International Business
Unit 5
Foreign Trade promotion measures and organizations in India

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Sources of finance for foreign trade

- **Bills of exchange**
- a negotiable instrument drafted by the exporter (the drawer), accepted by the importer (the drawee) who thereby agrees to pay for the goods/services either immediately or more commonly after a specified period of credit.
- If the importer accepts the bill it is known as a “trade bill”, whereas if the importer arranges for its bank to accept the bill, it becomes a less risky “bank bill”.
- Where payment will be made after the specified period of credit, the exporter can sell the bill at a discount to its face value and receive the cash immediately.
- If the bill is dishonoured the exporter can seek legal remedies in the country of the importer.

- **Promissory notes**
- similar, but less common than bills of exchange, since they cannot usually be discounted prior to maturity.

- **Documentary letters of credit**
- the importer obtains a Letter of Credit from its bank, which guarantees payment to the exporter via a trade bill. Though slow to arrange, this method is virtually risk free provided the exporter presents specified error free documents (eg **shipping documents, certificates of origin and a fully detailed invoice**) within a specified time period.
- The high bank fees for this procedure are normally borne by the importer, and the DLC is normally reserved for expensive goods only.

- **Factoring**
- the factoring company (often the subsidiary of a bank) assumes the responsibility for collecting the trade debts of another – in this case an exporter.
- The factor may provide a range of services (eg providing advances, administering the sales ledger, credit insurance etc) for an additional fee. Widely regarded as a useful means of obtaining trade finance and collecting of debts for small or medium sized exporters.
- However the exporter must always bear in mind the eventual consequences of dispensing with the services of the factor and undertaking the running of the sales ledger and cash collection activities itself.

- **Forfaiting**
- a medium term source of finance whereby a domestic bank will discount a series of medium term bills of exchange, which have normally been guaranteed by the importers bank. The forfaiting bank normally forgoes the right of recourse to the exporter if the bill is dishonoured.
- The exporter obtains the benefit of immediate funds, but the bank charges are expensive. Forfaiting is normally used for the export of capital goods, where the importer pays in a series of instalments over a period of years.
- **Leasing and hire purchase**
- the exporter sells capital goods to a lessor, which in turn enters into a leasing agreement with the exporter’s overseas customer.
- Alternatively the equipment can be sold to a hire purchase company which resells to the importer under a HP agreement.

- **Acceptance credits**
- a large reputable exporter can arrange for its bank to accept bills of exchange (which are related to its export activities) on a continuing basis.
- These bills can then be discounted at an effective cost, which is lower than the bank overdraft interest rate.
- **Producer loans**
- where an importer acquires commodities for the purpose of immediate resale, it can raise a loan from its bank, which takes custody of the goods until the importer is able to sell them.
- Thereafter the principal sum, interest and storage costs are repaid to the bank out of the proceeds of the sale.

Trade finance is the financial assistance provided in the field of international trade and commerce through the use of various financial products. A plethora of financial products fall under the ambit of international trade finance, each of which is designed to ease the conduct of business among importers and exporters around the world.

- Types of Trade Finance available in India
- The nature and purpose of trade finance are quite different from the usual financing of products and services. As such, trade finance products are unlike conventional financing products. Some typical trade finance products available in India are listed below:
- Term Loans
- Working Capital Limits like Overfraft and Cash Credit
- Letters of Credit
- Invoice Discounting or Invoice Factoring
- Export Credit (Packing Credit)
- Insurance

- Term Loans
- **What are term loans?**
- In Term Loans, the amount borrowed has to be repaid in installments over a certain period of time. Usually this period is upto 10 years, but in some cases it can go upto 30 years depending on the financer. Such funds are given at a certain rate of interest which is to be repaid along with the principal amount. Term Loans are mostly used for a long term project, where the business is expecting the return of investment to come in after a certain period of time.
- **Who provides term loans?**
- Term Loans are sanctioned for projected loans. They are basically provided by banks and financial institutions. Term loans are for a specific period of time and the repayment is done either in fixed rate or floating interest rate.
- **Benefit of term loans:**
- A business can have a large amount of money for urgent needs. Monthly costs can become affordable in terms of purchase of items and assets. They can easily be converted into equity and other sources at the conditions, laid by financial institutions.

