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   REVIEW OF LITERATURE

   NEED/IMPORTANCE OF THE STUDY

   STATEMENT OF THE PROBLEM

   OBJECTIVES

   HYPOTHESES

   RESEARCH METHODOLOGY

   RESULTS & DISCUSSION

   FINDINGS

   RECOMMENDATIONS/SUGGESTIONS

   CONCLUSIONS

   SCOPE FOR FURTHER RESEARCH

   ACKNOWLEDGMENTS

   REFERENCES

   APPENDIX/ANNEXURE

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BOOKS

- Bowersox, Donald J., Closs, David J., (1996), "Logistical Management." Tata McGraw, Hill, New Delhi.
- Hunker, H.L. and A.J. Wright (1963), "Factors of Industrial Location in Ohio" Ohio State University, Nigeria.

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- Garg, Sambhav (2011): "Business Ethics" Paper presented at the Annual International Conference for the All India Management Association, New Delhi, India, 19–22 June.

UNPUBLISHED DISSERTATIONS AND THESES

- Kumar S. (2011): "Customer Value: A Comparative Study of Rural and Urban Customers," Thesis, KurukshetraUniversity, Kurukshetra.

ONLINE RESOURCES

- Always indicate the date that the source was accessed, as online resources are frequently updated or removed.

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- Garg, Bhavet (2011): Towards a New Natural Gas Policy, Political Weekly, Viewed on January 01, 2012 http://epw.in/user/viewabstract.jsp

TRADE FINANCE AND METHODS & CHARACTERISTICS OF INTERNATIONAL PAYMENTS FOR INDIAN EXPORTERS

RAJENDRA KUMAR JHA
CONSULTANT & HEAD FASHION DESIGNING & PLACEMENT
FOOTWEAR DESIGN & DEVELOPMENT INSTITUTE
CENTRE OF RETAIL MANAGEMENT & FASHION DESIGNING
ROHTAK

ABSTRACT
Trade Finance has been reviewing the global trade market since more than 2 decades now. The remit of what we cover is somewhat broad, and as the market evolves to meet the requirements of financing global trade, so our content has changed. There are various definitions to be found online as to what trade finance is. It is described both as a 'science' and as 'an imprecise term covering a number of different activities'. In one form it is quite a precise science managing the capital required for international trade to flow. Yet within this science there are a wide range of tools at the financiers' disposal, all of which determine how cash, credit, investments and other assets can be utilized for trade. In its simplest form, an exporter requires an importer to prepay for goods shipped. The importer naturally wants to reduce risk by asking the exporter to document that the goods have been shipped. The importer's bank assists by providing a letter of credit to the exporter (or the exporter's bank) providing for payment upon presentation of certain documents, such as a bill of lading. The exporter's bank may make a loan to the exporter on the basis of the export contract. This article is designed to help Indian companies, especially small and medium-sized enterprises (SMEs), learn the basic fundamentals of trade finance to turn their export opportunities into actual sales and to achieve the ultimate goal: to get paid for their export sales, especially on time.

KEYWORDS
Export, Import, International Payments, Letter of Credit, Trade Finance.

INTRODUCTION TO TRADE FINANCE
Limited access to financing, high costs, and lack of insurance or guarantees are likely to hinder the trade and export potential of an economy, and particularly that of small and medium sized enterprises that too in developing nations.

Trade Facilitation aims at reducing transaction cost and time by streamlining trade procedures and processes. One of the most important challenges for traders involved in a transaction is to secure financing so that the transaction may actually take place. The faster and easier the process of financing an international transaction, the more trade will be facilitated.

Traders require working capital (i.e., short-term financing) to support their trading activities.

Exporters will usually require financing to process or manufacture products for the export market before receiving payment. Such financing is known as pre-shipping finance. Conversely, importers will need a line of credit to buy goods overseas and sell them in the domestic market before paying for imports. In most cases, foreign buyers expect to pay only when goods arrive, or later still if possible, but certainly not in advance. They prefer an open account, or at least a delayed payment arrangement. Being able to offer attractive payments term to buyers is often crucial in getting a contract and requires access to financing for exporters.

