



**ST. MARY'S UNIVERSITY
SCHOOL OF GRADUATE STUDIES**

**INTERNATIONAL TRADE FINANCE PRACTICES OF SELECTED
PRIVATE COMMERCIAL BANKS IN ETHIOPIA**

BY

HADDIS SAID

ID NO. SGS/0123/2006

**APRIL, 2015
ADDIS ABABA, ETHIOPIA**

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ABSTRACT

International trade exposes the trading partners to various difficulties and risks due to the physical distance between parties, different time zones and currencies, different legal rules applicable to the transaction as well as the fact that the parties may not generally know each other. Banks facilitate international commerce through a variety of products which include managing their international payments, mitigating the risks, and providing working capital. The research, a descriptive study using the survey method, makes an assessment of the trade service practices of selected Ethiopian private commercial banks in order to identify problems, expose any malpractices, indicate instances of non-compliance with international standard banking practices, shed light on risk areas, and identify knowledge gaps among the bank staff. From the research it has been found out that, most of the banks do not automatically effect payment to the remitting bank after releasing the shipping documents sent on documentary collection basis. Secondly, banks are having difficulty managing the level of approved purchase orders due to the fact that outstanding purchase orders are not considered as liabilities of banks under the Open Position directive of the National Bank of Ethiopia. On the other hand, most banks are not examining documents and notifying negotiating banks of discrepancies related to documents presented under letters of credits within the allowed period of five banking days. In addition, it can be concluded that most banks do not make a rigorous assessment of the creditworthiness of the importer and the marketability of the consignment when issuing letters of credit against a less-than 100% margin. In the study, it is recommended that banks should encourage importers to enter into a formal sales contract with sellers. Secondly, the National Bank of Ethiopia should revise its Open Position directive in such a way that banks would be allowed to account for at least 50-60% of their outstanding approved purchase orders as liabilities. Thirdly, banks should properly manage their commitments in foreign exchange so that they will not face liquidity problems when processing settlement of letters of credit and documentary collections.

CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

International trade is the cross-frontier exchange of both merchandise and services between a seller and an overseas buyer. It involves flow of goods from seller to buyer in accordance with the contract of sale and the subsequent flow of payment from buyer to seller.

According to Mueller(2013) international sales transactions expose the parties to various difficulties and risks due to the physical distance between parties, different time zones, and different legal rules applicable to transactions as well as the fact that usually the parties do not know each other.

Banks play a crucial role in facilitating international trade by providing a wide range of trade service products like letter of credits, documentary collections, consignment, advance payment, supplier's credit to name a few. (Niepmann, 2014)

In fact, these days, one cannot think of doing import and export business without the involvement of banks. Bank-intermediated international trade finance (or trade finance, in short) plays two vital roles: providing working capital needed for international trade transactions, and providing the means to diminish payment risk. (Committee on the Global Financial System, 2014)

International and local banks support international trade through a variety of products that help their customers manage their international payments and mitigate the associated risks, and provide the needed working capital. The term "trade finance" generally denotes

bank products which are specifically related to underlying international trade transactions. (Committee on the Global Financial System, 2014)

Ethiopian commercial banks, too, have long been actively taking part in the international trade of the country by way of the trade service products that they offer. Such services are usually rendered for lucrative fees in the form of service charges and commissions which might be as high as 5% of the transaction amount. As a result, the income generation of international banking services accounts for 28 to 47% of the total income for the majority of the banks as shown under Table 1.

Table 1: Data on Annual income from International Banking Activities

	Birr in Mill	% of Total Income	Year	Birr in Mill	% of Total Income	Year
DASHEN BANK	605.7	47.20%	2009/2010	714.6	41.30%	2010/2011
NIB INT BANK	255.5	30%	2012/2013	299.2	28.70%	2013/2014
OROMIA INT BANK	91.1	39%	2011/2012	113.3	34.00%	2012/2013

Source: Annual reports of respective banks for respective years

However, trade service products like the letters of credit may expose banks and the trade partners to some risks and challenges.

Indeed, Moses(2005) argues that though letters of credit are widely used payment methods, there is an irony in their use since in the majority of the cases the bank is relieved of its obligation to honor drafts due to discrepancies. The seller's documents have to strictly comply with the terms and condition of the letter of credit in order for the seller to get payment.

In a similar manner, Folsom et al. (2005) explains that the buyer who has arranged the issuance of a letter of credit has at least four different categories of potential problems. First, there is the possibility that the buyer's bank will pay when the documents are not those specified by the letter of credit. Second, there is the possibility that the buyer's bank may refuse to pay when the documents do conform to the letter of credit. Third, and more likely than either of the above, is that the parties may get into an argument about whether the documents do conform or not. Finally, the buyer's bank may learn that the seller has breached the sales contract by shipping non-conforming goods before it pays against the documents.

Documentary collection, on the other hand, carries the risk that the buyer will not or cannot pay for the goods upon receipt of the draft and documents. If this occurs it is the burden of the seller to locate a new buyer or pay for return shipment. (Giovannucci, 1996)

Thus, there is a need for a research on the trade service practice of Ethiopian commercial banks for the benefits of the banks and Ethiopian businessmen engaged in import and export as well.

1.2 STATEMENT OF THE PROBLEM

As noted by Niepmann(2014), international trade exposes exporters and importers to substantial risks, especially when the trading partner is far away or in a country where contracts are very difficult to enforce. Nonetheless, firms can mitigate these risks through specialized trade finance products offered by financial intermediaries.

Trade service products like the letter of credit have long been practiced by Ethiopian commercial banks and the income generated from these products by way of service

charges, commissions and other incomes account for a significant portion of their total incomes.

Nevertheless, trade service products like the letters of credit may pose some risks and challenges to banks and the trade partners as well.

For instance, according to Folsom et al. (2005) some surveys indicate that approximately fifty percent of the documents presented under the documentary credit are rejected because of discrepancies or apparent discrepancies. This diminishes the effectiveness of the letter of credit and can have a financial impact on those involved in the process. It may also increase the costs and reduce the profit margins of importers, exporters and banks. The marked increase in litigation involving documentary credits has also been of great concern.

In addition, an issuing bank which has learned that the merchandise tendered is not in truth the merchandise which the documents describe, is still obliged to make payment to the delinquent seller under the letter of credit irrespective of its knowledge. This is because the obligation of the issuing bank to honor drafts and documents presented under a documentary credit which appear on their face to be in accordance with the terms and conditions is independent of the performance of the underlying contract for which the credit was issued. (Folsom et al. 2005)

Under the cash-in-advance method of payment, the importer pre-finances the transaction and the exporter receives the payment before incurring the production costs. This exposes the buyer to a risk, because the seller may fail to deliver the goods after receiving payment. (Niepmann, 2014)

On the other hand, under the consignment method of payment, the exporter is not protected against loss that could arise if the agent or consignee fails to repatriate the proceeds to the exporter from the sale of goods. (Cherunilam, 2006)

Thus, businessmen engaged in international trade and banking professionals working in trade finance areas must be aware of the advantages and disadvantages of each method of payment and find way of mitigating the associated risks before actually engaging in the transactions.

The principal concern of this study is, therefore, to assess the trade service practice of Ethiopian commercial banks in light of the international and local standard banking practices in order to shed light on risk areas, identify operational problems, and expose any malpractices and areas on non-compliance with the standards.

RESEARCH QUESTIONS

The problem statement discussed above led to the following research questions:

- ✚ What are the major operational problems encountered by Ethiopian private commercial banks in the course of rendering trade service products?
- ✚ What types of malpractices are observed in these banks with respect to trade services?
- ✚ Are there instances of noncompliance with international and domestic standards and directives?
- ✚ What are the risk areas with respect to trade service products like documentary credits, documentary collections, advance payments and others?
- ✚ To what extent are bank employees familiar with international trade payment mechanisms, UCP, URC, ISBP, and the directives of the National Bank of Ethiopia?

1.3 OBJECTIVE OF THE STUDY

1.3.1 GENERAL OBJECTIVES OF THE STUDY

The overall objective of the study was to make a critical assessment of the trade service practices of selected Ethiopian private commercial banks in order to identify problems, uncover any possible malpractices, find out possible instances of non-compliance with international and local standard banking practices, shed light on risk areas, and identify familiarity and information gaps among the bank staff with regards trade payment mechanism.

1.3.2 SPECIFIC OBJECTIVES OF THE STUDY

The specific objectives of the study were:

- ✚ To assess the existing trade service practice of selected private commercial banks in order to expose major operational problems encountered by the banks.
- ✚ To identify any malpractices related to trade service operations.
- ✚ To find out instances of noncompliance with international and domestic standards and directives.
- ✚ To study major risk areas with respect to trade service products like letters of credit, documentary collections, advance payment and consignment.
- ✚ To investigate existing familiarity and information gaps among the bank staff with regards trade payment mechanism.

1.4 SIGNIFICANCE OF THE STUDY

Trade services have become one of the most important products that private commercial banks offer owing to the significant amount of revenue derived from these products and the attraction of customers and depositors looking for these services.

The outcome of this research paper has a close relevance to the day-to-day trade service practice of banks and helps improve such practices. The practical significance of the research outcome is also high in terms of inducing banks to revise their working procedures. More importantly, the research attempts to fill some of the familiarity and information gaps among the practitioners.

1.5 SCOPE OF THE STUDY

The scope of the research is limited to trade service practices (i.e. those related to import and export transactions) of selected private commercial banks without including other international banking services.

