



# A STUDY ON GARMENT EXPORTER'S VIEW ON LETTER OF CREDIT IN TIRUPUR CITY

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## Abstract

There are several uncertainties that arise when buyers and sellers across the globe engage in maritime trade operations. Some of these uncertainties revolve around delayed payments, slow deliveries, and financing-related issues, among others. The sheer distances involved in international trade, different laws and regulations, and changing political landscape are just some of the reasons for sellers needing a guarantee of payment when they deliver goods through the maritime route to their sellers. Letters of credit were introduced to address this by adding a third party like a financial institution into the transaction to mitigate credit risks for exporters. When possible, offering extended payment terms can be extremely attractive to new foreign buyers and may ultimately lead to winning more export sales. However, to offer this sought-after benefit, you must check the foreign buyer's credit which is not always easy to find. If you are unable to find reliable credit information, one trade finance tool available to the exporter is the Letter of Credit.

**Keywords:** Exporter, importer, trade, credit, goods, foreign, risks.

## Introduction

Letter of Credit has been a cornerstone of international trade dating back to the early 1900s. They continue to play a critical role in world trade today. For any company entering the international market, Letter of Credit is an important payment mechanism which helps eliminate certain risks. International trade between an Exporter and Importer would entail multiple transactions in terms of documentation exchange, physical

cargo movement as well as settlement of payment which have to be clearly defined and setup in order to ensure smooth business transaction. Normally when the Customer is new to the Exporter, the business transactions are done either based on advance payment or Letter of Credit option. L/C is one of the safest mechanisms available for an Exporter to ensure he gets his payment correctly and the importer is also assured of the Exporters adherence to his requirement in terms of quality, quantity, shipping instructions as well as documentation etc.

While dealing by an individual or entity in different countries, both seller and buyer do not have confidence on each other. Buyer would insist delivery of goods first and would like to pay after receipt of goods. But Seller on the other side would like to act on the contrary; he would like to receive funds first and then would like to send the goods. It provides guarantee to seller that in case the goods are shipped to the buyer, he would definitely get the value of goods. Similarly the buyer would be guaranteed that he would get the goods according to the worth of his money.

This bridge of confidence is built by at least two bankers, i.e. banker of seller and banker of buyer and this trust are managed by way of an instrument known as “Letter Of Credit”. And no doubt for providing such facility, both bankers earn by way of charges those are either borne by buyer, seller or both of them as agreed mutually between buyer and seller. A letter of Credit is the Buyer’s Banker’s promise to the Bank of the Seller / Exporter that the bank will honour the Invoice presented by the Exporter on due date and make payment, provided that the Seller/Exporter has complied with all the requirements and conditions set by the Importer mentioned in letter of credit or the Buyer’s Purchase Order and produced documentary evidence to prove compliance, along with the necessary shipment related documentation.

Letter of credit is sometimes known as ‘documentary credit’. This can offer a guarantee to the seller that they will be paid, and the buyer can be sure that no payment will be made until they receive the goods. The main advantage of using a letter of credit is that it can give security to both the seller and the buyer.

## Statement of the problem

Tirupur is a Dollar city which makes several international transactions. In international trade letter of credit plays an important role since the importer and exporter is unknown. It is necessary to know the behavior of exporters with regard to letter of credit. Hence this study aims to identify the exporters’ view on letter of credit.

## Objective of the study

- ❖ To study the garment exporter’s view on letter of credit.
- ❖ To know the importance of the letter of credit used in export and import trade.

## Scope of the study

International trade refers to export and import of goods and services in exchange of foreign currency. Payments for exports are open risk faced by the exporter due to changes in political and economic policies. This risk can be overcome by the documentary credit. Among other methods of payment, letter of credit is mostly preferred by the exporter, since it is the most secured instrument available and it is less risky. The present study reveals to avoid the payment problem and to know the different types of L/C and the things under to bank for presentation.

## Review of literature

**Ward and harfield** said that the L/C constitutes a contract between the issuing bank as promisor and the seller as promise, supported by consideration moving from the buyer in the form of an “indemnity” agreement to reimburse the issuer for drafts accepted or paid under the credit and to pay the issuer a commission for his services.

**Ex- imp times** this article stated that the bank has rejected 50% of letter of credit transactions of seller's documents because of the trivial variations between the terms of the credit and documents. It suggested that the exporters must learn to check the documents before submission. Another problem mentioned was to anticipate some aspects of the transactions. Thus, the article indicated to avoid these problems by understanding of the different types of commercial documents and the things under to bank for presentation.

**Ex – imp times** this article indicated that the final payment was to be made against one or more certain specified documents like draft, invoice and acceptance test certificate. These credits often allowed for payment against fewer documents being presented once a certain date or period of time has passed. It described that if a document which was not stated in the credit has not able to present by the defined date, the payment was not affected. It stated that a claim presented after such a date may be considered to be discrepant.

**Ex – imp times** The article declared that the documentary credit had been developed as a compromise between the sellers' need for the security of ownership of the goods and speed of payment and the buyers' need for speed of transit but the longest period of payment. It stated that a major UK bank estimated that it rejected had been 62% of first presentations and 40% of attempted to replace discrepant documents. The documents presented under the credit can be 100% in accordance with the terms stated there in and 99.9% was not good enough.

## Tools used for analysis

### Ranking Method

Exporters' views are differing from one another. So the researcher has applied weighted score analysis for measuring the level of satisfaction. Here weights "score" given by individual respondents.

