment.
- Financial institutions provide facilities to exporter to fund their procurement of inputs for production and meet other criteria as set by the importers.
- The State Bank of Pakistan (SBP) offers financing facilities to Pakistani businesses :
  - Export Finance Scheme (EFS Part – I and Part-II) as well as Long-Term Financing Facility (LTFF)

# Post-shipment Finance Options

- **Negotiation of documents under L/C**: The banks can pay the exporter the amount negotiated in the documentary credits less bank charges and interest payments.
- **Purchase or discount of export bill:** Where the L/C is not involved, banks may do so against D/A or D/P that have been drawn on the buyer.
- **Finance against foreign bills under collection basis**: The exporter's bank may send the documents to the importer's bank and finance the exporter on the basis of the receivables from the importer.

# Other methods of finance

- **Financing for when purchases are on consignment basis:** Exporters are likely to be dependent upon banks to finance production in such cases as payment is available only when importer has sold the goods.
- **Financing against export incentives:** Usually refunds to exporters on duties are given after exports are realized from the inputs. Finances required till payments received.
- **Financing against retention money:** Importers may hold payments till exporters meet specific conditions, forcing exporters to seek finance from banks.

# Export Financing Scheme – EFS

- The State Bank of Pakistan through Commercial Banks launched the Export Finance Scheme (EFS) in 1973.
- The objective of EFS is to provide Small Medium and Emerging exporters and large exporters additional financing options to increase their exports and generate much needed foreign reserves for Pakistan.
- Exporter must keep in mind that not all goods can be financed by EFS.
    - A negative list exists. Exporters should ensure that the product they are exporting do not fall under the category of prohibited goods.

# Types of Credit Facilities in EFS

The credit facilities providing to exporters can be classified into following types:

a. Export Finance Scheme (EFS) Part-I & II

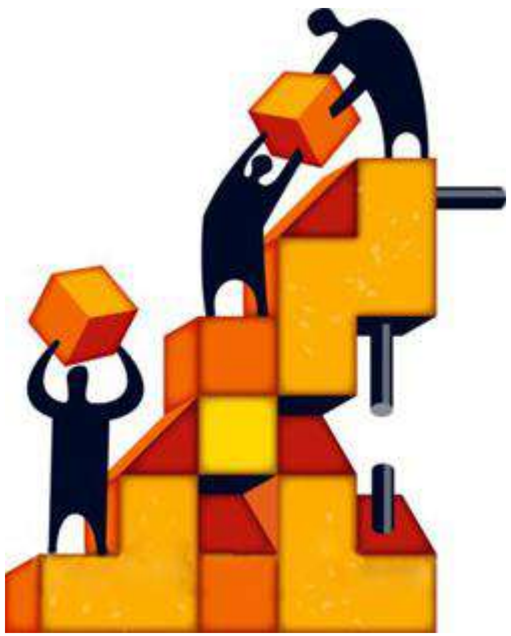
- i. Part-I comprises of Transaction-Based activities
- ii. Part-II comprises of Performance-Based activities

b. Islamic Export Refinance Scheme (IERS) and

c. Scheme for Long Term Financing for the Export Oriented Projects (LTF-EOP)

# Facilitation Services for Indirect Exporter

- Input suppliers/manufacturers (Indirect Exporters) of the Direct Exporters can also avail EFS Facility .
- They can avail the facility via Standardized Purchase Infrastructure Housing & SME Finance Department State Bank of Pakistan (EFS).
- The Inland Letter of Credit (ILC) or Standardized Purchase Order (SPO) can be established by the Direct Exporter against Letter of Credit/Contract/Export Order.
- Finance from banks against ILC or SPO can be availed by the Indirect Exporters. The given period of export financing to an Indirect Exporter is determined on the basis of terms of relevant Order/ Letter of Credit.
- The period of export financing is subject to a maximum of 120 days.



# Credit Risk Associated with EFS



- The credit risk is usually taken by the Banks under the scheme and SBP takes exposure on banks
- The bank is entitled to charge normal rate of mark up on such overdue principal amounts if a borrower is unable to make repayment of the loan on the due date
- Later the bank is entitled to take other required measures to recover the principal amount

# Long-Term Financing Facility (LTFF)

## For Imported and Locally Manufactured Plant and Machinery

- Available to export oriented producers who export at least 50% of their total sales or their annual exports exceed more than US$ 5 million.
- Available at the C&F value for imports and ex-factory price for locally manufactured machinery.
- The exporters can purchase their plant and machinery from commercial importers and authorized dealers. Ceiling imposed under the Prudential Rules for SME financing.
- A single exporter cannot obtain more than Rs 1.5 billion in LTFF. Banks can provide additional financing from their own sources.
- The list of eligible products and industries is on page 10 of the document, http://www.sbp.org.pk/MFD/2018/Instructions-LTFF.pdf

# Period of LTFF and its repayment

- The maximum number of years that an exporter can obtain LTFF is 10 years with 2 years as grace period.
- If the financing is provided for up to 5 years, the grace period cannot exceed 1 year.
- Repayments can be made in equal amounts in the form of half-yearly or quarterly disbursements.

# Financing on the basis of Export Targets:

Exporters will be required to meet the following targets over the maximum period of 4 years:

| | |
|---|---|
| Exports in First Two Years | Either US $2 million or 20% of Total Sales (whichever is lower) |
| Exports in Third Year | Either US$ 3 million or 30% of total sales, (whichever is lower) |
| Exports in Fourth Year | Either US$ 5 million or 50% of total sales, (whichever is lower) |





# Challenges in Trade Finance and Caution on Informal Channels

- Lack of transparency and credibility of buyers and financial institutions in developing countries, fluctuations in the exchange rates and liquidity crunches.
- Such challenges make it attractive to seek *informal channels* of trade finance, where payments are made using cash and payment
- Such informal channels are highly discouraged as they are unregulated and be suspicious under the anti-money laundering laws, the training program will strongly recommend participants to rely on formal channels.

# Activity

Handout # NETP-HO-M3L2-01 and 02

In your Activity Books take out handout #

NETP-HO-M3L2-01 and 02

Read the scenario and answer the given questions

# Activity

Handout # NETP-HO-M1-01

In your Activity Books take out handout # NETP-HO-M1-01

Read and answer the question given below the description

# Thank You