1.6 DEFINITION OF TERMS

- Letter of credit: Credit means any arrangement, however named or described, that is irrevocable and thereby constitutes a definite undertaking of the issuing bank to honor a complying presentation. (ICC, 2007)
- Documentary Collection: The handling by banks of draft and documents in accordance with the instructions of the principal in order to obtain payment or acceptance from drawee. (ICC, 1996)
- Trade Finance: bank products which are specially tailored to facilitate international trade transactions i.e. exports and imports. (Committee on the Global Financial System, 2014)

- Bill of lading: A bill of lading is a transport document issued by a carrier as a receipt for the goods. Bill of lading, like bills of exchange, may be made out to any bearer, or to a particular person or his order. The attribute of the bill of lading as a document of title is in fact what makes the consignment negotiable as well. (Folsom et al., 2005)
- UCP 600: The Uniform Customs and Practice for Documentary Credits, 2007 Revision, ICC Publication no. 600 (UCP) are rules that apply to any documentary credit when the text of the credit expressly indicates that it is subject to these rules. (International Chamber of Commerce, 2007)
- URC 522: The URC 522 are the Uniform Rules for Collections. URC 522 came into effect on 01 January 1996. The URC 522 were first published by the ICC in 1956. Revised versions were issued in 1967 and 1978. (International Chamber of Commerce, 1996)
- URR 525: The Uniform Rules for Bank-to-Bank Reimbursements under Documentary Credits (URR 525) come into effect on the 1st of July 1996. The seventeen articles of the URR525 deal with the situation covered by Article 19 of the UCP 500, where banks (an issuing bank, a claiming bank and a reimbursing bank) are involved. (Zsuzsanna, 2006)

1.7 LIMITATION OF THE STUDY

The major limitation of this study was that banks' practices with regards foreign bank guarantee could not be investigated as the transaction is not frequently practiced by private banks; rather, such foreign guarantees usually involve a local government body and an overseas vendor- a transaction usually handled by Commercial Bank of Ethiopia.

1.8 ORGANIZATION OF THE RESEARCH REPORT

The research report comprises of five chapters, which are explained as below.

The first chapter of the report discusses the background of the study, statement of the problem, basic research questions, objectives of the study, hypothesis, definition of terms, and significance of the study. Subsequently, the second chapter presents a vast review of literature relevant to the study.

The third chapter explains the type and design of the research; the participants in the study, the sources of data, the data collection tools, the procedure for data collection and the methods of data analysis used.

The fourth chapter of the report summarizes the results or findings of the study, and provides interpretation of the findings. In the end, the fifth chapter presents summary of findings, conclusions, limitations of the study and recommendations.

CHAPTER TWO

REVIEW OF THE RELATED LITERATURE

2.1 THEORETICAL FRAMEWORK

Early theories of international trade hold that countries trade for the same reason individuals trade. Countries, like individuals, are not equally capable of producing every good or service they want and need to consume. All countries, like individuals, can benefit if each country specializes in producing those goods it can produce best and satisfy their other wants and needs by trading for them. Specialization and trade makes total world output of goods and services larger than it would be without trade. (Sawyer and Sprinkle, 2005)

Adam Smith, a classical economist, was a leading advocate of free trade on the grounds that it promoted the international division of labor. With free trade, nations could concentrate their production on goods they could make most cheaply, with all the consequent benefits of the division of labor. According to Smith's principle of absolute advantage, each nation benefits by specializing in the productions of the good that it produces at a lower cost than the other nation, while importing the good that it produces at a higher cost. (Carbaugh, 2004)

Expanding upon Adam Smith's work based on absolute advantage, David Ricardo formulated the theory of comparative advantage, that is, a country's ability to produce a good at a lower opportunity cost than another country. (Sawyer and Sprinkle, 2005)

Later, John Stuart Mill was able to formulate the theory of reciprocal demand which suggests that the actual price at which trade takes place depends on the trading partner's interacting demands.(Carbaugh, 2004)

Modern trade theory contends that the pattern of world trade is governed by international differences in supply conditions and demand conditions. (Carbaugh, 2004)

International trade brings about difficulties and risks due to the physical distance between parties, different time zones and currencies, the need for additional conciliators, the relevance of multiple jurisdictional transactions and the possibility of different legal rules applicable to the transaction as well as the fact that the parties do not generally know each other. (RLF, 2009)

In the case of open account method of payment, the exporter ships the consignment to the buyer and the latter makes payment only after receiving the goods; thus, the exporter pre-finances the transaction. On the other hand, the importer effects payment in advance of shipment of the goods by the exporter in the case of cash-in-advance payment method. In both cases, however, banks are usually involved by providing working capital finance to the exporter in the first case and to the importer in the second.(Niepmann, 2014)

According to Heffernan(2005), banks distinguish themselves from other types of financial firms mainly by the provision of deposits and loan products. Banks must manage these deposits, which are liabilities for them, in order to maximize profit. Thus, banks' core activity is to act as financial intermediaries between savers and borrowers.

Banks play a major role in all the economic and financial activities in modern society. They are playing key role in activities financing the industries. All trade and commerce would slow down badly if banks are not there to handle their financial transactions. The economic development of a modern society depends on industrial growth and modernization of agriculture. Banks promote both these activities; they mobilize small deposits from the public and provide financial resource to big industries. Indeed, banks perform the major task of capital formation. (Buckova, 2005)

Banks also conduct other types of services like the trade finance which facilitate international trade. Niepmann & Eisenlohr (2014) explain that when exporters and importers engage in an international trade, they have to agree and decide on who finances the transaction and who bears which risk; and banks come in to the picture by way of providing finance and mitigating the risk involved.

2.2 TRADE FINANCE

According to Committee on the Global Financial System (2014), banks facilitate international commerce through a variety of products which include managing their international payments, mitigating the risks, and providing working capital. Indeed, the term “trade finance” is used to signify bank products which are specially tailored to expedite international trade transactions i.e. exports and imports.

When exporters and importers engage in a trade, they have to agree on who finances the transaction and who bears the risks. Banks help both with financing and with mitigating the risk. (Niepmann & Eisenlohr, 2014)

Likewise, Cherunilam (2006) emphasizes that the international market is characterized by stiff competition and sensitivity; and thus, the credit facilities that banks deliver to the buyers are among the most important factors for the success of export business.

Further, Niepmann & Eisenlohr(2014)demonstrate that international trade exposes both buyers and sellers to considerable risks, since the trading partner resides in a foreign land and enforcing of contracts is very difficult. Trade finance products are designed and offered by banks with the aim of mitigating such risk associated with international trade.

Bank-intermediated trade finance performs two vital roles; providing working capital tied to and in support of international trade transactions and providing the means to reduce payment risk. The principal alternative to bank-intermediated products is the inter-firm

trade credit. Firm's ability to directly extend credit is supported by possibilities to discount their receivables and the availability of financing not directly tied to trade transactions, as well as possibilities to diminish payment risk by purchasing trade credit insurance. Banks also help meet working capital needs of buyers and sellers by providing trade finance loans linked either to a letter of credit or other forms of documentation related to the underlying transaction.(Committee on the Global Financial System, 2014)

Cherunilam(2006) also argues that even if an exporter gets payment at the time of shipment of goods, he has to make arrangements with a bank to meet his financial needs at the pre-shipment stage. And, if the sale is on credit, the seller will still be more constrained financially. Thus, it is very important to make institutional credit available to exporters to meet their pre-shipment and post-shipment financial needs. Such credit facilities not only help exporters meet their pre-shipment working capital needs but also enable them extend credit facilities to their foreign trade partners.

Similarly, Niepmann(2014) argues that trade finance can constrain exports, especially to the poorer countries during crisis times. Owing to the reductions in the supply of letters of credit associated with a contraction in bank lending, the lack of trade finance can explain the collapse in exports to the smaller and poorer countries in 2008/2009.

2.2.1 PRE-SHIPMENT AND POST-SHIPMENT FINANCE

In order to meet expenditures on the purchase of materials and components, processing, packaging, packing, marking, transactions, warehousing, etc, according to Cherunilam (2006), the exporter has to arrange for a pre-shipment finance from banks. As the name implies, pre-shipment finance refers to the credit extended to the exporter prior to the shipment of goods.

In many cases, Cherunilam (2006) explains, it takes the exporter a period of time—short, medium or long—even after effecting shipment of goods to get the export proceeds. As a result, the exporter seeks post-shipment finance, for the period from the shipment of the goods until payment is received from the overseas trade partner.

Post-shipment advances are granted by banks mainly by negotiating shipping documents under a letter of credit, by purchasing documents against payments, and by lending against export bills sent for collection abroad. Post-shipment advances are normally settled against the export proceeds of the related export bills or the remittances received from abroad. Due to the competitiveness of the export business, exporters, most often, are expected to extend some kind of credit to their overseas buyers. This burden of credit must be shifted from exporters to the financial institutions by extending credit to the exporters to enable them extend credit to their buyers. (Cherunilam, 2006)

Under the supplier's credit, the exporter extends credit to the buyer. However, the exporter obtains payment directly from the banks upon presentation of the shipping documents. Such supplier's credit is usually granted for the purchase of capital goods. On the other hand, under the line of credit scheme, banks in the exporter's country extend credit to banks in the buyers' country which in turn extend the credit to a number of buyers. The banks in the buyers' country are the ones responsible for determining the creditworthiness of each buyer. (Cherunilam, 2006)

2.2.2. TRADE SERVICE PRODUCTS

The credit needs of the exporter depend to a very large extent on the type of sales terms. The sales contract must clearly specify the terms and conditions of the payment. The five most common trade payment methods are discussed below.

2.2.2.1 CASH IN ADVANCE

The most beneficial payment terms for the seller, according to Cherunilam (2006) is when payment is received in advance of the shipment of goods, i.e. the cash-in-advance payment term. It is not common for an importer to be willing to make advance payments. However when the consignment is to be manufactured to the order of and according to the specifications outlined by the importer, advance payment is usually required by the seller.

By the same token, under the cash-in-advance terms, the importer is actually pre-financing the transaction and the exporter receives the payment before incurring the production costs. This exposes the buyer to a risk, because the seller may fail to deliver the goods after receiving payment. (Niepmann, 2014)

The other case which gives rise to advance payment, according to Cherunilam (2006) is when the seller has a monopolistic position in the market. Here the buyer's bargaining power is lesser and as a result he has to make payment in advance of the shipment of the goods by the seller.

2.2.2.2 OPEN ACCOUNT

In contrast to the cash-in-advance method, the supplier first ships the goods and then the buyer effects payment under the open account method of payment. Since the exporter incurs production and distribution costs before receiving the payment, he is actually pre-financing the transaction. The risk to the exporter materializes when the importer fails to make payment for the goods after receiving them. (Niepmann, 2014)

In a similar manner, Cherunilam (2006) also demonstrates that under the open account scheme, the exporter delivers the goods with no financial documents to his advantage except the commercial invoice. Thus, the seller carries the entire financial burden with no

documentary evidence. Since high risk is associated with the open account method, it is usually exercised between affiliated companies or when the buyer and seller have had a long standing business relationship.