Therefore, governments whose economic growth strategy involves trade development should provide assistance and support in terms of export financing and development of an efficient financial infrastructure. There are three main types of financial tools and packages designed to facilitate the financing of trade transactions.

• Trade Financing Instruments • Export Credit Insurances • Export Credit Guarantees

- **TRADE FINANCING INSTRUMENTS**

• **Documentary Credit:** This is the most common form of the commercial letter of credit. The issuing bank will make payment, either immediately or at a prescribed date, upon the presentation of stipulated documents. These documents will include shipping and insurance documents, and commercial invoices. The documentary credit arrangement offers an internationally used method of attaining a commercially acceptable undertaking by providing for payment to be made against presentation of documentation representing the goods, making possible the transfer of title to those goods. A letter of credit is a precise document whereby the importer's bank extends credit to the importer and assumes responsibility in paying the exporter.

A common problem faced in emerging economies is that many banks have inadequate capital and foreign exchange, making their ability to back the documentary credits questionable. Exporters may require guarantees from their own local banks as an additional source of security, but this may generate significant additional costs as the banks may be reluctant to assume the risks. Allowing internationally reputable banks to operate in the country and offer documentary credit is one way to effectively solve this problem.

• **Countertrade:** As mentioned above, most emerging economies face the problem of limited foreign exchange holdings. One way to overcome this constraint is to promote and encourage countertrade. Today's modern counter trade appears in so many forms that it is difficult to devise a definition. It generally encompasses the idea of subjecting the agreement to purchase goods or services to an undertaking by the supplier to take on a compensating obligation. The seller is required to accept goods or other instruments of trade in partial or whole payment for its products.

Some of the forms of counter trade include:

• Barter – This traditional type of countertrade involving the exchange of goods and services against other goods and services of equivalent value, with no monetary exchange between exporter and importer.

• Counter purchase – The exporter undertakes to buy goods from the importer or from a company nominated by the importer, or agrees to arrange for the purchase by a third party. The value of the counter purchased goods is an agreed percentage of the prices of the goods originally exported.

• Buy-back – The exporter of heavy equipment agrees to accept products manufactured by the importer of the equipment as payment.

• **Factoring:** This involves the sale at a discount of accounts receivable or other debt assets on a daily, weekly or monthly basis in exchange for immediate cash. The debt assets are sold by the exporter at a discount to a factoring house, which will assume all commercial and political risks of the account receivable. In the absence of private sector players, governments can facilitate the establishment of a state-owned factor; or a joint venture set-up with several banks and trading enterprises.

• **Pre-Shipping Financing:** This is financing for the period prior to the shipment of goods, to support pre-export activities like wages and overhead costs. It is especially needed when inputs for production must be imported. It also provides additional working capital for the exporter. Pre-shipment financing is especially important to smaller enterprises because the international sales cycle is usually longer than the domestic sales cycle. Pre-shipment financing can take in the form of short term loans, overdrafts and cash credits.

• **Post-Shipping Financing:** Financing for the period following shipment. The ability to be competitive often depends on the trader's credit term offered to buyers. Post-shipment financing ensures adequate liquidity until the purchaser receives the products and the exporter receives payment. Post-shipment financing is usually short-term.

• **Buyer's Credit:** A financial arrangement whereby a financial institution in the exporting country extends a loan directly or indirectly to a foreign buyer to finance the purchase of goods and services from the exporting country. This arrangement enables the buyer to make payments due to the supplier under the contract.

• **Supplier's Credit:** A financing arrangement under which an exporter extends credit to the buyer in the importing country to finance the buyer's purchases.

- **EXPORT CREDIT INSURANCE**

In addition to financing issues, traders are also subject to risks, which can be either commercial or political. Commercial risk arises from factors like the non-acceptance of goods by buyer, the failure of buyer to pay debt, and the failure of foreign banks to honor documentary credits. Political risk arises from factors like war, riots and civil commotion, blockage of foreign exchange transfers and currency devaluation. Export credit insurance involves insuring exporters against such risks. It is commonly used in Europe, and increasing in importance in the United States as well as in developing markets.

