CHAPTER 1

INTRODUCTION AND DESIGN OF THE STUDY

INTRODUCTION

India's foreign exchange crisis seems to be getting grimmer. The widening trade deficit in recent years brings home the stark fact that there is no alternative to stepping up Indian Exports. Despite an increase in exports the BOP position continued to be under severe strain mainly due to an increase of 32.4% in imports during 1992-93 and repayment of dues to IMF and other obligations. The pressures on India's BOP continued unabated despite maintenance of high ratio of export growth.¹

Stepping up exports is one of the top priorities before the country. At present exports form 7.61% of GDP (1992-93) which is rather low as compared to other countries. World trade has been growing at 3% to 4% per year but India's share in it is only 0.5% at present.

Of the exports originating from the developing countries, Taiwan, Hong Kong and South Korea accounted for over 50% while India's share was less than 4%.² Against this backdrop India's exports sported a sparkling look during 1993-94. From an export of $8905 million in 1985-86, the figure rose

by over 100 per cent in five years to $18143 million in 1990-91 and later slipped to $17866 million during 1991-92. Exports staged a recovery in the next year and finally rose to $22,238 million during 1993-94. This recorded a sharp increase of 20 per cent over the year.3

Import slackened and the trade deficit was low at $1068 millions during 1993-94. The trade deficit during 1993-94 was the lowest in the last 16 years. The imports form 9.23 per cent of GDP in the year 1980-81. It decreased marginally to 8.98 per cent of GDP during 1993-94.4

**EXPORTS AND GLOBALISATION**

Exports are to be increased to pay for imports as well as for debt servicing not marginally but by leaps and bounds. The success of Indian reforms package depends upon how soon the exports reach the take off stage as otherwise the country cannot hope to be out of external debt trap accounting for 27 per cent of debt service ratio. Admittedly there is a time lag between structural adjustments and improvements in the balance of trade. Once the industrial activity picks up, inflation reduces and the import liberalisation of exports are also expected to yield better results.

An opening of the economy in response to globalisation reflects the attempt to capture as large a market share as possible for one's own country.

3 DGCI&S.
The response towards outward orientation can be categorised in external response and internal response. The external response means evolving the strategies taking into account the changes in the world economy while internal response is towards making domestic economy more competitive so as to carve a niche for itself in global market.  

Exports indicate a country's global competitiveness and they help a nation's economy multifariously. Employment generation, industrial development, technological advances, improving standard of living of the people and such other macro socio economic benefits flow from export growth. As exports depend on international competitiveness of products needless to say the developed countries account for much of global exports. An effective penetration in international market requires formulation of export marketing strategy taking into account factors such as the total size of the market, degree of competition, potential for growth in market size, ability to create product differentiation so as to segmentise the markets as the strategic goal of an Indian Company with respect to market share. Exporters with strong domestic base competing for significant share in export markets are essential.  

Exporters are given several incentives by the Government to enable them to achieve higher rate of export growth. As the country continues to face severe problems in BOP an all-out effort is needed to tide over the crisis. An

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1 Neera Kataria, Economic Officer PNB, PNB monthly review, June 1993, p. 364
3 Op.cit., p. 3
attempt is made to present briefly the various types of banking facilities available to the exporters to meet their growing requirements. Needless to add banks have a vital role in achieving the ambitious export targets. In view of the fact that most of exporters are starved of funds, timely help from the banks becomes imperative.

Financial assistance required from banking institutions by the exporters is shown under chart 1.1

**SIGNIFICANCE OF THE STUDY**

The year 1991-92 was a year of challenge as also a year of change. Due to the critical BOP situation the year began with severe curbs on imports and import compression had to continue almost throughout the year. GDP was expected to grow at 3% to 3.5%, but it actually dwindled to 2.5%. There was a decline of about 0.9% in industrial production. This resulted in the decline of inventories for production both for domestic market and for export market and a decline in exportable surpluses. Besides there were other constraints external to India. The disintegration of the erstwhile Soviet Union, the recession in the economies of India's major trading partners (USA, UK and Japan) and slow down in world trade and economies of some of the major trading countries like Germany and France affected India's foreign trade to a great extent.
Financial assistance required from banking institutions

Chart 1.1
The performance of India's share in the global export has been dismal in recent times. India's share which stood at 2% in 1950's has drastically receded to 0.4% in 1980's. India was 33rd country with a share of 0.5 per cent in global exports in the year 1992. The balance of trade has also all along been negative which stood at Rs.370.30 crores in 1950's has reached an unprecedented mark of Rs.13242 crores in 1992-93.