2.2.2.3 CONSIGNMENT SALE

Under the consignment method of payment, the seller delivers the goods to his agent in the foreign land, who arranges for the sale of the goods and remits the payment to the supplier. Title to the goods remains with the exporter until the goods is sold to the ultimate buyer.

Under this method, the exporter is not protected against loss that could arise if the agent or consignee fails to repatriate the proceeds to the exporter from the sale of goods. (Cherunilam, 2006)

2.2.2.4 DOCUMENTARY COLLECTION (D/C)

Niepmann(2014) discusses that in a documentary collection method of payment, banks handle shipping documents based on the instructions of the seller. In this method of payment the buyer can get hold of the documents only after effecting payment for the document value without which he cannot receive the goods from the customs; thus a documentary collection provides better reliability of payment as compared to an open account basis.

Under this scheme, the importer benefits from not having to pay for the goods in advance, while the exporter can essentially withhold the relevant documents that allow the importer to take possession of the shipped goods until payment has been made. A documentary collection is a transaction whereby the exporter entrust the collection of payment to the remitting bank which in turn sends documents to a collecting bank along with the 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. The banks' liability is limited to the forwarding and release of documents against payment and acceptance or promise of payment by the importer. (Committee on the Global Financial System, 2014)

Even with a DC arrangement, however, Niepmann (2014) explain that the buyer may still refuse to take up the documents and the exporter may be at risk.

Documentary collection carries the risk that the buyer will not or cannot pay for the goods upon receipt of the draft and documents. If this occurs it is the burden of the seller to locate a new buyer or pay for return shipment. (Giovannucci, 1996)

Documentary collections are of two types: documents against payment and documents against acceptance. Under the document against payment terms, also known as cash against documents the seller effects shipment of goods to the overseas buyer, but the shipping documents are handled through the banking channel and delivered to the buyer only against payment. (Niepmann, 2014)

In a similar manner, Cherunilam (2006) explains that under this method of payment, title to the goods remains with the seller until such time that the buyer pays for the value of the goods.

Documentary collections are governed by the URC 522. The URC 522 are the Uniform Rules for Collections. URC 522 came into effect on 01 January 1996. The URC 522 were first published by the ICC in 1956. Revised versions were issued in 1967 and 1978. (International Chamber of Commerce, 1996)

The Uniform Rules for Collections, 1996 Revision, ICC Publication No. 522, shall apply to all collections, where such rules are incorporated into the text of the collections instruction and are binding on all parties thereto unless otherwise expressly agreed or

contrary to the provisions of a national, state or local law and/or regulation which cannot be departed from. (International Chamber of Commerce, 1996)

The URC 522 defines collection as:

“Collection means the handling by banks of documents in accordance with instructions received, in order to:

1. Obtain payment and or acceptance,
2. Deliver documents against payment and/or against acceptance,
3. Deliver documents on other terms and conditions.” (International Chamber of Commerce, 1996, p. 5)

The URC 522 distinguishes between two types of documents:

Financial documents means bills of exchange, promissory notes, cheques, or other similar instrument used for obtaining the payment of money. Commercial documents means invoices, transport documents, documents of title or other similar documents, or any other documents whatsoever, not being financial documents. Clean collection means collection of financial documents not accompanied by commercial documents. Documentary collection means collection of:

1. Financial documents accompanied by commercial documents;
2. Commercial documents not accompanied by financial documents. (International Chamber of Commerce, 1996, p. 6)

In addition, Article 3 of the URC 522 further identified parties to a collection:

1. The principal who is the party entrusting the handling of a collection to a bank;
2. The remitting bank which is the bank to which the principal has entrusted the handling of the collection;
3. The collecting bank which is any bank, other than the remitting bank, involved in processing the collection
4. The presenting bank which is the collecting bank making presentation to the drawee;
5. The drawee is the one to whom presentation is to be made in accordance with the collection instruction. (International Chamber of Commerce, 1996, p. 8)

2.2.2.5 DOCUMENTARY LETTERS OF CREDIT (L/C)

DEFINITION OF AN L/C

Cherunilam (2006) states that a letter of credit is an instrument containing the undertaking of a bank to honor on it a draft drawn by a seller or beneficiary, under certain terms and conditions and up to a fixed amount.

A documentary letter of credit ensures that the exporter will be definitely paid for the value of goods shipped, provided that he fulfills the terms and conditions of the credit. In addition, under this payment method, the exporter can obtain payment from a bank at his own locality by presenting the shipping documents to the bank immediately after the shipment of goods. Thus, the letter of credit covers the major part of the export and import business in the world.

The letter of credit is a tripartite transaction. The buyer is the customer of the issuing bank at whose request the credit is issued. The beneficiary, on the other hand, is the seller of the goods to the buyer who receives the benefit of that credit. The letter of credit substitutes the bank's credit for that of the buyer. These transactions are considered to be three separate contract transactions. (Alphonse, 2010)

One significant reason for the popularity of commercial credits is the ability to substitute the established and reliable credit rating of one or more banks for the often unknown credit rating of the buyer. (Lipton, 1998)

Even more, the letter of credit allows the buyer and seller to contract a trusted intermediary (a bank) that will guarantee full payment to the seller provided that he has shipped the goods and complied with the terms of the agreed-upon letter. The L/C serves to evenly distribute risk between buyer and seller since the seller is assured of payment when the conditions of the L/C are met and the buyer is reasonably assured of receiving the goods ordered. (Giovannucci, 1996)

Thus, use of documentary credits keeps commercial activity flowing efficiently without the need for lengthy gaps between shipment of goods and payment, and the possible consequential need for provisional finance for the seller. (Lipton, 1998)

TYPE AND CLASSIFICATION OF L/C

Letters of credit are classified in many ways and into many different types. However, in a general sense they fall into two main categories, namely the commercial letter of credit, which is a payment mechanism and a standby letter of credit which is basically a guarantee. Despite the similar nature of commercial and standby letter of credit, there are major differences between the two as regards the commercial purpose, the honoring of the credit and the risk involved. The risk of fraudulent calls is much higher in standby

letter of credit transaction than in a commercial letter of credit. That is because in a commercial letter of credit, the beneficiary must provide a whole set of documents, which in general produced and issued by third parties, unlike a standby letter of credit where in general the beneficiary produces the documents. (Mueller, 2013)

The standby credit may be paid against a written demand as the stipulated document or against a written demand as the stipulated document or against a demand with some other documents specified, such as a certificate from a third party that there has been non-performance under the underlying contract. (Lipton, 1998)

Even though the irrevocable letter of credit is used most frequently in international trade, letters of credit may also be revocable allowing the exporter to obtain payment unless previously revoked by the importer. Documentary credits may be drawn at sight or at a fixed maturity date. Most letters of credit allow the beneficiary to transfer its rights to another (Folsom et al., 2005)

A confirmed L/C is one when a banker other than the issuing bank, adds its own confirmation to the credit. In case of confirmed L/C, the beneficiary's bank would submit the documents to the confirming banker. (ICSI, 1999)

In a back to back credit, the exporter (the beneficiary) requests his banker to issue an L/C in favor of his supplier to procure raw materials, goods on the basis of the export L/C received by him.(ICSI, 1999)

While an L/C is not a negotiable instrument, the bills of exchange drawn under it are negotiable. A transferable credit is one in which a beneficiary can transfer his rights to third parties.(ICSI, 1999)

In a Red Clause & Green Clause L/C a special clause allows the beneficiary to avail of a pre-shipment advance (a type of export finance granted to an exporter, prior to the export

of goods). In case of Green Clause credit, the exporter is entitled for an advance for storage (warehouse) facilities of goods. The advance would be granted only when the goods to be shipped have been warehoused, and against an undertaking by the exporter that the transportation documents would be delivered by an agreed date.(ICSI, 1999)

Revolving credit, on the other hand, is a type of credit used commonly where the buyer is a regular customer of the seller. It is a credit for a certain sum at any one time outstanding, which is automatically renewed by putting on at the bottom what you have taken off at the top. Therefore it is automatic in its operation and does not need any renewal. (Mallaya, 2007)

PRINCIPLES OF LETTER OF CREDIT

The fundamental principle of letters of credit, also known as the autonomy principle, is that the responsibility of the opening bank to pay against drafts drawn under a credit accompanied by documents which conform to the conditions of the credit is independent of performance of any party under the underlying contract. (Folsomet al., 2005)

The key element of any letter of credit, regardless of the set of rules applicable, and the reason for its widely spread use is the autonomy of the bank's obligation from the underlying contract and other related contracts. (Mueller, 2013)

The principle of strict compliance is contained in Articles 7,8, and 15 of UCP 600 and accords with the autonomy principle. It provides that the beneficiary must conform with documentary requirements specified in the letter of credit. The autonomy principle takes a significant role within a letter of credit. The justification behind it is to obtain a particular warranty that the issuing bank's undertaking will not in any way be influenced by or interfered with any irregularity with regard to the underlying contract. (Mueller, 2013)

Whilst the autonomy principle gives advantage to the beneficiary (“pay first, argue later”) the strict compliance doctrine benefits the applicant in so far as he will have to reimburse the issuing bank only against presentation of a complying set of documents. (Mueller, 2013)

ISSUING BANK’S OBLIGATION UNDER AN L/C

The issuing bank’s main obligations are to issue the letter of credit at the request of the applicant, to make the credit available to the beneficiary, via an advising bank; to examine the presented documents; to either accept or reject the documents; to honor or dishonor the credit and to reimburse the negotiating bank that has honored a complying presentation. (Mueller, 2013)

According to the Uniform Customs and Practice for Documentary Credits, 2007 Revision, as long as the stipulated documents are presented to the issuing bank and as long as they conform to the terms and conditions of the letter of credit, the issuing bank must effect payment to the presenter.