The type of export credit insurance used varies from country to country and depends on traders' perceived needs. The most commonly used are as follows:

• Short-term Export Credit Insurance – Covers periods not more than 180 days. Protection includes pre-shipment and post-shipment risks, the former covering the period between the awarding of contract until shipment. Protection can also be covered against commercial and political risks.

• Medium and Long-term Export Credit Insurance – Issued for credits extending longer periods, medium-term (up to three years) or longer. Protection provided for financing exports of capital goods and services.

• Investment Insurance – Insurance offered to exporters investing in foreign countries.

• Exchange Rate Insurance – Covers losses as a result of fluctuations in exchange rates between exporters' and importers' national currencies over a period of time.

The benefits of export credit insurance include:

• Ability of exporters to offer buyers competitive payment terms.
• Protection against risks and financial costs of non-payment.
• Access to working capital.
• Protection against losses from foreign exchange fluctuations.
• Reduction of need for tangible security when borrowing from banks.

Export credit insurance mitigates the financial impact of the risk. There are specialized financial institutions available that offer insurance cover, with premium dependent on the risk of the export markets and export products.

- **EXPORT CREDIT GUARANTEES**

Export credit guarantees are instruments to safeguard export-financing banks from losses that may occur from providing funds to exporters. While export credit insurance protects exporters, guarantees protect banks offering the loans. They do not involve the actual provision of funds, but the exporters' access to financing is facilitated.

An export credit guarantee is issued by a financial institution, or a government agency, set up to promote exports. Such guarantee allows exporters to secure pre-shipment financing or post-shipment financing from a banking institution more easily. Even in situations where trade financing is commercially available, companies without sufficient track records may not be looked upon favourably by banks. Therefore, the provision of financial guarantees to the banking system for purveying export credit is important elements in helping local companies go into exporting. The agency providing this service has to carefully assess the risk associated in supporting the exporter as well as the buyer.

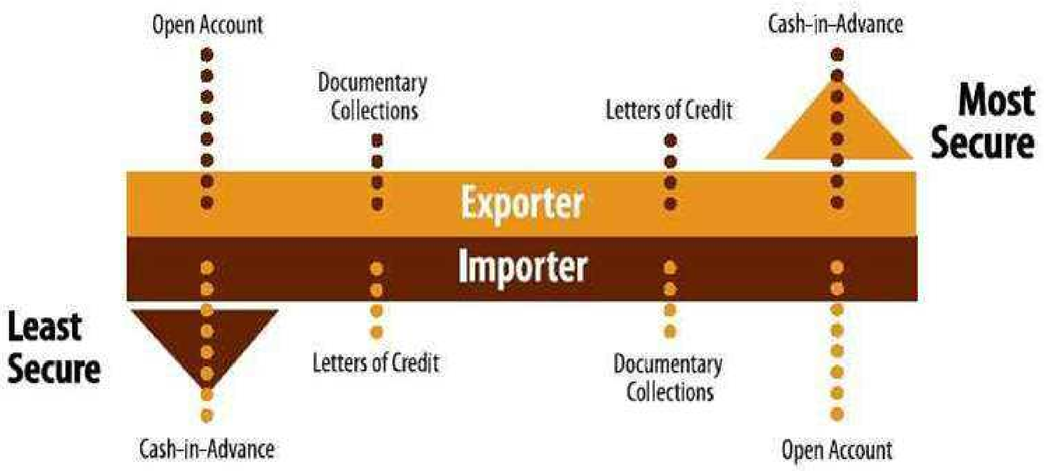
METHODS OF PAYMENT IN INTERNATIONAL TRADE

To succeed in today's global marketplace, exporters must offer their customers attractive sales terms supported by the appropriate payment method to win sales against foreign competitors. As getting paid in full and on time is the primary goal for each export sale, an appropriate payment method must be chosen carefully to minimize the payment risk while also accommodating the needs of the buyer. As shown below, there are four primary methods of payment for international transactions. During or before contract negotiations, it is advisable to consider which method in the diagram below is mutually desirable for a company and its customer.