The severe foreign exchange crunch in India since 1963 forced the commercial banks with their socio economic obligations advance export credit on priority basis. The priority in lending overtly provides that "no worthwhile export proposal should languish for want of finance". The banks which are the purveyors of export credit provide adequate finance at a right time and at concessional rate of interest.  

Exports are instrumental in the development of an economy, particularly developing nations. The Indian Financial System, through commercial banks under the direction of RBI have been making all out efforts to offer financial resources for promoting exports by providing both pre and post shipment finances. Liberalised Exchange Rate Management System and full convertibility on trade account of Indian Rupee have provided export financing to importers. So also the New Trade Policy provides a favourable climate for exports.

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Exports constitute the edifice of citadel of a sound economy more particularly for a developing nation like India, which has been suffering from a persistent BOP problem for more than a decade, reaching to a crisis proportion in June 1991. Therefore thrust towards development of Indian economy has been promotion of exports.

One of the major contributory factors for promotion of export trade is the availability of "Special Finance" both at pre and post shipment stages. An exporter has not only to procure raw materials either indigenous or imported for processing them into finished goods and loading them on ship/air, but also has to often allow credit terms to an overseas buyer. Delivery period in international trade transactions is normally longer compared to the domestic counterpart and corresponding lead time for getting payment from the overseas buyer is also longer.

The exporter has thus to be extra cautious to ensure that the overseas buyer is reliable one and the payment for the goods and services sold or rendered will be realised expeditiously.

No doubt Indian financial system has a well developed and integrated mechanism of offering financial assistance to exporters. The commercial banks are actively engaged in financing genuine and need based short term requirements of the borrowers.

Export finance primarily consists of 1. availability of adequate and timely finance. 2. provision of concessional credit in order to make the export internationally competitive. 3. Institutional support to protect the losses on account of default risks of the overseas buyers and 4. availability of special deferred credit for promotion of project exports including turnkey assignments.

Export refinance mechanism from RBI takes care of the augmentation of their resources besides contributing to their profitability. Export - Import Bank of India and Export Credit Guarantee Corporation of India Limited are the other two institutions launched for export promotion.

EXIM BANK

In the year 1982 a separate development bank (EXIM Bank) was established as a specialised institution for co-ordinating the activities of various agencies engaged in export and import financing. India is one among the countries in the world which has been using medium and long term concessional export financing to promote engineering goods exports. In the modern world especially in developing countries the success of an export promotion drive depends among other things, on the capacity of the supplier to offer deferred payment to prospective buyers. Because of BOP and debt trap of I.C's export credit financing policy is the key determinants for winning export contract and project orders. 11

For medium and long-term financing the central government thought it fit to establish a specialised agency (EXIM Bank) to broaden the credit base. It was anticipated that the EXIM Bank would be filling the gap in the financial infrastructure. The schemes adopted by EXIM Bank for promoting engineering goods exports and projects are. (1) Direct financial assistance (2) buyers credit (3) export bills rediscounting (4) export oriented units (5) export credit refinance (6) lines of credits. (7) Overseas investment finance. (8) pre-shipment (9) re-lending facility and (10) Others funded assistance and export guarantee.

The Exim bank has been permitted to introduce forfaiting in the country. However EXIM bank will not provide the finance directly. It will only work as an intermediary between overseas forfaiting agency and the exporter. The finance would however be routed through authorised dealers.

Forfaiting is a technique to help the exporter to sell the goods on credit and yet receive the cash well before the due date. It is a technique mostly employed for financing goods on medium term deferred basis. In certain circumstances, forfaiting may also be used to finance goods for a period of one year or so.\textsuperscript{12}

The term forfait is a French word which means to give something or give up one's right. In forfaiting the exporter surrenders his right to receive

\textsuperscript{12} Kochar M.G., "International Factoring and Forfeiting", The Journal of IIB July-Sep 1994. p.161
payments under an export receivable falling due for payments in the future for immediate cash payment. Forfaiting emerged as an important tool of financing to an exporter while retaining the benefits of a cash sale. The exporters get the money soon on receipt of the notes from the importer which are presented to the forfaitor. Forfaiting is done without recourse. i.e., the forfaitors cannot go back to the exporter for recovery of the money which the importer has not paid him.

Mechanism of forfaiting is shown in a chart 1.2.