Once the letter of credit is issued by the issuing bank, the bank’s liability is absolute given that the seller performs as required by the terms of the letter of credit. (Alphonse, 2010)

PARTIES TO A LETTER OF CREDIT

There are four parties to a letter of credit: namely the beneficiary, applicant, the issuing bank and the advising bank. The beneficiary under a letter of credit is the exporter of the goods in whose favor the letter of credit is issued. The applicant, on the other hand, is the party who intends to import the goods and instructs the bank to establish the letter of credit. (Jain, 2012)

The applicant is the party on whose request the credit is issued. He is obliged to lodge security as demanded by the issuing bank and to reimburse and pay the issuing bank fees for payments made under the letter of credit. (Mueller, 2013)

The bank in the importer's country that issues the letter of credit at the request of the importer is termed as the issuing bank. While, the bank in the exporter's country who is authorized by the issuing bank to advise the letter of credit to the beneficiary is referred to as the advising bank. (Jain, 2012)

A confirming bank is usually the bank in the exporter's country, who adds confirmation to the letter of credit at the request of the beneficiary, so that the latter gets payment without recourse from the confirming bank. (Alphonse, 2010)

FOUR AUTONOMOUS CONTRACTS PERTAINING TO AN L/C

The letter of credit consists of at least three different autonomous contracts. First, the underlying sale contract under which the seller agrees to sell the goods to the buyer and the buyer agrees to pay the seller the purchase price. Secondly, a contract between the buyer and the issuing bank under which the issuing bank agrees to issue the letter of credit for the benefit of the seller and the buyer agrees to reimburse the bank for the payment made under the letter of credit and commissions. Thirdly, the issuing bank's undertaking towards the seller under which the issuing bank undertakes to honor the beneficiary's drafts provided it is accompanied by a complying set of documents. (Mueller, 2013)

In addition there is a contract between the issuing bank and a confirming bank authorizing the latter to make payments on presentation of documents by the seller and to remit the documents to the issuing bank on reimbursement for amounts paid out by the confirming bank. A confirming bank will often be used in situations in which there is no

accessible branch of the issuing bank available to deal in credits in the jurisdiction in which the seller is physically situated. (Lipton, 1998)

THE MECHANISM OF L/C

Because banks effectively screen out buyers who are not dependable or creditworthy, most buyers who are letter of credit applicants are trustworthy companies which want to do business, and are not going to object to minor discrepancies in a seller's documents. By waiving discrepancies, they permit the letter of credit to be honored. (Moses, 2005)

The seller's control of the bill of lading works to create an incentive for letters of credit to be paid even in the absence of a duty to pay. Sellers who use letters of credit should understand that if they do not control the goods by maintaining control of the bill of lading, they face the possibility that the letter of credit will not protect them from the risk of non-payment. A buyer who gains possession of the goods, and then learn that there are discrepancies in the documents, can take advantage of the seller simply by delaying any waiver of discrepancies or by trying to negotiate a lower price. (Moses, 2005)

AMENDMENT TO AN L/C

A change made to a letter of credit after it has been issued is called an amendment. For the seller to change the terms of an irrevocable letter of credit, it must request an amendment from the buyer. The amendment process is as follows:

1. The seller requests a modification or amendment of questionable terms in the letter of credit;
2. If the buyer and issuing bank agree to the changes, the issuing bank will change the letter of credit;
3. The buyer's issuing bank notifies the seller's advising bank of the amendment;
and

4. The seller's advising bank notifies the seller of the amendment. (Vaidya, 1990)

UCP 600

The UCP 600 states that an issuing bank is irrevocably bound by an amendment as of the time it issues the amendment. A confirming bank may extend its confirmation to an amendment and will be irrevocably bound as of the time it advises the amendment. (International Chamber of Commerce, 2007)

The Uniform Customs and Practice for Documentary Credits, 2007 Revision, ICC Publication no. 600 (UCP) are rules that apply to any documentary credit when the text of the credit expressly indicates that it is subject to these rules. (International Chamber of Commerce, 2007)

The UCP 600 defines a complying presentation as:

Complying presentation means a presentation that is in accordance with the terms and conditions of the credit, the applicable provisions of these rules and international standard banking practice. (International Chamber of Commerce, 2007, p.11)

Article 2 of the UCP600 provides a definition of a letter of credit as:

Credit means any arrangement, however named or described, that is irrevocable and thereby constitutes a definite undertaking of the issuing bank to honor a complying presentation. Honor means:

- a) To pay at sight if the credit is available by sight payment
- b) To incur a deferred payment undertaking and pay at maturity if the credit is available by deferred payment.

- c) To accept a bill of exchange drawn by the beneficiary and pay at maturity if the credit is available by acceptance. (International Chamber of Commerce, 2007, p. 7)

ISBP 2006

In 1996 the US Council on International Banking published a paper titled “Standard Banking Practice for the Examination of Letters of Credit Documents” which provided a checklist for banks on what must be considered when inspecting the documents. The goal was to try to reduce the number of presentations rejected by the banks by providing a standard for documentary checkers. The International Standard Banking Practice for the Examination of Documents under Documentary Letters of Credit, commonly called ISBP, was approved by the Commission at its meeting in Rome in October 2002. (Zsuzsanna, 2006)

Article 1 of the ISBP states that:

The terms of a credit are independent of the underlying transaction even if a credit expressly refers to that transaction. To avoid unnecessary costs, delays, and disputes in the examination of documents, however, the applicant and beneficiary should carefully consider which documents should be required, by whom they should be produced and the time frame for presentation. (International Chamber of Commerce, 2006, p.5)

With regards the commercial invoice Article 58 of the ISBP holds that:

The description of the goods, services or performance in the invoice must correspond with the description in the credit. There is no requirement for a

mirror image. The description must reflect what has actually been shipped or provided. (International Chamber of Commerce, 2006, p.9)

URR 525

The Uniform Rules for Bank-to-Bank Reimbursements under Documentary Credits (URR 525) come into effect on the 1st of July 1996. The seventeen articles of the URR525 deal with the state of affairs covered by Article 19 of the UCP 500, where banks (an issuing bank, a claiming bank and a reimbursing bank) are involved. It does not alter the provisions of the UCP but sets out a detailed code for the reimbursing process. (Zsuzsanna , 2006)

The URR defines reimbursement authorization as:

Reimbursement authorization means an instruction or authorization, independent of the credit, issued by an issuing bank to a reimbursing bank to reimburse a claiming bank or if so requested by the issuing bank, to accept and pay a time draft drawn on the reimbursing bank. (International Chamber of Commerce, 1996, p.2)

2.2.2.6 GUARANTEE

Jain(2012) defines guarantee as a contract between the issuing bank and a named beneficiary in whose favor the guarantee has been furnished; and it is an act of trust to facilitate the smooth flow of trade and commerce in both domestic and international trade. Although the initiation of a bank guarantee begins with the primary or underlying contract between the parties, it is nevertheless, independent and autonomous.

In a bank guarantee, the issuing bank binds itself to pay unconditionally to the beneficiary upon receipt of first claim. A letter of credit ensures that a transaction proceeds as planned; bank guarantee, on the other hand, are meant to reduce the loss if the transaction fails to go as planned. A guarantee is a responsibility of a bank to answer for the debt, default or non-performance of its client. (Jain, 2012)

A bank guarantee can be used in relation to an open account transaction under which goods are delivered to the buyer before receipt of payment by the exporter in order to warrant against default by the buyer. In a similar way, the bank guarantees the buyer when he has made an advance payment to an exporter prior to the shipment of goods. Under a bank guarantee, the bank or the guarantor is secondarily obligated to the obligee should the primary obligor or the applicant fail in his obligation to perform. (Jain, 2012)

2.3 MOST COMMON SHIPPING DOCUMENTS IN INTERNATIONAL TRADE

International trade transactions, especially those involving documentary collection and letters of credit, usually call for presentation of the four most common shipping documents which are discussed briefly as below.

2.3.1 COMMERCIAL INVOICE

A commercial document that itemizes a transaction between a buyer and a seller. An invoice will usually include the quantity of purchase, price of goods and/or services, date, parties involved, unique invoice number, and tax information. If goods or services were purchased on credit, the invoice will usually specify the terms of the deal, and provide information on the available methods of payment. (Alphonse, 2010)

Article 18 of the UCP 600 states that a commercial invoice must appear to have been issued by the beneficiary; must be made out in the name of the applicant; must be made out in the same currency as the credit and; need not be signed.

2.3.2 PACKING LIST

A credit requirement for a “Packing List” , which is a detailed list of items shipped, may be met by a document containing packing details whether titled “Packing Note”, “Packing and Weight List”, etc., or an untitled document. However, the content of a packing list or any document must appear to fulfill the purpose of the required document. (International Chamber of Commerce, 2006)

2.3.3. CERTIFICATE OF ORIGIN

A document declaring in which country a commodity or good was manufactured. The certificate of origin contains information regarding the product's destination and country of export and is required by many treaty agreements before being accepted into another nation. (Folsomet al., 2005)

A certificate of origin must be signed, dated and certify the origin of the goods. A certificate of origin should be issued by the party specified in the letter of credit. If a credit does not state party who issues the certificate, then a document issued by any party, including the beneficiary or the exporter himself, is accepted. (International Chamber of Commerce, 2006)

2.3.4 BILL OF LADING

A bill of lading is a transport document issued by a carrier as a receipt for the goods. Bill of lading, like bills of exchange, may be made out to any bearer, or to a particular person

or his order. If made out to bearer, they can be transferred by delivery; while if made out to order, they can be transferred by endorsement and delivery of the bill of lading. In practice, however, bill of lading made out to bearer is seldom used, as the bill of lading serves as a document of title. The feature of the bill of lading as a document of title is in fact what makes the consignment negotiable as well. (Folsom et al., 2005)

In addition, the bill of lading retains its attribute of document of title until such time that the contract of carriage by sea is completed by delivery of the goods against the bill. If the carrier, however, delivers the consignment to a person who is not, actually, the holder of the bill of lading, the carrier bears the responsibility. (Folsomet al., 2005)

The negotiability quality of the order bill of lading implies that it functions as a document of title. The goods are merged with the document, and the legitimate holder of the bill of lading has title to the goods. The exporter thus, can retain control of the goods in transit by requiring the payment of the price of the goods before the bill of lading is delivered to the importer. An intermediary bank, usually referred to as the negotiating bank, that advances funds to the exporter, is protected by becoming a consignee or retaining ownership of the bill of lading. If the shipping company delivers the consignment without taking up or cancelling the bill of lading, it remains legally responsible to any party who has purchased the bill. (Folsomet al., 2005)

2.3.5 AIRWAY BILL

A document that accompanies goods shipped by an international courier to provide detailed information about the shipment and allow it to be tracked. The air waybill has multiple copies so that each party involved in the shipment can document it. (Giovannucci, 1996)

2.4 EMPIRICAL STUDIES ON LETTERS OF CREDIT

Jain(2012) observes that a bank is absolutely bound to effect payment under a letter of credit even if it is informed that the merchandise shipped is not of the quality contract for. Disputes as to the quality of the goods may arise and be litigated later between buyer and seller; but the issuing bank remains obligated to honor drafts drawn by the seller in conformity with the terms and conditions of the letter of credit. A documentary credit has an immediate legal effect. In contrast to a guaranty, which undertakes to answer for the debt, default or nonperformance of another, the issuing bank under a letter of credit is primarily liable upon it.