KEY POINTS

- International trade presents a spectrum of risk, causing uncertainty over the timing of payments between the exporter (seller) and importer (foreign buyer).
- To exporters, any sale is a gift until payment is received. Therefore, the exporter wants payment as soon as possible, preferably as soon as an order is placed or before the goods are sent to the importer.
- To importers, any payment is a donation until the goods are received. Therefore, the importer wants to receive the goods as soon as possible, but to delay payment as long as possible, preferably until after the goods are resold to generate enough income to make payment to the exporter.

PAYMENT RISK DIAGRAM



CASH-IN-ADVANCE

With the cash-in-advance payment method, the exporter can avoid credit risk or the risk of nonpayment, since payment is received prior to the transfer of ownership of the goods. Wire transfers and credit cards are the most commonly used cash-in-advance options available to exporters. However, requiring payment in advance is the least attractive option for the buyer, as this method tends to create cash flow problems, and unless the seller sees no other option or the buyer has other vendors to choose from, it often is not a competitive option. In addition, foreign buyers are often concerned that the goods may not be sent if payment is made in advance. Exporters that insist on this method of payment as their sole method of doing business may find themselves losing out to competitors who may be willing to offer more attractive payment terms.

KEY POINTS

- Full or significant partial payment is required, usually via credit card or bank/wire transfer, prior to the transfer of ownership of the goods.
- Cash-in-advance, especially a wire transfer, is the most secure and favorable method of international trading for exporters and, consequently, the least secure and attractive option for importers. However, both the credit risk and the competitive landscape must be considered.
- Insisting on these terms ultimately could cause exporters to lose customers to competitors who are willing offer more favorable payment terms to foreign buyers in the global market.
- Creditworthy foreign buyers, who prefer greater security and better cash utilization, may find cash-in-advance terms unacceptable and may simply walk away from the deal.
- *Wire Transfer—Most Secure and Preferred Cash-in-Advance Method*

An international wire transfer is commonly used and has the advantage of being almost immediate. Exporters should provide clear routing instructions to the importer when using this method, including the name and address of the receiving bank, the bank's SWIFT, Telex and the seller's name and address, bank account title, and account number. This option is more costly to the importer than other options of cash-in-advance method, as the fee for an international wire transfer is usually paid by the sender.

Credit Card—A Viable Cash-in-Advance Method

Exporters who sell directly to the importer may select credit cards as a viable method of cash-in-advance payment, especially for consumer goods or small transactions. Exporters should check with their credit card company(s) for specific rules on international use of credit cards as the rules governing international credit card transactions differs from those for domestic use. As international credit card transactions are typically placed via online, telephone, or fax methods that facilitate fraudulent transactions, proper precautions should be taken to determine the validity of transactions before the goods are shipped. Although exporters must endure the fees charged by credit card companies, this option may help the business grow because of its convenience.

- *Payment by Cheque—A Less-Attractive Cash-in-Advance Method*

Advance payment using an international cheque may result in a lengthy collection delay of several weeks to months. Therefore, this method may defeat the original intention of receiving payment before shipment. If the cheque is in INR or drawn on an Indian bank, the collection process is the same as any Indian cheque. However, funds deposited by non-local cheque may not become available for withdrawal for up to 21 business days due to RBI Regulation. In addition, if the cheque is in a foreign currency or drawn on a foreign bank, the collection process is likely to become more complicated and can significantly delay the availability of funds. Moreover, there is always a risk that a cheque may be returned due to insufficient funds in the buyer's account.

WHEN TO USE CASH-IN-ADVANCE TERMS

- The importer is a new customer and/or has a less-established operating history.
- The importer's creditworthiness is doubtful, unsatisfactory, or unverifiable.
- The political and commercial risks of the importer's home country are very high.
- The exporter's product is unique, not available elsewhere, or in heavy demand.
- The exporter operates an Internet-based business where the use of convenient payment methods is a must to remain competitive.