- Working Capital Limits like Overdraft or Cash Credit (CC)
- **What are working capital limits?**
- Different types of credit meant for financing foreign trade are overdraft and cash credit, which can help both importers and exporters to apply for cash as and when they need against it, as long as the credit line is open. These lines of credit are just another form of borrowing, the only difference being that this is a short term funding and interest here is charged on the basis of amount and period of utilization.
- **How to use working capital limits?**
- Businesses are supposed to borrow small amounts from the line of credit when they have insufficient balance in their current accounts for operational business transactions, and put it back as soon as they receive funds to avoid high interest charges.
- **Their benefit:**
- It can gauge the commercial viability of an export business and extend financial support based on their assessment. In trade finance, an exporter doesn’t need to liquidate their equity to attract fresh investments.

- Letter of Credit
- **How letter of credit works in India?**
- Letters of credit are used to reduce the risk of non-receipt. The buyer's bank provides a payment guarantee to the seller against the goods shipped. Banks are often ready to finance against Letter of Credit (LC) as there is an inborn security in an confirmed LC that the issuing bank will make the payment in case of default.
- **Who provides Letter of Credit?**
- Banks are involved in various aspects of international trade and offer services like letter of credit (LOC)-based financing, supply chain finance, open account financing etc. Trade finance companies also provide supply chain finance and letters of credit. Besides, they can provide structured trade finance, invoice factoring, receivables discounting, and other customised products.
- **LOC - Beneficial for which party:**
- The beneficiary is the party which gets the payment under a letter of credit. Once the beneficiary gives all the necessary documents with the bank in accordance with the terms and conditions, he becomes the main party under letter of credit.

- Invoice Factoring or Invoice Discounting
- **What is invoice factoring?**
- You can approach your bank, a financial institution or a trade finance company and present your invoice to them for faster liquidation. The banker or the financial institution could purchase, collect, or even discount the bill. For example in Invoice Discounting you can submit your invoice along with certain other documents to Drip Capital, which advances up to 80% of the invoice value within 24 hours. On maturity of the invoice, the importer pays Drip Capital, which then settles the remaining amount after accounting for the agreed-upon fee.
- **How it works?**
- A business client makes an agreement with a factoring company, where after an agreement the company handles the clients sales and credit for a period of time. Factoring companies provide goods & service to customers who have credit worth & then submit correct invoices. Once the procedure is completed the company will then pay you the remaining balance, taking their commission in account.
- **Benefits of Invoice Factoring:**
- If you are awaiting payment against shipments made and receive a new order, you may not have the working capital to start production immediately. By factoring in your existing receivables, you get the working capital required to kick-start the next round of production. This way, you are able to expand your market presence and business volume.

- Export Credit
- **Export Credit - Offering:**
- One can avail pre-shipment finance from a financier against an export order received from the importer in the form of Packing Credit. Once the funds are received from the overseas buyer, the concerned export packing credit amount will be adjusted and the loan will be closed against that order.
- **Importance of Export Credit:**
- International trade finance offers a flexible finance option through credit lines, which helps exporters in availing cash at any time. As a result, exporters are able to ship their products frequently and at a more competitive rate. Besides, it is apparent that trade financers provide exporters with the finances that subsequently help them to increase their business and profitability.

- Insurance
- **Trade Insurance:**
- Export trade insurance products provide assurance against the shipping, payment, and the delivery of goods, which are designed to safeguard the foreign exchange receivable risk of the business.
- **Insurance Service Providers:**
- Insurers are also involved in trade finance in roles that are quite similar to banks. Their services include receivable finance, payable finance, letters of credit, asset-based lending, and term loans.
- **Benefits of trade insurance:**
- It increases profits and reduces risk factors in terms of foreseen conditions. Not only does it boost sales for the business, but also offers favourable credit terms to customers. Banks will be in favor of businesses who have trade insurance and will offer them more favourable lending terms, in concern of their accounts receivable.

Introduction

- A Special Economic zone (SEZ) is a geographical region that is designed to **export goods** and **provide employment**. SEZs are exempt from federal laws regarding taxes, quotas, FDI-bans, labor laws and other restrictive laws in order to make the goods manufactured in the SEZ at a globally competitive price.

- It is a specifically delineated **duty-free enclave** and shall deemed to be a foreign territory for the purposes of trade operations and duties and tariffs.

- To provide and **internationally competitive and hassle-free environment for exports**

History of SEZ

- First known SEZ- Puerto Rico-1947
- Ireland and Taiwan followed- 1960
- China made the SEZ's a global concept- largest number of SEZ's – Shenzen 1980
- Revolution came in 2000- inorporation of SEZ in EXIM policy
- SEZ act introduces in India- 2005

Categories that SEZ includes

- Free trade zones (FTZ)
- Free Zones (FZ)
- Industrial parks or Industrial estates (IE)
- Free economic zones
- Urban enterprise zones.