Though letters of credit are a widely used trade payment method, and considered to be a secure payment device, however Moses (2005) argues that there is an irony in the use of letters of credit, although they serve as effective payment mechanisms most of the time, in the majority of the cases the bank refuses to honor drafts due to discrepancies. The slightest discrepancy would relieve the issuing or confirming bank of its obligations to honor draft and documents.

Hashim(2000)argues that the principle of strict compliance is aimed at protecting the importer who has neither the opportunity to check the physical goods nor to supervise the process of loading the goods in the exporter's country due to the geographical distance. Hence, the documents are the only security available to the importer. The shipping documents evidence that the goods have been delivered in accordance with the terms and conditions in the sale contract.

Moses (2005)on the other hand discusses that banks only deal with documents, not with goods, and have no obligation to investigate or determine if the underlying transaction has actually occurred. Instead the bank's obligation is limited to determining whether the required documents have been presented in proper form.

In an empirical study of the letters of credit in 500 transactions, it is found that documents presented did not conform to the letter of credit requirements 73 percent of the time. It is also discovered that in almost every case, buyer promptly waived the discrepancies, thereby permitting payment under the letter of credit to occur. Since seller's right to be paid vanishes if the discrepancies cannot be cured, in the majority of documentary presentations, payment by the bank will occur if buyer decides to waive the defects in the seller's presentations. (Moses, 2005)

2.5 SUMMARY OF LITERATURE REVIEW

International trade exposes the trading partners to various difficulties and risks due to the physical distance between parties, different time zones and currencies, different legal rules applicable to the transaction as well as the fact that the parties may not generally know each other.

Banks facilitate international trade through a variety of trade service products like the letter of credit which are used to effect international payments and mitigate the risks, and also by providing the necessary working capital in the form of pre-shipment and post-shipment finance.

While cash-in-advance method of payment is the riskiest method from the buyer's point of view, open-account method, to the contrary, is the most disadvantageous from the seller's perspective. On the other hand, the letter of credit protects the interest of the seller through the principle of autonomy and the interest of the buyer through the principle of strict compliance.

CHAPTER THREE

RESEARCH DESIGN AND METHODOLOGY

This section of the research paper presents the methodology that was employed by the researcher to conduct the study, to select the sample, to collect and analyze data used to assess the trade service practices of selected commercial banks in the country.

3.1 RESEARCH DESIGN

According to Creswell(2009) research design are plans and the procedures for research that span the decision from broad assumptions to detailed methods of data collection and analysis. The selection of the research design is based on the nature of the research problem or issue being addressed, the researcher's personal experience and the audiences of the study.

A research design is simply the framework for the study. Based on the research techniques or methods, research designs are classified as exploratory, descriptive and causal. Research design stands for advance planning of the methods to be adopted for collecting the relevant data, the techniques to be used in their analysis, keeping in view the objective of the research and availability of resources like time and money. (Kothari, 2007)

In line with the objective of the research, which is to make an assessment of the existing trade service practice of commercial banks, the author employed a descriptive type of study. According to Kothari (2007) the major purpose of descriptive research is description of the state of affairs as it exists at present; the main characteristic of this method is that the researcher has no control over the variables; he can only report what

has happened or what is happening. In a similar way, Creswell(2009) defines a descriptive study as a technique of gathering information about the existing condition.

3.2 RESEARCH METHOD

The survey method is considered as the most appropriate research strategy for any descriptive study. As noted by Kothari (2007), surveys are concerned with describing, recording, analyzing and interpreting conditions that either exist or existed; surveys are only concerned with conditions or relationships that exist, opinions that are held, processes that are going on.

Accordingly, the survey method has been employed in the study which comprises of questionnaires and interviews.

3.3 POPULATION AND SAMPLING TECHNIQUES

The researcher employed purposive sampling method while conducting the study. Purposive sampling, also known as judgmental, selective or subjective sampling, is a type of non-probability sampling technique. Non-probability sampling focuses on sampling techniques where the units that are investigated are based on the judgment of the researcher. The main goal of purposive sampling is to focus on particular characteristics of a population that are of interest, which will best enable the researcher to answer his or her research questions. (Kothari, 2007)

The study was conducted on seven selected private commercial banks in the country namely, Dashen Bank, Awash International Bank, Wegagen Bank, United Bank, NIB Bank, Oromia International Bank and Abay Bank. The sample was selected based on purposive sampling.

Semi-structured questionnaires were distributed to a sample consisting of 2 division managers, 3 senior international banking officers, and 5 international banking officers from each of the 7 selected banks. Consequently, the total sample comprises of 70 international banking professionals with varying levels of experience and responsibility.

Moreover, semi-structured interviews were conducted, through telephone and in person, with 5 international banking division managers from 5 of the 7 selected banks. The results of the interview helped the researcher to verify and supplement the data obtained from the questionnaires.

3.4 TYPES OF DATA AND INSTRUMENTS OF DATA COLLECTION

The researcher used primary source of data to undertake the study which were collected through semi-structured questionnaires and interviews.

Questionnaires and interviews were used to collect primary source of data which include both qualitative and quantitative data.

3.5 METHODS OF DATA ANALYSIS

The researcher used descriptive statistics for data analysis. Thus, the questionnaires that were answered and retrieved were coded, analyzed and presented with the help of frequency tables.

To this end, the researcher employed the SPSS software (Version 20) in processing and analyzing the data.

3.6 ETHICAL CONSIDERATIONS

The researcher sought the necessary permission from the respective banks for this study and specifically for the questionnaires that were distributed to the selected employees.

Participants were also made aware that no information would be made public, and that the study was for academic purpose only.

CHAPTER FOUR

DATA PRESENTATION, ANALYSIS AND INTERPRETATION

This chapter, which comprises of 10 sections, is meant for presenting, analyzing and interpreting the data and findings of the study. The first section presents and describes the respondents' demographic characteristics while the rest sections are devoted to the presentation, analysis, and interpretation of the data gathered through questionnaire and interview.

Semi-structured questionnaires were distributed to 10 international banking professionals from each of the 7 selected private banks out of which 65 could have been dully filled out and returned implying a response rate of 92.8% as depicted on Table 4.1 below.

Table 4.1: Number of Questionnaires Distributed and Returned

Designation	Number of questionnaires distributed	Number of questionnaires returned	Approximate Percentage (%)
Division Managers	14	14	100%
Senior International Banking Officers	21	20	95.2%
International Banking Officers	35	31	88.6%
Total	70	65	92.8%

Source: Own survey (2015)

In addition, semi-structured interviews were conducted with 5 international banking division managers and the results have been consolidated with the data obtained from the questionnaires and presented in detail.

4.1 RESPONDENT'S DEMOGRAPHIC CHARACTERISTICS

The data was solicited from banking professionals with diverse demographic characteristics. The first part of the questionnaire consists of demographic information of the participants. The variables include: sex, educational background, working experience and office positions which are summarized and presented as below.

Table 4.2: General Information about Respondents

	Frequency	Percentage
1. Educational Background		
• Diploma		
• 1 st Degree	50	77%
• Masters and above	15	23%
Total	65	100%
2. Working Experience		
• 1-5 Years	5	8%
• 5-10 Years	12	18%
• More than 10 Years	48	74%
Total	65	100%
3. Position		
• Managerial	14	22%
• Professional	51	78%
• Clerical		
Total	65	100%

Source: Own survey (2015)

As depicted on Table 4.1, out of the 65 respondents, the majority (77%) had attained 1st degrees while the balance (23%) had earned Master's degree. Looking into their working experience, 74% of the respondents had service years of more than 10 years, while 18% of them had working experience of 5 to 10 years. Only 8% of respondents had service years of less than 5 years.

In terms of their positions, 22% had managerial positions, namely division managers, in their respective banks, while the remaining 78% were still professional staff comprising of senior and intermediate international banking officers.

4.2 GENERAL TRADE SERVICE ISSUES

According to Committee on the Global Financial System (2014), banks facilitate international commerce through a variety of products which include managing their international payments, mitigating the risks, and providing working capital. Indeed, the term “trade finance” is used to signify bank products which are specially tailored to expedite international trade transactions i.e. exports and imports.

Under Part II, Section 1 of the questionnaires, issues related to general trade service practices were raised and the responses are summarized as follows.

Table 4.3: General Trade Service Issues

Where: 1. All the time 2. Most of the time 3. Sometimes 4. Never

N= number of respondents, %=approximate percentage

Issues	1		2		3		4		Total
	N	%	N	%	N	%	N	%	
Requesting buyer to sign a sales contract	5	8%	5	8%	40	62%	15	23%	65
Advising customers on the risk and benefits	4	6%	3	5%	46	71%	12	18%	65
Checking the delinquent list	45	69%	10	15%	5	8%	5	8%	65
Creating awareness about obligation towards NBE	6	9%	54	83%	3	5%	2	3%	65
Items imported/exported consistent with license	8	12%	44	68%	7	11%	6	9%	65
Consignments in final documents correspond to PO	41	63%	13	20%	8	12%	3	5%	65

Source: Own survey (2015)

On the question of whether they request the buyer to sign a sales contract with the seller before proceeding with any method of payment, the majority (62%) responded that they seldom do so while 23% admitted that they never did.