Characteristics of a Cash-in-Advance Payment Method

Applicability

Recommended for use in high-risk trade relationships or export markets, and ideal for Internet-based businesses.

Risk

Exporter is exposed to virtually no risk as the burden of risk is placed nearly completely on The importer.

Pros

• Payment before shipment
• Eliminates risk of nonpayment

Cons

• May lose customers to competitors over payment terms
• No additional earnings through financing operations

LETTERS OF CREDIT

Letters of credit (LCs) are among the most secure instruments available to international traders. An LC is a commitment by a bank on behalf of the buyer that payment will be made to the beneficiary (exporter) provided that the terms and conditions have been met, as verified through the presentation of all required documents. The buyer pays its bank to render this service. An LC is useful when reliable credit information about a foreign buyer is difficult to obtain, but you are satisfied with the creditworthiness of your buyer's foreign bank. This method also protects the buyer, since no payment obligation arises until the documents proving that the goods have been shipped or delivered as promised are presented. However, since LCs have many opportunities for discrepancies, they should be prepared by well-trained documenters or the function may need to be outsourced. Discrepant documents can negate payment.

KEY POINTS

• An LC, also referred to as a documentary credit, is a contractual agreement whereby a bank in the buyer's country, known as the issuing bank, acting on behalf of its customer (the buyer or importer), authorizes a bank in the seller's country, known as the advising bank, to make payment to the beneficiary (the seller or exporter) against the receipt of stipulated documents.

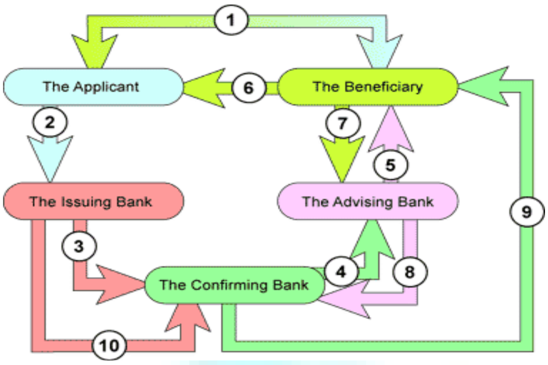
• The LC is a separate contract from the sales contract on which it is based and, therefore, the bank is not concerned whether each party fulfills the terms of the sales contract.

• The bank's obligation to pay is solely conditional upon the seller's compliance with the terms and conditions of the LC. In LC transactions, banks deal in documents only, not goods.

ILLUSTRATIVE LETTER OF CREDIT TRANSACTION

- The importer arranges for the issuing bank to open an LC in favor of the exporter.
- The issuing bank transmits the LC to the advising bank, which forwards it to the exporter.
- The exporter forwards the goods and documents to a freight forwarder.

- The freight forwarder dispatches the goods and submits documents to the advising bank.
- The advising bank checks documents for compliance with the LC and pays the exporter.
- The importer's account at the issuing bank is debited.
- The issuing bank releases documents to the importer to claim the goods from the carrier.



IRREVOCABLE LETTER OF CREDIT

LCs can be issued as revocable or irrevocable. Most LCs are irrevocable, which means they may not be changed or cancelled unless both the buyer and seller agree. If the LC does not mention whether it is revocable or irrevocable, it automatically defaults to irrevocable. Revocable LCs are occasionally used between parent companies and their subsidiaries conducting business across borders.

CONFIRMED LETTER OF CREDIT

A greater degree of protection is afforded to the exporter when a LC issued by a foreign bank (the importer's issuing bank) is confirmed by an Indian bank (the exporter's advising bank). This confirmation means that the Indian bank adds its guarantee to pay the exporter to that of the foreign bank. If an LC is not confirmed, the exporter is subject to the payment risk of the foreign bank and the political risk of the importing country. Exporters should consider confirming LCs if they are concerned about the credit standing of the foreign bank or when they are operating in a high-risk market, where political upheaval, economic collapse, devaluation or exchange controls could put the payment at risk.