ECGC

In the year 1957 Government established an Export Risk Insurance Corporation Ltd. to support and strengthen export promotion activities in the country by providing risk insurance covers to exporters against loss in export of goods and services and also by offering guarantees to banks and financial institutions to enable exporters to obtain better facilities to cover risks. ERIC was converted into ECGC in 1964 has to give adequate focus to its image in the field of export promotion. It has to tone up its operational areas for boosting up exports of the country. A better export coverage should also be expected from this premier export promotion organisation.

Deolalkar G.H., "Case for starting International factoring in India", Chartered Secretary February 1994, p.129.
Chart 1.2
Mechanism of International Factoring
EXPORT CREDIT POLICY CHANGES

In view of the imperative need to promote exports banks were advised to review the systems, procedures, organisational arrangements and delegation of powers so as to ensure that adequate credit is available to the export sector without delay. 14

Given the importance of finance in the export promotion strategy, credit policy has been geared to provide increased availability of credit to exporters. Effective Nov. 1993 the Pre-shipment Credit in Foreign Currency (PCFC) scheme was introduced under which authorised dealers in India are allowed to extend PCFC at internationally Competitive rates of interest to enable exporters to compete favourably in international markets. The scheme will be available to cover both the domestic and imported inputs of the goods exported and will serve as an additional window for providing pre-shipment credit to Indian exporters. Further to provide increased incentive to their export efforts, a 'Running Account' facility has been made available to exporters with a good track record all along. In addition, authorised dealers in India have been allowed to arrange for several lines of credit from abroad.

To provide increased protection to exporters from having to incur conversion costs when making payment for imports, the limit of foreign exchange earnings of exporters that is allowed to be retained in their Exchange

Earners' Foreign Currency (EEFC) accounts has been raised from 15 per cent to 25 per cent in general under the union budget 1994-95. As a special incentive the retention limit for the 100 per cent Export Oriented Units (EOU), the units located in Export Processing Zones, the Software Technology parks, and the Electronic Hardware Technology parks has been raised to 50 per cent.

**EXPORT PRODUCTS**

Included within the purview of the study are the following items that have been selected among non-traditional items of goods entering the foreign trade:

- Cut and polished granite.
- Gem and Jewellery.

**STATEMENT OF THE PROBLEM**

Commercial banks-public, private or International are the institutions which exporters look upto for financing the production and sale. For conducting business abroad the government has provided for subsidised financing which is given out at concessional rate compared to the rates prevailing in the market. The main component of subsidised export finance are pre shipment or packing credit and post shipment credit. Pre-shipment finance is essentially a working capital made available to the exporter for the procurement and processing of raw material, packing of goods and shipping
them to their destination. This credit is provided at concessional interest rate for specified period. Similarly post shipment credit is the advance given by the bank after the goods have been loaded on board. These are given for specific time period and mainly against cash incentive, duty drawback and for transit period against demand bills, and usance bills.

- The terms of packing credit on both counts i.e., interest rate and the period of credit are extremely poor in comparison to the terms extended by the competing countries like Japan, Hong Kong, South Korea and Singapore.
- Lack of professionalism in the financial institutions. From such attitudes spring many problems that result in inefficient handling of papers and causes avoidable delay in execution of export orders.
- Lack of co-ordination between the different financial institutions i.e., commercial banks, EXIM Bank and ECGC so as to achieve maximum possible push and cover for export.
- Lack of timely review by the Board of Directors of Scheduled Commercial Banks with regard to their performance in supporting export efforts by extending adequate export credit.

**REVIEW OF LITERATURE**

Rajiwade in his study Export Financing A World Review observed that a more stable exchange rate policy can go a long way in saving precious foreign exchange. The devaluation of the Indian rupee and the most recent increases in the interest rates applicable to export financing may well lead to a

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change in the way banks gave pre-shipment finance for import intensive exports. Hitherto all exporters preferred to seek such finance in rupees as this was extremely profitable. The pre-shipment finance interest rate was ultra cheap in the last several years with the rupee being depreciated by RBI which was giving additional profit margins for the exporters.

A study by Manjappa, 'Export credit-medium and long term financing' 16 considered the year 1982 as a signpost in the sphere of foreign trade financing in India because separate development bank (EXIM Bank) was established as a specialised institution for co-ordinating activities of various agencies engaged in trade financing.

In the study Export finance. The forfeit option. 17 Ganesan Sridhar found that export finance to be an important component of export competitiveness. International trade in engineering and capital goods dominating in terms of export credit accomplishments. Traditionally in many countries official agencies have been the main provider of finance and insurance for exports. Support from official agencies are supplemented and complemented by sources which seek to offer flexible terms to suit particular needs of an export transaction. One such form of non traditional option is forfeiting.