1<sup>st</sup> rank – 4<sup>th</sup> scores

2<sup>nd</sup> rank – 3<sup>rd</sup> scores

3<sup>rd</sup> rank – 2<sup>nd</sup> scores

4<sup>th</sup> rank – 1<sup>st</sup> scores

### Chi-Square Test

Chi-square test enables the researcher to find out whether the divergence between expected and actual frequencies is significant or not.

$$\text{Chi-square test} = \sum (\text{O}_{ij} - \text{E}_{ij})^2 / \text{E}_{ij}$$

### Limitations of the study

- The numbers of respondents are limited.
- The busy schedule of the exporters also makes the collection of information a difficult one.
- Time available for the study is not sufficient and it permits to collect data for a short period.
- The study is limited with Tirupur city.

**ANALYSIS AND INTERPRETATION****REASON FOR PREFERRING LETTER OF CREDIT- RANK**

S. No	REASON FOR PREFERRING L/C	I	II	III	IV	WEIGHTED SCORE	RANK
1	Minimize risk	148	75	40	18	281	IV
2	International trade	320	30	12	4	366	II
3	Availing bank finance	360	9	12	1	382	I
4	Secure form of payment	228	75	30	3	336	III

**SATISFACTION OF L/C TRANSACTION**

S. No	SUGGESTION	SA	A	M	DA	SDA	TOTAL POINTS	MEAN VALUE
1	You are satisfied with L/C	200	180	30	10	0	420	4.20
2	You are satisfied with the mode of payment.	75	244	60	4	2	387	3.87
3	In case of dishonor of L/C, you get assistance.	105	112	123	14	3	357	3.57
4	You receive the same amount mentioned in the L/C.	70	92	78	60	7	307	3.07
5	The document is properly signed with L/C.	95	112	117	28	0	352	3.52
6	There is an incorrect mention of quantity & price level of goods in L/C at times.	40	36	45	114	11	246	2.46
7	The L/C gets cancelled because of commercial and political reasons.	0	0	45	140	15	200	2.00

**Mean value: 3.2**



## INTERPRETATION

The above table reveals that the respondents are strongly agreed with the satisfaction of L/C transaction with the mean value of 4.2 respectively.

The respondents had the opinion on satisfaction of L/C such as satisfied with mode of payment with the mean value of 3.87 respectively.

The respondents had a neutral satisfied with L/C such as dishonor of L/C, receive the same amount mentioned in L/C and document is properly signed with L/C with the mean value 3.57, 3.07 and 3.52 respectively.

The respondents had dissatisfied with the L/C on such factors, there is an incorrect mention of quantity & price level of goods in L/C at times and the L/C get cancelled because of commercial and political reasons with the mean value of 2.46 and 2 respectively.

### ACCEPTABILITY REGARDING L/C TRANSACTION

S. No	SUGGESTION	HA	A	M	NA	HNA	TOTAL POINTS	MEAN VALUE
1	Bank may scrutinize the documents properly to avoid the discrepancies.	295	88	39	12	0	434	4.34
2	The charges are high in LC	95	152	87	20	4	358	3.58
3	Banks may lead to their customer in a better way to minimize the risk.	75	82	147	18	6	330	3.30
4	Bank may pay more attention in electronic bank.	50	100	195	0	0	345	3.45
5	Reduce the lengthy and over procedure in letter of credit.	185	80	54	6	2	407	4.07

**Mean value: 3.7**

## INTERPRETATION

The above table reveals that the respondents are highly agree with the acceptability regarding L/C transaction such as bank may scrutinize the documents properly to avoid the discrepancies with the mean value of 4.34 respectively.

The respondents had the opinion on acceptability regarding L/C transaction such as the charges are high, banks may lead to their customer in a better way to minimize the risk, bank may pay more attention in electronic bank and reduce the lengthy and over procedure in letter of credit with the mean value of 3.58, 3.30, 3.45 and 4.07 respectively.

## FINDINGS

- The respondents are strongly agreed with the satisfaction of L/C transaction with the mean value of 4.2 respectively.
- The respondents are highly agree with the acceptability regarding L/C transaction such as bank may scrutinize the documents properly to avoid the discrepancies with the mean value of 4.34 respectively
- There is a significant association between year of experience and person responsible for preparing L/C.
- There is a significant association between educational qualification and problems of invalid L/C.
- There is no significant association between annual turnover and L/C transaction problem.
- There is no significant association between age and type of L/C.
- There is no significant association between nature of concern and days to receive L/C amount.

## SUGGESTIONS

- ❖ Bank may scrutinize the documents properly to avoid the discrepancy made in letter of credit.
- ❖ The banks may reduce the charges of L/C, since it is high.
- ❖ Banks may lead to their customer (importer or exporter) in a better way to minimize the risk.
- ❖ The method of payment which is through letter of credit is lengthy and time consuming one. So RBI may take an initiative to overcome this problem.
- ❖ There is no prescribed format for letter of credit by RBI. So RBI may provide a common prescribed format of letter of credit and pay more attention in electronic bank service to their users.

## CONCLUSION

Letter of credit is very important instrument in the field of national and international trade. They provide security for the Importer, which he can ensure to get the goods and for the exporter, which he can ensure, he sends the goods and for the importer. Letter of credit also makes the transactions very smoothly. It gives the mechanism stability; especially from the Importer and the Exporter's perspective. For instance, there is little or no previous trading relationship among the parties; the letter of credit provides them to work with confidence and security. The exporters also concentrate more on that. Hence letter of credit plays an important role for international trade.

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