Similarly, interview responses also show that banks do not usually request the importer to sign a sale contract with the overseas trade partners.

Respondents were also asked whether or not they advise their customers on the risk and benefits of the intended trade payment methods before proceeding with the transactions. Surprisingly, 71% of the respondents replied that only in few occasions they would do so while an additional 18% responded that they never do so. Results of the interview made with division managers also confirmed that bankers give such an advice only at the demand of the customer.

With regard to checking the delinquent status of the customer, most of the respondents replied that they check the status. Similarly, the majority (83%) confirmed that they create awareness among the importing customers of the obligation to submit proof of entry of goods into the country to the National Bank of Ethiopia.

On the other hand, 68% and 12% of the respondents responded positively to the question whether they check that the items to be imported or exported are consistent with those listed at the back of the trade license. However, during the interview, respondents pointed out that the classification of import items set out by the Ministry of Trade is vague and lacks clarity in most of the cases. Thus, bankers are in a difficult situation as to decide whether or not the item to be imported really falls under the category of goods indicated on the back of the trade license.

In a similar manner, most of the respondents (an aggregate of 83%) reported that they, all or most of the time, check that the consignment covered by the final documents are in line with those stipulated in the import permit (for L/C) or the purchase order for (CAD).

Table 4.4:The degree of bank employees’ familiarity with the mechanism of trade service

Issues	Sufficient		Moderate		Poor		Total
	N	%	N	%	N	%	
The degree of bank employees’ familiarity with the mechanism of trade service	5	8%	47	72%	13	20%	65

Source: Own survey (2015)

The respondents were asked to assess the degree of bank employees’ familiarity with the mechanism of trade service, Uniform Rules for Collection, Uniform Customs Practice for Documentary Credits and the directive of the National Bank of Ethiopia. Surprisingly, the majority (72%) testified that, on average, the level of familiarity is only moderate.

High staff turnover among the experienced professionals was cited, during the interview, as one of the reasons for the lack of international banking staff with sufficient job knowledge. The interviewees further indicated that training is not sufficiently provided to the international banking staff periodically.

4.3 IMPORT LETTERS OF CREDIT

A documentary letter of credit ensures that the exporter will be definitely paid for the value of goods shipped, provided that he fulfills the terms and conditions of the credit. In addition, under this payment method, the exporter can obtain payment from a bank at his own locality by presenting the shipping documents to the bank immediately after the

shipment of goods. Thus, the letter of credit covers the major part of the export and import business in the world. (Cherunilam, 2006)

Under this category, a series of questions were posed to respondents with the goal of assessing the letter of credit practices of the banks.

Table 4.5:Issues related to import letters of credit practices

Where: 1. All the time 2. Most of the time 3. Sometimes 4. Never

N= number of respondents, %=approximate percentage

Issues	1		2		3		4		Total
	N	%	N	%	N	%	N	%	
Assessing the creditworthiness of importer before issuing L/C	3	5%	15	23%	43	66%	4	6%	65
Assessing the marketability of the consignment when granting margin	2	3%	12	18%	36	55%	15	23%	65
Ascertaining that the pro-forma is a recent one	46	71%	10	15%	7	11%	2	3%	65
Ascertaining that pro-forma indicates 2 nd advising bank	20	31%	37	57%	5	8%	3	5%	65
Assisting the applicant in filling out the L/C application himself/herself	48	74%	12	18%	2	3%	3	5%	65
Restricting negotiation to a nominated bank	2	3%	5	8%	40	62%	16	25%	65
Making a timely examination of documents	17	26%	9	14%	35	54%	4	6%	65
Sending cancellation of reimbursement authorization for unutilized portion of L/C	5	8%	4	6%	34	52%	22	34%	65

Source: Own survey (2015)

One of the questions posed to the respondents was on whether or not the concerned department of the bank makes an assessment of the creditworthiness of the importer before issuing a letter of credit. 66% of the respondents reported that such an assessment is only made sometimes while 6% reported that no such assessment is ever made. Similarly, 55% of the respondents reported that rarely does the concerned department make an assessment of the marketability of consignment when granting margin facility, while still another 23% replied that such an assessment hardly exists. However, it should be noted that the issuing bank may resort to clearing and foreclosure of the imported items in case where the importer fails to settle any unpaid margin under a letter of credit; implying the importance of assessing the marketability of the consignment.

According to interview responses on the same issue, most of the interviewees explained that such a rigorous assessment is made only when few regular customers are granted a standing margin facility of up to a certain sum by the credit committee. Otherwise, no such rigorous assessment is made for one time margin approvals.

To the questions concerning pro-forma invoices, the majority of the respondents (an aggregate of 86%) replied that they ascertain the validity and recentness of the pro-forma invoice in most or all of the cases. In addition, most of the respondents (an aggregate of 88%) confirmed that they make sure that the pro-forma invoice does indicate a 2nd advising bank.

On the other hand, 74% and an additional 18% of the respondents reported that, all or most of the time, they do assist the customer in properly filling out the L/C application himself or herself.

On the question of whether or not the bank restricts negotiation to a nominated bank, 62% of the respondents reported that only frequently the bank does so, while 25% admitted that no such practice exists.

When asked if they make a timely examination of documents and notify the presenting bank of any discrepancies within 5 banking days, 54% responded that they seldom do so, while only 14% reported that they frequently identify and advise the discrepancies within the allowed period.

Further, the responses from the interview revealed that especially at branch levels, banks do not have the habit of timely advising discrepancies (Advice of Refusal) to the presenting bank within the allowed period of 5 days.

To the question of whether or not they send cancellation of reimbursement authorization for the unutilized portion of an L/C, a total of only 14% reported that they do so in most or all of the cases. The majority (an aggregate of 86%) admitted that such practice is very infrequent.

4.4 INTERNATIONAL STANDARD BANKING PRACTICE (ISBP)

International Standard Banking Practice for the Examination of Documents under Documentary Credits (ISBP), ICC Publication 645 has evolved into a necessary companion to the UCP for determining compliance of documents with the terms of letters of credit. It explains how the practices articulated in UCP 600 are applied by documentary practitioners. (International Chamber of Commerce, 2006)

A total of 5 questions on most relevant articles of the International Standard Banking Practice were posed to the respondents with the goal of soliciting information on compliance with international standards.

Table 4.6: International Standard Banking Practice (ISBP)

Where: 1. All the time 2. Most of the time 3. Sometimes 4. Never

N= number of respondents, %=approximate percentage

Issues	1		2		3		4		Total
	N	%	N	%	N	%	N	%	
ISBP Article No. 6-42: General Principles	45	69%	12	18%	5	8%	3	5%	65
ISBP Article No. 57-67: Invoice	54	83%	5	8%	4	6%	2	3%	65
ISBP Article No. 91-114: Bill of lading	19	29%	35	54%	5	8%	6	9%	65
ISBP Article No. 134-169: Other Transport Documents like Airway Bill and Truck way bill.	10	15%	48	74%	4	6%	2	3%	65
ISBP Article No. 181-185: Certificate of Origin	17	26%	44	68%	3	5%	1	2%	65

Source: Own survey (2015)

Out of the 65 respondents, an aggregate of 87% reported that, in most or all of the time, they take into account Article No. 6-42 (General Principles) of the ISBP when examining documents and determining whether the documents have discrepancy or not.

In a similar manner, the majority (80-90%) replied that, in most or all of the cases, they observe ISBP articles on invoice (Article No. 57-67), bill of lading (Article No. 91-114), other transport documents (Article No. 134-169) and certificate of origin (Article No. 181-185) during examination of documents presented under a letter of credit.

Not surprisingly, responses of the interviewees on the same issue also confirm that banks make such examination of documents by taking into account the relevant articles of the ISBP. In fact, in most of the cases banks use document examination check lists that directly and indirectly refer to the ISBP articles.

4.5 ISSUES RELATED TO IMPORT DOCUMENTARY COLLECTION PRACTICES

Niepmann (2014) discuss that in a documentary collection method of payment, banks handle shipping documents based on the instructions of the seller. In this method of payment the buyer can get hold of the documents only after effecting payment for the document value without which he cannot receive the goods from the customs; thus a documentary collection provides better reliability of payment as compared to an open account basis.

Table 4.7:Issues related to Import Documentary Collection practices

Where: 1. All the time 2. Most of the time 3. Sometimes 4. Never

N= number of respondents, %=approximate percentage

Issues	1		2		3		4		Total
	N	%	N	%	N	%	N	%	
Collection documents evidencing shipment of goods prior to PO	3	5%	5	8%	43	66%	14	22%	65
Collection documents presented outside the banking channel	7	11%	10	15%	38	58%	8	12%	65
Revised collection documents presented outside banking channel	3	5%	8	12%	31	48%	23	35%	65
Action taken on collection documents based on collection instruction	5	8%	10	15%	43	66%	7	11%	65
Promptly advising customers of the arrival of shipping documents	15	23%	40	62%	10	15%			65
Reminders to take up documents as early as possible	5	8%	6	9%	51	78%	3	5%	65
Advising the remitting bank of the fate of documents by SWIFT	7	11%	10	15%	36	55%	12	18%	65
Effecting payment automatically once buyer takes up documents	3	5%	5	8%	39	60%	18	28%	65
Sending advice of payment	7	11%	9	14%	41	63%	8	12%	65
Sending advice of non-payment etc.	8	12%	9	14%	38	58%	10	15%	65
Returning collection documents 60 days of advice of non-payment	15	23%	45	69%	2	3%	3	5%	65

Source: Own survey (2015)

To the question of whether or not banks accept and handle collection documents evidencing shipment of goods effected prior to purchase order approval, 66% of the respondents replied that such practice is quite infrequent. On the other hand, the results of the survey appear to indicate that the banks, in most of the cases, accept and handle collection documents (both original and revised ones) that are presented only through the banking channel. For instance, 58% of respondents reported that, only in few occasions, they accept and handle collection documents presented outside the banking channel.

On a related issue, respondents were asked whether or not their actions on collection documents were solely based on the instruction of the remitting bank. Surprisingly, only 8% of the respondents reported that they heed the collection instruction all the time, while 66% replied that only rarely do they observe the instruction of the remitting bank.