A study Exports - Towards strategic shift. \(^\text{18}\) by Neera Kataria brought forth the role of government in providing impetus to exports. Recently it has given many export incentives like reduction in interest rate on rupee export credit, waiver of interest tax in case of export credit from banks and reduction in import duties on specified capital goods for textiles, leather, marine products and gems and jewellery where India has comparative advantage.

Dinakaran in his study 'Export Credit-Disenchantment all around' \(^\text{19}\) observed that exporters apprehend a serious shortfall in the quantum of credit and are demanding funds on softer terms. For some time now, exporters have been complaining about the scarcity of credit and the huge cost at which it is being made available. Similarly there were initially few takers for credit schemes in dollars, which attract lower interest; though of late they have been picking up. The draft report of the G.Sundaram Committee suggests that the interest rate be reduced from 14 to 10 per cent in two phases. With lower refinancing limits banks will have to borrow Rs. 500 crores at market rates for export credit says an RBI estimate.

Navin Chandra Joshi in his study Forfeiting needed for export finance \(^\text{20}\) observed that forfaiting to be an important measure currently being considered by the RBI. This French term means "to surrender or relinquish rights to something". In the field of exports it would simply surrender by an exporter of

\(^\text{18}\) Op. cit, p.3  
the rights to claim payments for goods or services rendered to an importer in
return for cash payment for those goods or services from the forfai tor who
takes over the importers promissory note or the exporters bill of exchange. The
forfai tor thus, assumes responsibility for the collection of such documents from
the importer.

A study, development of country's exports. 21 by Solomon Raj found
that banks have a major role to play in the promotion and development of the
country's exports. Right from locating a buyer abroad for the exporters
products, till the exporter realises the export proceeds and incentives, banks
assist the exporters at every stage. Export credit is the most vital instrument for
promoting a country's exports. Banks extend credit to exporters at concessional
rates of interest specified by RBI and are much lower compared to the interest
rates on domestic lending.

A study of export trade financing in India with particular reference to
commercial banks 22 by Sen Gupta and Keshari estimated the role and share of
commercial banks in export financing and issues in export financing. They
suggest for increasing the flow of bank credit to export sector restructuring the
interest rates. They also call for change in attitude of banks. The need for
c o-ordination between banks and financial institutions role of ECGC in timely
settlement of claims are impetus for a favourable export business. The stress is
on introducing the new innovative services of counter trade, overseas

borrowings forfaiting and banks acceptance facility for accelerating promotion of exports.

A study 'Export financing mechanisms' by Sharma considered competition in the dynamic markets the bargaining power has shifted from the seller to the buyer who tends to dictate terms in regard to price, quality and delivery schedules and above all insists on appropriate credit terms. The availability of an adequate supply of credit at reasonable cost therefore greatly facilitates the task of the exporter. The difficult foreign exchange position in many countries makes it imperative for importers to ask for credits of varying duration and the credit terms offered often influence the buyers choice of supplier and thus the sources of supply.

A case study was conducted by NCAER on banking problems of Indian exporters. For commercial banks are the institutions which exporters look upto for financing the production and sale. And for financing short term or long term credit on deferred payment to an importer one looks upto the EXIM Bank for fulfilling this role. For conducting business abroad Government has provided for subsidised financing which is given out at concessional rate compared to the rates prevailing in the market. The main component of subsidised export finance are called pre-shipment packing credit and post shipment credit. Other than these commercial banks also provide ancillary

services to the exporters which comprise market intelligence report, status report for the buyer, foreign exchange regulators of importing country and guidance in preparation of documents. These services are rendered by commercial banks towards export finance.

In his study 'Export finance - An update' Balachandran observes that exporters are given many incentives by the government to enable them to achieve higher rate of exports from the country. An all-out effort is needed to tide over the BOP crisis. As is well known, exports from the country have grown significantly over the years and that too in many non-traditional areas and items due to the pains-taking efforts of exporters and other institutions operating in this field.

Exporters demand have been met by the government over the years. A case in point is the recent reduction in the rate of interest levied upon with the exporters and given all possible help for faster export growth. e.g., recent guidelines on convertibility.

In the study 'India's Exports scenario' Selvam observes that export finance is a crucial input. With increased exports added credit is needed. The RBI is considering raising the export credit limit for commercial banks to 12 per cent from the present 10 per cent of net bank credit. Banks have been advised to reach an export credit target of 10 per cent failing which they have

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to face a rise in the reserve requirements and withdrawal of export credit refinance facilities. The refinance limit by the RBI as percentage of outstanding export credit has been stepped up from 42.3 per cent in 1992 to 69.2 per cent in 1993.