SPECIAL LETTERS OF CREDIT

LCs can take many forms. When an LC is issued as transferable, the payment obligation under the original LC can be transferred to one or more "second beneficiaries." With a revolving LC, the issuing bank restores the credit to its original amount once it has been drawn down. Standby LCs can be used in lieu of security or cash deposits as a secondary payment mechanism.

TIPS FOR EXPORTERS

- Consult with your bank before the importer applies for an LC.
- Consider whether a confirmed LC is needed.
- Negotiate with the importer and agree upon detailed terms to be incorporated into the LC.
- Determine if all LC terms can be compiled within the prescribed time limits.
- Ensure that all the documents are consistent with the terms and conditions of the LC.
- Beware of many discrepancy opportunities that may cause nonpayment or delayed payment.

Characteristics of a Letter of Credit

Applicability

Recommended for use in new or less-established trade relationships when you are satisfied with the creditworthiness of the buyer's bank.

Risk

Risk is evenly spread between seller and buyer provided all terms and conditions are adhered to.

Pros

- Payment after shipment
- A variety of payment, financing and risk mitigation options

Cons

- Process is complex and labor intensive
- Relatively expensive in terms of transaction costs

DOCUMENTARY COLLECTIONS

A documentary collection (D/C) is a transaction whereby the exporter entrusts the collection of payment to the remitting bank (exporter's bank), which sends documents to a collecting bank (importer's bank), along with instructions for payment. Funds are received from the importer and remitted to the exporter through the banks involved in the collection in exchange for those documents. D/Cs involve the use of a draft that requires the importer to pay the face amount either on sight (document against payment—D/P) or on a specified date in the future (document against acceptance—D/A). The draft lists instructions that specify the documents required for the transfer of title to the goods. Although banks do act as facilitators for their clients under collections, documentary collections offer no verification process and limited recourse in the event of nonpayment. Drafts are generally less expensive than letters of credit (LCs).

KEY POINTS

- D/Cs are less complicated and less expensive than LCs.
- Under a D/C transaction, the importer is not obligated to pay for goods prior to shipment.
- The exporter retains title to the goods until the importer either pays the face amount on sight or accepts the draft to incur a legal obligation to pay at a specified later date.
- Banks that play essential roles in transactions utilizing D/Cs are the remitting bank (exporter's bank) and the collecting bank (importer's bank).
- While the banks control the flow of documents, they do not verify the documents nor take any risks, but can influence the mutually satisfactory settlement of a D/C transaction.

TYPICAL SIMPLIFIED D/C TRANSACTION FLOW

- The exporter ships the goods to the importer and receives in exchange the documents.
- The exporter presents the documents with instructions for obtaining payment to its bank.
- The exporter's remitting bank sends the documents to the importer's collecting bank.
- The collecting bank releases the documents to the importer upon receipt of payment.
- Or the collecting bank releases the documents on acceptance of draft from the importer.
- The importer then presents the documents to the carrier in exchange for the goods.
- Having received payment, the collecting bank forwards proceeds to the remitting bank.
- Once payment is received, the remitting bank credits the exporter's account.

DOCUMENTS AGAINST PAYMENT (D/P) COLLECTION

Under a D/P collection, the exporter ships the goods, and then gives the documents to his bank, which will forward them to the importer's collecting bank, along with instructions on how to collect the money from the importer. In this arrangement, the collecting bank releases the documents to the importer only on payment for the goods. Upon receipt of payment, the collecting bank transmits the funds to the remitting bank for payment to the exporter.

Time of Payment: After shipment, but before documents are released
Transfer of Goods: After payment is made on sight
Exporter Risk: If draft is unpaid, goods may need to be disposed

DOCUMENTS AGAINST ACCEPTANCE (D/A) COLLECTION

Under a D/A collection, the exporter extends credit to the importer by using a time draft. In this case, the documents are released to the importer to receive the goods upon acceptance of the time draft. By accepting the draft, the importer becomes legally obligated to pay at a future date. At maturity, the collecting bank contacts the importer for payment. Upon receipt of payment, the collecting bank transmits the funds to the remitting bank for payment to the exporter.