Further, during the interview, it is discovered that banks do not usually seek instruction from the remitting bank when returning the collection documents for various reasons, making replacement of some of the documents and when there is disparity between commercial invoice amount and that of the covering letter of the remitting bank. Instead, they simply execute the wishes and instructions of the drawee.

The respondents were also asked whether or not they promptly advise customers of the arrival of shipping documents. 62% of them responded that they do so in most of the cases while 23% confirmed that they consistently advise customers in a timely manner. By contrast, the majority of the respondents (78%) reported that the practice of urging customers by way of letter reminders to take up documents is an infrequent one.

Included in the questions was also, a question on whether or not they advise the remitting bank of the fate of documents by SWIFT. An aggregate of 73% of respondents replied that they seldom or never do so. Similarly, the practice of sending advice of payment, advice of non-payment or non-acceptance to the remitting bank by SWIFT is an infrequent one.

Also, information obtained from the interviews explain that most banks only respond to queries sent by the remitting bank and don't take the initiative to acknowledge receipt of the documents and advise the fate of the documents even when the documents remain outstanding for several months.

More importantly, a total of 88% of the respondents admitted that only infrequently do banks effect payment to the remitting bank automatically once the buyer takes up the documents. Likewise, results of the interviews indicate that , in most of the cases, payment to the remitting bank under documentary collections are delayed up to two or three months after settlement by the importer.

Lastly, the majority of respondents (92%) reported that in line with the international banking practice and the directive of the National Bank of Ethiopia, collection documents not taken up by the importer for up to 60 days are returned back to the remitting bank in most or all of the cases.

One important issue raised, during the interview and under the open-end questions on the issue of documentary collections, is that banks are not properly managing the level of approved purchase orders (which are prerequisites for documentary collections) since the National Bank of Ethiopia does not consider approved purchase order as liabilities to the banks. According to the directive on Open Position, (which is a daily report on the foreign currency assets and liabilities of the bank)only letters of credit are considered as liabilities of the bank. Banks are only allowed to hold excess foreign currency up to the

equivalent of 15% of their paid capital; any excess holding above that limit shall be sold out to the NBE or other banks. As a result, banks are having difficulty in allocating or reserving foreign currency needed for settlement of documentary collections. In fact, one interviewee recommended that at least 20% of outstanding purchase orders should be included in the open position report so that banks may be able to allocate some foreign exchange for the settlement of related documentary collections.

4.6 ISSUES RELATED TO IMPORT CASH-IN-ADVANCE

The most beneficial payment terms for the seller, according to Cherunilam (2006) is when payment is received in advance of the shipment of goods, i.e. the cash-in-advance payment term. It is not common for an importer to be willing to make advance payments. However when the consignment is to be manufactured to the order of and according to the specifications outlined by the importer, advance payment is usually required by the seller.

Table 4.8:Issues related to Import Cash-in-advance

Where: 1. All the time 2. Most of the time 3. Sometimes 4. Never

N= number of respondents, %=approximate percentage

Issues	1		2		3		4		Total
	N	%	N	%	N	%	N	%	
Ascertaining that buyer and seller have long-standing business relationship	5	8%	1	2%	42	65%	17	26%	65
Checking that pro-forma invoice states beneficiary's bank details	18	28%	39	60%	7	11%	1	2%	65
Letting an importer to send multiple cash-in-advance payment to same supplier on same date	15	23%	44	68%	3	5%	3	5%	65
Requesting the importer to confirm that shipment has not been effected prior to permit issuance	39	60%	17	26%	4	6%	5	8%	65

Source: Own survey (2015)

On the question of whether or not they ascertain that buyer and seller have long-standing business relationship to justify a sale on cash-in-advance, 65% and 26% of the respondents reported that they seldom or never do so. In most of the cases, bankers simply process the request of the customers and don't take time to know if there exists a long-standing business relationship.

Respondents were also asked if they check that the pro-forma invoice clearly states beneficiary's bank details to which, the majority (an aggregate of 88%) replied that they

do so in most or all of the cases. In addition, according to the survey results, the banks in most of the cases request the importer to confirm that shipment has not been effected prior to the issuance of import permit.

On the other hand, based on the survey responses, most of the respondents (an aggregate of 91%) reported that they allow an importer to send multiple cash-in-advance payments, each not exceeding USD 5,000, to same supplier on same date.

4.7 ISSUES RELATED TO EXPORT LETTER OF CREDIT

Table 4.9: Issues related to Export Letter of Credit

Where: 1. All the time 2. Most of the time 3. Sometimes 4. Never

N= number of respondents, %=approximate percentage

Issues	1		2		3		4		Total
	N	%	N	%	N	%	N	%	
Assessing the credibility of the issuing bank before advising the L/C to the beneficiary	5	8%	6	9%	44	68%	10	15%	65
Examining the terms and conditions of the L/C and checking if the exporter can comply	5	8%	4	6%	38	58%	18	28%	65
Comparing the conditions of the L/C against conditions specified in the sales contract	7	11%	8	12%	36	55%	14	22%	65
Urging exporters to make presentation immediately after effecting shipment	3	5%	5	8%	39	60%	18	28%	65
Effecting payment to exporters against discrepant documents	19	29%	34	52%	10	15%	2	3%	65
Letting the exporter sign a personal guarantee when negotiating discrepant documents	7	11%	9	14%	39	60%	10	15%	65
The practice of assessing the creditworthiness of the exporter	10	15%	7	11%	45	69%	3	5%	65

Source: Own survey (2015)

To the question of whether or not they assess the credibility of the issuing bank before advising the L/C to the beneficiary, a total of 83% of the respondents admitted that they seldom or never do so. Similarly, the survey results appear to indicate that, the practice of examining the terms and conditions of the L/C before advising the L/C to the exporter is an infrequent one. Responses to the interview also confirmed that banks are only concerned that the terms and conditions of the letter of credit are not in contravention of the NBE directives. If not they simply advise the L/C to the respective exporters.

On the other hand, according to the survey responses, the banks are only concerned that the exporter presents documents before the expiry date of the L/C. Most of the respondents (an aggregate of 88%) reported that they don't urge exporters to make presentation immediately after effecting shipment as long as the L/C has not expired. In addition, interviewees also confirmed that banks do not usually make such a follow up and simply wait until documents are presented to check whether the latest shipment date stipulated in the L/C has been met or not.

The survey also indicated that in the majority of the cases (an aggregate of 81%) these banks effect payment to exporters or make negotiations against discrepant documents. Surprisingly, however, only 11% of respondents reported that they consistently request the exporter to sign a personal guarantee agreement when negotiating documents bearing discrepancies. On a similar issue, only 15% of the respondents reported that they, consistently and all the time, assess the creditworthiness of the exporter before negotiating discrepant documents.

Interviews on the same issue revealed that mostly banks do not have clear procedures on negotiating discrepant documents. Instead they make decisions based on their past experience with the issuing.

In addition, the interviewees also reported that, due to the stiff competition between banks for foreign exchange, most banks do not follow stringent or rigorous precautionary procedures like assessing the creditworthiness of the exporter and the marketability of the goods, while negotiating export documents. In a bid to retain the exporting customer, banks are keen to do the will of the exporter, even at any cost at times.

4.8 ISSUES RELATED TO EXPORT DOCUMENTARY COLLECTION

Table 4.10 Issues related to Export Documentary Collection

Where: 1. All the time 2. Most of the time 3. Sometimes 4. Never

N= number of respondents, %=approximate percentage

Issues	1		2		3		4		Total
	N	%	N	%	N	%	N	%	
Ascertaining that buyer and seller have a long-standing business relationship to justify a sale on collection basis	4	6%	8	12%	46	71%	7	11%	65
Sending a follow up SWIFT to the collecting bank after sending the documents	15	23%	42	65%	5	8%	3	5%	65
Making a follow up of exports on D/C to see that the proceeds of previous shipments are received before granting subsequent export permits	7	11%	8	12%	48	74%	2	3%	65

Source: Own survey (2015)

Asked whether or not they ascertain that the buyer and seller do have a long-standing business relationships that justifies a sale on documentary collection, a total of 82% of the respondents reported that they rarely do so. Respondents were also asked whether or not they send a follow up SWIFT message to the collecting or presenting bank after sending the documents. A total of 88% of the respondents replied that they do so in most or all of the cases.

On the other hand, the majority of the respondents (an aggregate of 77%) admitted that they would grant subsequent export permits without making sure that the proceeds of previous shipments have been received or not.

Indeed, feedbacks from interviews also confirmed that the responsibility of making a follow up of repatriation of export proceeds is left for the National Bank of Ethiopia which puts the exporter on the monthly delinquent list if the export proceeds are not received in 90 days' period.

4.9 ISSUES RELATED TO EXPORT ON CASH-IN-ADVANCE

Table 4.11 Issues related to Export on Cash-in-advance

Where: 1. All the time 2. Most of the time 3. Sometimes 4. Never

N= number of respondents, %=approximate percentage

Issues	1		2		3		4		Total
	N	%	N	%	N	%	N	%	
Reminding exporters to effect shipment of goods on time once they have received the advance payment	5	8%	10	15%	47	72%	3	5%	65
Making sure that the purpose of payment of the advance payment is stated and matches with the item to be exported	38	58%	20	31%	5	8%	2	3%	65

Source: Own survey (2015)

On the question of whether they remind exporters to effect shipment of goods on time after receiving the advance payment, the majority of the respondents (an aggregate of 77%) reported that they seldom or never do so.

On a related issue, the survey results show that in most of the cases the banks, in line with the NBE directives, make sure that the purpose of payment of the advance payment stated in the SWIFT message or cash receipt matches with the items to be exported.

4.10 ISSUES RELATED TO EXPORT ON CONSIGNMENT

Under the consignment method of payment, the seller delivers the goods to his agent in the foreign land, who arranges for the sale of the goods and remits the payment to the supplier. Title to the goods remains with the exporter until the goods are sold to the ultimate buyer. Under this method, the exporter is not protected against loss that could arise if the agent or consignee fails to repatriate the proceeds to the exporter from the sale of goods. (Cherunilam, 2006).

