RISKS IN FOREIGN TRADE

With increased opportunities of export and import, the attendant risk associated with international trade flow has also increased. As exporters and **importers from different countries, separated not only by physical distance but by socio political conditions, international trade was always been quite risky.**

Risks in International Trade are the major barriers for its growth. International trade has been a much-debated topic. Economists have differed on the real benefits of international trade. The increase in the export market is **highly beneficial to an economy, but on the other hand the increase in imports can be a threat to the economy of that country.**

But at the same time certain domestic players can be outperformed by financially stronger multi nationals and forced to close down or get merged. Sometimes these multinational **companies become so powerful, especially in smaller countries, that they can dictate political terms to the government for their benefit.**

International trade is characteristically costlier in terms of domestic trade. There are a number of **reasons such as, tariffs, cost of delay, cost related to differences in legal system, etc.**

Risks in international trade can be divided under several types

Economic risks

• Risk of concession in economic control
• Risk of insolvency of the buyer
• Risk of non-acceptance

• Risk of protracted default i.e the failure of the buyer to pay off the due amount after six months of the due date
• Risk of Exchange rate

Political risks
• Risk of non- renewal of import and exports licenses
• Risks due to war
• Risk of the imposition of an import ban after the delivery of the goods
• Surrendering of political sovereignty

Buyer Country risks
• Changes in the policies of the government
• Exchange control regulations
• Lack of foreign currency

Commercial risk
• A bank's lack of ability to honour its responsibilities
• A buyer's failure pertaining to payment due to financial limitations
• A seller's inability to provide the required quantity or quality of goods

Others Risks
• Cultural differences e.g., some cultures **consider the payment of an incentive to help trading is absolutely lawful**
• Lack of knowledge of overseas markets
• Language barriers
• Inclination to corrupt business associates
• Legal protection **for breach of contract or nonpayment** is low
• Effects of unpredictable business environment and fluctuating exchange rates
• **Sovereign risk** - the ability of the **government of a country to pay off its debts**
• **Natural risk** - due to the various kind natural catastrophes, which cannot be controlled

ROLE OF EXIM BANK, RBI AND FEDAI

ROLE OF EXPORT-IMPORT BANK OF INDIA

Export-Import Bank of India (Exim Bank) was set up by an Act of the Parliament "THE EXPORT-IMPORT BANK OF INDIA ACT, 1981" for providing financial assistance to exporters and importers, and for functioning as the principal financial institution for coordinating the working of **institutions engaged in financing export and import of goods and services with a view to promoting the country's international trade and for matters connected therewith or incidental thereto.**

Exim Bank has two **broad business streams: one, the traditional export finance typical of export credit agencies around the world and two,** financing of export-oriented units (export capability creation), which are non-traditional for **export credit agencies. Since inception, Exim Bank has been the principal financial institution in the country for financing project exports and exports on deferred credit terms.**

i. Supply of goods/equipment on deferred payment terms
ii. Civil construction contracts it. Industrial turnkey projects iv. Consultancy/services contracts

Exim Bank extends funded and non-funded facilities for overseas turnkey projects, civil construction contracts, technical and consultancy service contracts as well as supplies.

• Turnkey Projects are those which involve supply of equipment along with related services, like design, detailed engineering, civil construction**, erection and commissioning of plants and power transmission & distribution.**

• Construction Projects involve civil works, steel structural works, as well as associated **supply of construction material and equipment for various infrastructure projects.**
• Technical and Consultancy Service contracts, involving provision of know-how, **skills, personnel and training are categorised as consultancy projects.**

ROLE OF RESERVE BANK OF INDIA

Exchange Rate Management: The RBI manages the exchange rate regime in India, which involves monitoring and influencing the value of the Indian rupee against other currencies.

Fluctuations in exchange rates can impact the competitiveness of Indian exports and **the cost of imported goods. The RBI intervenes in the foreign exchange market to stabilize the currency and mitigate the risks associated with volatile exchange rates.**

Foreign Exchange Reserves: The RBI maintains a pool of foreign exchange reserves to meet any **balance of payments requirements and ensure stability in foreign trade. These reserves can be used to manage exchange rate fluctuations, support the import-export** activities, and provide liquidity to the market during times of crisis. The RBI actively manages these reserves to mitigate risks and maintain a stable foreign trade environment.

Trade Finance and Payment Systems: The RBI oversees the trade finance activities in India, **including letters of credit, bank guarantees, and other instruments used in international trade transactions. It regulates and supervises the banking system to ensure compliance with international trade regulations, such as the guidelines** provided by the International Chamber of Commerce (ICC). The RBI also facilitates efficient payment systems for foreign trade transactions, reducing settlement risks and promoting smooth trade flows.

Foreign Trade Policy: The RBI collaborates with **the government and other stakeholders in formulating foreign trade policies. It provides inputs on monetary aspects, exchange rate implications, and financial risks associated with various trade-related measures. The RBI's** role in policy formulation helps in identifying and managing risks in foreign trade and aligning them with broader economic objectives.

Regulatory Oversight: The RBI acts as a regulatory authority for banks and financial institutions involved in foreign trade activities. It sets guidelines and **monitors compliance to mitigate risks related to capital flows, credit risks, and money laundering in cross-border transactions. The RBI's regulatory oversight helps maintain the integrity and stability of the financial system, which is crucial for managing risks in** foreign trade.