Free Trade Zones (FTZ)

- Also known as export processing zone (EPZ), also called foreign-trade zone, formerly free port

- It is an area within which goods may be landed, handled, manufactured or reconfigured, and re-exported without the intervention of the customs authorities

- Only when the goods are moved to consumers within the country in which the zone is located do they become subject to the prevailing customs duties

- The world's first Free Trade Zone was established in Shannon, Ireland (Shannon Free Zone)

- Most FTZs located in developing countries like Brazil, Colombia, India, Indonesia, El Salvador, China, the Philippines, Malaysia, Bangladesh, etc.

Free Port Or Free Zones (FZ)

- Most commonly a free port is a special customs area or small customs territory with generally less strict customs regulations

- Many international airports have free ports, though they tend to be called customs areas, customs zones, or international zones.

Industrial Parks Or Industrial Estates (IE)

- It is an area zoned and planned for the purpose of industrial development

- It can be thought of as a more "lightweight" version of a business park or office park, which has offices and light industry, rather than heavy industry.

- Industrial parks are usually located on the edges of, or outside the main residential area of a city, and normally provided with good transportation access, including road and rail

- An example can be large number of Industrial Estates located along the River Thames in the Thames Gateway area of London

Free Economic Zones

- Free economic zones or free zones refer to designated areas in which companies are taxed very lightly or not at all in order to encourage economic activity.

- Sometimes they are called **free** ports

- Example : the free port of Trieste (in Italy)

Urban Enterprise Zones

- It is an area in which policies to encourage economic growth and development are implemented

- Urban Enterprise Zone policies generally offer tax concession, infrastructure incentives, and reduced regulations to attract investments and private companies into the zones.

- Urban Enterprise Zones are areas where companies can locate free of certain local, state, and federal taxes and restrictions.

- Urban Enterprise Zones are intended to encourage development in blighted neighborhoods through tax and regulatory relief to entrepreneurs and investors who launch businesses in the area.

Facts

Some EPZ's converted to SEZ's

Name of Area	State	Year of conversion	Area of SEZ (in Acers)
Kandala	Gujarat	1965	625
Seepz	Maharashtra	1975	110
Noida	Uttar Pradesh	1986	310
Madras	Tamil Nadu	1986	262
Cochin	Kerala	1986	103
Fatala	West Bengal	1986	280
Vishakhapattanam	A P	1994	360
Surat	Gujarat	1998	103

Advantages

- 15 year corporate tax holiday on export profit
- Allowed to carry forward losses
- No license required for import made under SEZ units
- Duty free import of goods for setting up of the SEZ units
- Exemption from payment of Service Tax
- Setting up Off-shore Banking Units (OBU) allowed in SEZs
- External Commercial Borrowings up to $500 million a year

  allowed without any maturity restrictions

Disadvantages

- Revenue losses because of the various tax exemptions and incentives
- Acquire land at cheap rates and create a land bank
- May not match up to expectations

SPECIAL ECONOMIC ZONES (SEZ) IN INDIA

Definition of SEZ

Promotion of goods manufacturing in the SEZ at a globally competitive price

SEZs are exempt from federal laws regarding taxes, quotas, FDI-bans, labour laws and other restrictive laws

A Special Economic zone (SEZ) is a geographical region that is designed to export goods and provide employment

A Special Economic Zone (SEZ) has economic laws that are more liberal than a country's typical economic laws.

SEZ in India

- India was one of the first in Asia to recognize the effectiveness of the Export Processing Zone (EPZ) model in promoting exports, with Asia's first EPZ set up in Kandla in 1965.

- With a view to overcome the shortcomings experienced on account of the multiplicity of controls and clearances; absence of world-class infrastructure, and an unstable fiscal regime and with a view to attract larger foreign investments in India, the Special Economic Zones (SEZs) Policy was announced in April 2000

History of Special Economic Zones

- From 1965 onwards, India experimented with the concept of such units in the form of Export Processing Zones (EPZ).

- But a revolution came in 2000, when Murlisone Maran, then Commerce Minister, made a tour to the southern provinces of China. After returning from the visit, he incorporated the SEZs into the EXIM Policy of India. Five year later, SEZ Act (2005) was also introduced and in 2006 SEZ Rules were formulated.