Time of Payment: On maturity of draft at a specified future date
Transfer of Goods: Before payment, but upon acceptance of draft
Exporter Risk: Has no control of goods and may not get paid at due date

WHEN TO USE DOCUMENTARY COLLECTIONS

Under D/C transactions, the exporter has little recourse against the importer in case of nonpayment. Thus, the D/C mechanism should only be used under the following conditions:

- The exporter and importer have a well-established relationship.
- The exporter is confident that the importing country is stable politically and economically.
- An open account sale is considered too risky, but an LC is also too expensive for the importer.

Characteristics of a documentary collection

Applicability

Recommended for use in established trade relationships and in stable export markets.

Risk

Exporter is exposed to more risk as D/C terms are more convenient and cheaper than an LC to the importer.

Pros

• Bank assistance in obtaining payment
• The process is simple, fast, and less costly than LCs

Cons

• Banks' role is limited and they do not guarantee payment
• Banks do not verify the accuracy of the documents

OPEN ACCOUNT

An open account transaction means that the goods are shipped and delivered before payment is due, usually in 30 to 90 days. Obviously, this is the most advantageous option to the importer in cash flow and cost terms, but it is consequently the highest risk option for an exporter. Because of the intense competition for export markets, foreign buyers often press exporters for open account terms. In addition, the extension of credit by the seller to the buyer is more common abroad. Therefore, exporters who are reluctant to extend credit may face the possibility of the loss of the sale to their competitors. However, while this method of payment will definitely enhance export competitiveness, exporters should thoroughly examine the political, economic, and commercial risks, as well as cultural influences to ensure that payment will be received in full and on time. It is possible to substantially mitigate the risk of nonpayment associated with open account trade by using such trade finance techniques as export credit insurance and factoring. Exporters may also wish to seek export working capital financing to ensure that they have access to financing for both the production for export and for any credit while waiting to be paid.

KEY POINTS

- The goods, along with all the necessary documents, are shipped directly to the importer who agrees to pay the exporter's invoice at a future date, usually in 30 to 90 days.
- Exporter should be absolutely confident that the importer will accept shipment and pay at agreed time and that the importing country is commercially and politically secure.
- Open account terms may help win customers in competitive markets, if used with one or more of the appropriate trade finance techniques that mitigate the risk of nonpayment.

HOW TO OFFER OPEN ACCOUNT TERMS IN COMPETITIVE MARKETS

Open account terms may be offered in competitive markets with the use of one or more of the following trade finance techniques: (1) Export Working Capital Financing, (2) Government-Guaranteed Export Working Capital Programs, (3) Export Credit Insurance, (4) Export Factoring, and (5) Forfeiting.

Characteristics of an Open Account

Applicability

Recommended for use (1) in secure trading relationships or markets or (2) in competitive markets to win customers with the use of one or more appropriate trade finance techniques.

Risk

Exporter faces significant risk as the buyer could default on payment obligation after shipment of the goods.

Pros

- Boost competitiveness in the global market
- Establish and maintain a successful trade relationship

Cons

- Exposed significantly to the risk of nonpayment
- Additional costs associated with risk mitigation measures

CONCLUSION

This Article can be used as a guide to explain the need for trade finance and introduced some of the most common trade finance tools and practices. Also it explained the details on various methods of international payments. However, the best long-term solution in resolving the constraints in trade financing is to encourage the growth and development of a vibrant and competitive financial system, comprising mainly private sector players. The role of the government and other parties involved in trade finance will need to evolve along with the country's economy. We also need to take care of various methods of payment while doing International Trade as this could be used as a backup for Trade Financing. Trade Financing options and International Payment Methods are complimentary to each other. This article can be useful as a Guide for Indian Exporters while Exporting & Importing.

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