ROLE OF FEDAI

Foreign Exchange Dealers' Association of India (FEDAI) was set up in 1958 as an Association of banks dealing in foreign exchange in India (typically called Authorised Dealers - ADs) as a self- regulatory body and is incorporated under Section 25 of the Companies Act, 1956. Its major activities include **framing of rules governing the conduct of inter-bank foreign exchange business among banks vis-à-vis public and liaison with RBI for reforms and development of forex market.**

Presently some of the functions are as follows:

• Guidelines and Rules for Forex Business.
• Training of Bank **Personnel in the areas of Foreign Exchange Business.**
• **Accreditation of Forex Broker** (Accreditation of Forex brokers refers to the process of verifying and certifying the legitimacy and reliability of a Forex broker by a recognized regulatory body or organization)
• Advising/**Assisting member banks in settling issues/matters in their dealings.**

• Represent member banks on **Government/ Reserve Bank of India/Other Bodies.**
• Announcement of **daily and periodical rates to member banks**.

FEDAI GUIDELINES AND FOREX VALUATION

Notes:
1. Valuation Date: Last working day of each month/year.
2. Valuation Rate: The middle rates as prescribed by authorities should be applied in the case of valuation of both spot and forwards. In case of forwards, if the rate is not available for any particular month, the applicable rate may be arrived at through interpolation.
3. Periodicity of Valuation: Revaluation of spot and forward positions should be done at least once every half-year and monitored monthly on an estimate basis.

REVALUATION OF MIRROR ACCOUNT BALANCES

- In respect of Mirror Account balances, the foreign currency amount in each of the Nostro **mirror (position transactions only) are revalued in rupee terms by applying the mirror revaluation rates as provided by FEDAI.**

- The difference between the actual rupee outstanding and the rupee equivalent after **revaluation is the profit/loss for that mirror account.**

- The revaluation report is generated on monthly basis for MIS only and **the profit/loss is not appropriated. The booking of profit/loss is done on half-yearly basis.**

FORWARDS VALUATION

All transactions listed in the table above other than mirror account balances, are to be valued at the rates provided by FEDAI for forward evaluation. **All outstanding forwards are revalued in rupee terms by applying these rates.**

The difference between the actual rupee outstanding and the rupee equivalent after **revaluation is the profit/loss for that particular transaction.**

The revaluation is carried out on monthly basis for MIS and the profit/loss is **appropriated on half-yearly basis only and reversed on the next working day after valuation date.**

EFFECTS OF REVALUATION

(a) Mirror (Pos) Balances/Forwards -

INR Equivalent Before Revaluation	INR Equivalent After Revaluation	Profit/Loss
Debit	(+)Increase	Profit
Debit	(-) Decrease	Loss
Credit	(+) Increase	Loss
Credit	(-) Decrease	Profit

(b) Accounting Entries for Mirror Balances

Profit

Debit: Nostro Mirror A/C

Credit: Exchange A/C (Mirror)

Loss

Debit: Exchange A/c (Mirror)

Credit: Nostro Mirror A/c

(c) Accounting Entries for Forwards

Profit

Debit: Profit and Loss A/c
Credit: Profit and Loss on Revaluation A/c
Loss
Debit: Profit and Loss on Revaluation A/C
Credit: Profit and Loss A/c

The above entries in **respect of forward valuation are reversed on the next working day after the valuation date.**

REGISTERED FOREIGN PORTFOLIO INVESTORS

In March, 2014, Reserve Bank of India reviewed the extant guidelines for Portfolio Investment Scheme for Foreign Institutional Investor (FII) and Qualified **Foreign Investor (QFI) and decided to put in place a framework for investments under a new scheme called 'Foreign Portfolio Investment' scheme.**

The salient features of the new scheme are:

- The portfolio investor registered in accordance with SEBI guidelines shall be called **'Registered Foreign Portfolio Investor (RFPI).**

  The existing portfolio investor class, namely, Foreign Institutional Investor (FII) and **Qualified Foreign Investor (QFI) registered with SEBI shall be subsumed under RFPI;**

- RFPI may purchase and sell shares and convertible debentures of Indian company through registered broker on recognised stock exchanges **in India as well as purchases shares and convertible**

debentures which are offered to public in terms of relevant SEBI guidelines/ regulations.

- RFPI may sell shares or convertible debentures so acquired:

- The individual and aggregate investment limits for the RFPIs shall be below 10% (per cent) or 24% (per cent) respectively of the total paid-up equity **capital or 10% (per cent) or 24% (per cent) respectively of the paid-up value of each series of convertible** debentures issued by an Indian company.

- RFPI shall be eligible to open a Special **Non -Resident Rupee (SNRR)** account and a foreign currency account with Authorised Dealer bank and to transfer sums from **foreign currency account to SNRR account at the prevailing market rate for making genuine investments in securities.**

- The Authorised Dealer **bank may transfer repatriable proceeds (after payment of applicable taxes) from SNRR account to foreign currency account;**

- RFPI shall be eligible to invest in **government securities and corporate debt subject to limits specified by the RBI and SEBI from time to time;**

- RFPI shall be permitted to trade in all exchange **traded derivative contracts on the stock exchanges in India subject to the position limits as specified by SEBI from time to time;**

- RFPI may offer cash or foreign sovereign securities with AAA rating or corporate bonds or domestic Government Securities, as collateral to the recognized Stock **Exchanges for their transactions in the cash as well as derivative segment of the market.**