Objectives of setting up SEZ in India

- Generation of additional economic activity
- Promotion of exports of goods and services
- Promotion of investment from domestic and foreign sources
- Creation of employment
- Development of infrastructure facilities
- Simplified procedures for development, operation, and maintenance of the Special Economic Zones and for setting up units and conducting business
- Single window clearance for setting up of a SEZ and an unit in SEZ
- Single window clearance on matters relating to Central as well as State Governments

Benefits from SEZs

- Investment of the order of Rs.100,000 crore including FDI of US $ 5-6 billion.
- 500,000 direct jobs.
- At present, 1016 units are in operation in the SEZs, providing direct employment to over 1.79 lakh persons; about 40 per cent of whom are women.
- Exports from the SEZs during the 10-year period could touch 352 billion dollars, nearly half of India's total annual exports.

Facilities ofSEZ in India

Exemption on duties on Indian capital goods and inputs are offered as per the requirements of the approved business activity

Taxes are either exempted or waived and even reimbursed in case they are paid in advanced to the concerned authority

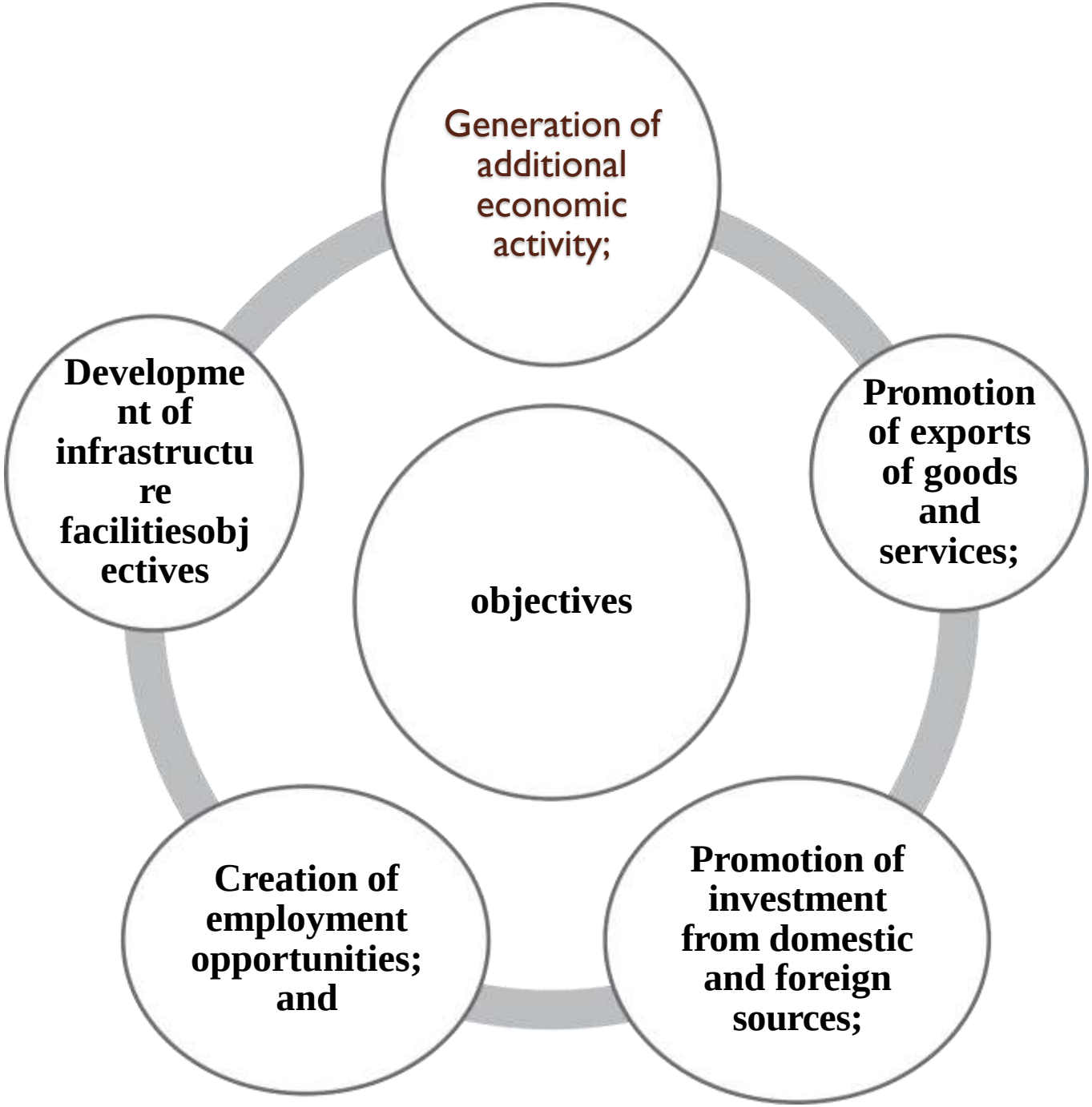
Duty-free imports of spares, raw materials, capital goods, and consumables are offered as per the requirements of the approved business activity