The study 'Towards Financial Liberalisation, 27 Narasimham highlights that the time is opportune for India now to consider further these measures of financial deregulation, and move towards financial liberalisation in a series of sequenced and structured steps as was done in the last decade in Korea rather than a sudden dismantling of controls which as the experience of Latin American countries demonstrated could be counter productive.

Meera Murti observed in her study 'Financing of export trade in India 28 in a fully developed market, banks are strong enough to undertake the risks of financing exports based on bank credit investments and be the lender of last resort rediscounting facility of the central bank. It is surprising to note that trade financing system in India all the necessary systems outlined in the case of Korea have been in existence for some time in India. India has a transaction based self-liquidating trade loan system in the form of export packing credit and purchasing /discounting of foreign bills by banks. The RBI provides refinance and the ECGC gives WTPCG (Whole Turnover Packing Credit Guarantee) to banks for pre-shipment finance and buyer-wise post shipment

guarantee to exporters Indian banks are well equipped to handle export/import or back to back LC's.

In his study 'Export finance and payments'. 29 Mathew observes that export finance has not only contributed to the economic development but also helped to establish balanced industrial development of different nations. International payments made easier because of different currency system in different countries of the world there arises payments problem in international trade. The export finance arrangement made this problem solved through the bill of exchange, i.e., documentary credit etc. dealt with banks and other financial institutions.

OBJECTIVES OF THE STUDY

The objectives of the study are.

• To review the performance of commercial banks.
• To analyse the India's foreign trade scenario.
• To study the export financing by Indian commercial banks.
• To study the export potentialities of the selected industries and bank. finance extended to these industries and impact of bank credit (pre and post shipment) on their export performance.
• To Study the factors influencing export performance of the selected industries.

To Discuss the problems faced by the Indian commercial banks in providing export finance.

To summarise the findings and offer suitable suggestions for improving the exports of the country.

HYPOTHESES

Following are the hypotheses formulated in the present study:

- Pre-shipment credit promotes exports. When pre-shipment credit is more the export value is also more.
- Post-shipment credit promotes exports. When post-shipment credit is more the export value is also more.

METHODOLOGY

In this expost facto study it is proposed to use the past data and materials available with the banks both published as well as unpublished for analysis and interpretation. Out of the 28 public sector banks and 24 private sector banks presently functioning in India, the study embraces in its fold nine public sector banks and one private sector bank administered through the offices located in Tamil Nadu. Both primary as well as secondary data are collected from published annual returns of the banks and also from the key officials of the banks through follow-up personal interviews. Questionnaire method is adopted with the exporters for ascertaining the various problems confronted by them in
their export trade. Besides data is collected from National Social Science Documentation centre, New Delhi, Indian Institute of Management, Bangalore, Institute for Financial Management and Research, Madras and also from Indian Institute of Bankers, Bombay, National Institute of Bank Management Pune, the apex institutes presently functioning in the realm of banking.

PERIOD OF STUDY

The present study is confined to a period of five years. i.e., 1989-90 to 1993-94.

LIMITATIONS OF THE STUDY

The following are important limitations.

The sample size is ten banks both in the public and private sector the time and cost constraints have prevented the researcher in taking samples in a large scale. There is yet another limitation in the present study is that wherein the factors like political instability, devaluation of rupee and all other external and uncontrollable forces which have got bearing on the export of the country have been excluded from the purview of the study. Invisible trade which comprises major segment of the BOP position of the country is ignored. This study ignores other institutional support in export financing from EXIM Bank, IDBI etc.
CHAPTERISATION

First chapter is introductory and covers a brief review of foreign trade and economic development of India. It deals with meaning and concept of export financing, the objectives of the study, methodology adopted, period of study. Principal hypotheses are mentioned. This chapter contains the limitations of the study as well.

Second chapter discloses the performance of commercial banks in India.

Third chapter focuses India's foreign trade scenario.

Fourth chapter contains export financing mechanism by commercial banks.

The analysis of the export potentiality of selected industries by select commercial banks of Tamil Nadu as also analysis made relating the bank credit (pre and post shipment) to export performance of select industries are presented in the fifth chapter.

The sixth chapter deals with factors influencing export performance of select industries.

In the seventh chapter the problems faced by the select industries in getting bank credit for exports and that the problems faced by commercial banks which extend export credit are discussed.

The concluding eight chapter portrays the key findings of the study and also suggestions for overall improvement of export trade in Tamil Nadu through commercial banks.