Preferential treatment of these units to the Indian market for easy dissemination of their products and / or service

Facilitated to retain 100 % in foreign currency in EEFC (Exchange Earners' Foreign Currency) account

Total tax exemption on corporate incomes as per the provisions of Section 10 Aand 10 B of the Indian Income Tax Act

Easy and automatic acceptance system for use of existing trademarks, brand names and technological know-how


Generation of additional economic activity;
Promotion of exports of goods and services;
Promotion of investment from domestic and foreign sources;
Creation of employment opportunities; and
Developme nt of infrastructu re facilitiesobj ectives
objectives

The salient features/provisions of SEZ Rules

- **Different minimum land requirement for different class of SEZs;**
- **Every SEZ is divided into a processing area where alone the SEZ units would come up and the non-processing area where the supporting infrastructure is to be created;**
- **Simplified procedures for development, operation and maintenance of the Special Economic Zones and for setting up units and conducting business in SEZs;**
- **Single window clearance for setting up of an SEZ;**
- **Single window clearance for setting up a unit in a Special Economic Zones;**
- **Single window clearance for matters relating to Central as well as State Governments;**
- **Simplified compliance procedures and documentation with an emphasis on self certification**

SEZ Controversy

In spite of the strong objectives of the Indian Government The SEZ policy is in following controversy

Generation of little new activity as there may be relocation of industries to take advantage of tax concessions,

Revenue loss due to Tax exemption .

Large-scale land acquisition by the developers, may lead to displacement of farmers with meager compensation,

Acquisition of prime agricultural land, having serious implications for food security

Misuse of land by the developers for real estate

Uneven growth aggravating regional inequalities.

SEZ ACT & GUIDELINES FOR IMPLEMENTATION

History Of SEZ In India

- first ever Export Processing Zone (EPZ) in Asia was set up by Government of India in Kandla in 1965.
- Based on the success of Kandla EPZ, in the beginning of eighties, seven more EPZs were set up in Bombay, Noida, Surat, Madras, Falta, Visakhapaptnam and Cochin.
- To invite larger foreign investments in India, these EPZs were converted into Special Economic Zones (SEZs) in the year 2000 under a new policy announced by the Government of India.

Aim of SEZ's

The policy intended to make these SEZs an engine for economic growth supported by quality infrastructure complemented by an attractive fiscal package with minimum possible regulations.

SPECIAL ECONOMIC ZONES ACT, 2005 Promulgated On 23rd June, 2005

- An act to provide for the establishment,
- Development and management of the
- Special economic zones for the
- Promotion of exports and for matters
- Connected herewith or incidental thereto.
- Enacted by parliament in the fifty-sixth year of the
- republic of india.

Special Economic Zones Act, 2005 promulgated on 23rd June, 2005

An act to provide for the establishment, development and management of the special economic zones for the promotion of exports and for matters connected herewith or incidental.

Enacted by parliament in the 56th year of the republic of India.

EXPORT ORIENTED UNITS

- EOU scheme was introduced in the year 1980 vide Ministry of Commerce resolution dated 31st December 1980.

- The purpose of the scheme was basically to boost exports by creating additional production capacity.

- It was introduced as a complementary scheme to the Free Trade Zones/ Export Processing Zone (EPZ)Scheme introduced in the sixties, which had not attracted many units due to locational restrictions.

- T he exporters showed willingness to set up units with long term commitment to exports under Customs bond operations provided they had the freedom to locate them in places of their choice and given most of the benefits as provided to units set up in the Zones

- The Export Oriented Units (EOUs) are governed by the provisions of Chapter 6 of the Foreign Trade Policy (FTP) and its procedures, as contained in the Handbook of Procedure (HBP)

- The Scope of EOU has changed over the years. It was initially set up for manufacturing sector with certain minimum value addition in terms of export earnings. Presently it includes not just the aforesaid but also services, software development, repair, remaking, reconditioning, reengineering, agriculture etc.

BENEFITS TO EXPORT ORIENTED UNITS

- EOUs are allowed to procure raw materials/ capital goods duty free, either through import or through domestic sources.
- Reimbursement of Central Sales Tax (CST)
- Reimbursement of duty paid on fuels procured from domestic oil companies.
- CENVAT credit on the goods and service and refund thereof.
- Fast track clearance facilities;
- Exemption from Industrial Licensing for manufacture of items reserved for SSI sector.