Export on consignment is allowed for perishable items like flowers, fruits and vegetables and fresh meat according to the National Bank of Ethiopia directives on export.

Table 4.12 Issues related to Export on Consignment

Where: 1. All the time 2. Most of the time 3. Sometimes 4. Never

N= number of respondents, %=approximate percentage

Issues	1		2		3		4		Total
	N	%	N	%	N	%	N	%	
Ascertaining that the seller and buyer have a long-outstanding relationship to justify consignment sale	5	8%	6	9%	42	65%	12	18%	65
Making a follow up of consignment sales to see that proceeds of previous shipments are received before granting subsequent export permits	3	5%	2	3%	44	68%	16	25%	65

Source: Own survey (2015)

As shown in Table 4.12, most of the respondents (an aggregate of 83%) seldom or never ascertain that the seller and buyer have a long-standing relationship that justifies consignment sale. Instead, they simply process the transaction at the request of the customer and do not take time to check if there is such a long-standing business relationship.

Lastly, according to the survey responses, these banks in the majority of the cases, do not check that proceeds of previous shipments are received before granting subsequent export permits on consignment basis.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 SUMMARY OF FINDINGS

The broad objective of the study was to make a critical assessment of the trade service practices of selected Ethiopian private commercial banks in order to shed light on risk areas, identify problems, expose malpractices and indicate instances of non-compliance with international standard banking practices.

In line with the objective of the research, which is to make an assessment of the existing trade service practice of commercial banks, the author used a descriptive type of study. In addition, the survey method has been employed in the study which comprises of semi-structured questionnaires and semi-structured interviews. The questionnaires and interviews were designed to solicit data on trade service issues that enable the researcher to address the research questions namely:

- ✚ What are the major operational problems encountered by Ethiopian private commercial banks in the course of rendering trade service products?
- ✚ What types of malpractices are observed in these banks with respect to trade services?
- ✚ Are there instances of noncompliance with international and domestic standards and directives?
- ✚ What are the risk areas with respect to trade service products like documentary credits, documentary collections, advance payments and others?
- ✚ To what extent are bank employees familiar with international trade payment mechanisms, ICC publications on trade payment methods, and the directives of the National Bank of Ethiopia?

Accordingly, the major findings of the study are:

5.1.1 OPERATIONAL PROBLEMS ENCOUNTERED BY THE BANKS IN THE COURSE OF RENDERING TRADE SERVICE PRODUCTS

- ✚ The classification of import items set out by the Ministry of Trade is found to be vague and lacks clarity in most of the cases. Thus, banks sometimes face difficulty in deciding whether or not the item to be imported really falls under the category of goods indicated on the back of the trade license.
- ✚ Banks are not properly managing the level of approved purchase orders (which are prerequisites for documentary collections) since the National Bank of Ethiopia does not consider approved purchase order as liabilities to the banks. According to the directive on Open Position, (which is a daily report on the foreign currency assets and liabilities of the bank) only letters of credit are considered as liabilities of the bank. As a result, banks are having difficulty in allocating or reserving foreign currency needed for settlement of documentary collections.

5.1.2 MALPRACTICES OBSERVED IN THE BANKS WITH RESPECT TO TRADE SERVICES

- ✚ Especially at branch levels, most banks (60% of respondents) do not examine documents presented under a letter of credit on time nor notify the presenting bank of discrepancies within the allowed period of 5 banking days.
- ✚ Only infrequently do banks effect payment to the remitting bank automatically once the buyer takes up the documents; only 14% of respondents reported that they do so. Likewise, results of the interviews indicate that , in most of the cases, payment to the remitting bank under documentary collections are delayed up to two or three months after settlement by the importer.

5.1.3 INSTANCES OF NONCOMPLIANCE WITH INTERNATIONAL AND DOMESTIC STANDARDS AND DIRECTIVES

- ✚ Most of the banks (88% of respondents) do not usually seek instruction from the remitting bank when returning the collection documents for various reasons, making replacement of some of the documents and when there is disparity between commercial invoice amount and that of the covering letter of the remitting bank. Instead, they simply execute the wishes and instructions of the drawee. Only 12% of the respondents replied that they seek such instructions from the remitting bank.
- ✚ Especially at branch levels, according to 83% of the respondents, banks do not have the practice of urging customers by way of letter reminders to take up documents presented to the banks either under letters of credit or on documentary collection basis.
- ✚ The practice of sending advice of payment, advice of non-payment or non-acceptance to the remitting bank by SWIFT is an infrequent one amongst the banks; only 13% to 17% of respondents reported that they do so. Most of the banks only respond to queries sent by the remitting bank and don't take the initiative to acknowledge receipt of the documents and advise the fate of the documents to the remitting bank.

On the other hand, it is found that most banks comply with the directives of the National Bank of Ethiopia and the international standard practice in terms of: checking the delinquent status of the customer, creating awareness among the customers of the need to submit proof of entry of goods to the NBE, making sure that the final documents are in line with the import permit or the purchase order, checking for the validity of the proforma invoice, taking into account ISBP guidelines when examining documents. The banks' compliance is also apparent in terms of: discouraging shipment of goods prior to

approval of purchase orders, making sure that shipping documents are channeled through banks, returning collection documents not taken up by importers for more than 60 days.

5.1.4 RISK AREAS WITH RESPECT TO TRADE SERVICE PRODUCTS

- ✚ Except in the case of exports where the sales contract is required by law, most banks (85% of respondents) do not usually request the importer to enter into a sales contract with the overseas trade partner.
- ✚ Most banks (89% of respondents) do not have the practice of advising their customers on the risk and benefits of the intended trade payment methods before proceeding with the transaction.
- ✚ Most banks do not rigorously assess the creditworthiness of the importer and the marketability of the consignment before issuing a letter of credit at a less than 100% margin (72% and 78% of respondents respectively).
- ✚ In most of the cases (87% of respondents) the banks do not have the practice of restricting negotiation to the nominated bank while issuing letters of credit.
- ✚ The practice of sending cancellation of reimbursement authorization for the unutilized portion of the letter of credit is uncommon amongst the banks; only 14% of respondents do so.
- ✚ The findings suggest that, most banks do not examine documents on time and notify the presenting bank of discrepancies within the allowed period of 5 banking days, previously cited as a malpractice, can also be considered as one risk factor.
- ✚ Mostly the banks (more than 83% of respondents) do not take time to ascertain that the buyer and seller do have a long-standing business relationship to justify a sale on cash-in-advance method in case of imports and documentary collections and consignments in the case of exports.

- ✚ The banks also allow an importer to send multiple cash-in-advance payments, each not exceeding USD 5,000, to same supplier on same date, according to 91% of respondents.
- ✚ The banks do not have the practice of assessing the credibility of the issuing bank and examining the terms and conditions of the incoming export letter of credit against the sales contract to see that the exporter can comply. They simply advise the letter of credit to the exporter as long as it is not in contravention of the directives of the National Bank of Ethiopia, as confirmed by more than 77% of respondents.
- ✚ Most of the banks, according to 88% of respondents, do not urge exporters to make presentation immediately after effecting shipment and simply wait until documents are presented to check whether the latest shipment date stipulated in the letter of credit is met or not.
- ✚ The banks, in most cases, (75% of respondents) do not make an assessment of the creditworthiness of the exporter and marketability of the consignment nor request the exporter to sign a personal guarantee when negotiating documents bearing discrepancies.
- ✚ Most of the banks do not usually check that proceeds of previous shipments are received before granting subsequent export permits on documentary collection and consignment basis, according to 77% and 93% of respondents respectively.
- ✚ Most of the banks (77% of respondents) do not usually urge exporters to effect shipment of goods on time after receiving advance payments for export purposes.

5.1.5 THE DEGREE OF BANK EMPLOYEES' FAMILIARITY WITH TRADE PAYMENT MECHANISMS AND LOCAL AND INTERNATIONAL STANDARDS

✚ The degree of familiarity of most international banking personnel with trade payment mechanisms (according to 72% of respondents) is found to be only moderate owing to the relatively high staff turnover in the banks and due to the lack or insufficiency of training on trade service practices.

Knowledge gaps in the following areas need urgent attention:

- 1) The mechanism of trade payment methods,
- 2) Uniform Rules for Collection,
- 3) Uniform Customs Practice for Documentary Credits and
- 4) The relevant directives of the National Bank of Ethiopia

5.2 CONCLUSION

The overall objective of the research was to make an assessment of the trade service practices of selected private commercial banks of the country in order to identify operational problems, uncover malpractices, find out instances of non-compliance with international standard banking practices, identify risk areas, and explore knowledge gaps amongst the practitioners.

The study, which was a descriptive type of research and which employed the survey method of data collection namely, interview and questionnaires, has enabled the author to come up with several findings discussed above.

Based on the results, the author concludes the following:

5.2.1 OPERATIONAL PROBLEMS ENCOUNTERED BY THE BANKS IN THE COURSE OF RENDERING TRADE SERVICE PRODUCTS

From the research it has been found out that, banks are having difficulty when checking imported items against the categories of items listed on the back of trade license due to the fact that the categories of goods stated by the Ministry of Trade is not clearly defined and lacks clarity. Further, banks are not provided with an exhaustive list of imported items and their categories to which they may refer to in case of doubt.

On the other hand, based on the results, it can be concluded that banks are not properly managing the level of approved purchase orders (which are prerequisites for documentary collections) since the National Bank of Ethiopia does not consider approved purchase order as liabilities to the banks. According to the directive on Open Position, (which is a daily report on the foreign currency assets and liabilities of the bank) only letters of credit are considered as liabilities of the bank. As a result, banks are having difficulty in allocating or reserving foreign currency needed for settlement of documentary collections.

5.2.2 MALPRACTICES OBSERVED IN THE BANKS WITH RESPECT TO TRADE SERVICES

It has been found out that, in general, banks' do not consistently make a timely examination of documents and notify the presenting bank of any discrepancies within the allowed period of 5 banking days. Further, it is found that the malpractice is more prevalent among trade service practitioners at the branch level rather than the headquarters since there is lesser supervision at the former. Failing to notify the presenting bank of any discrepancies within the allowed period of 5 banking days

deprives the issuing bank of the right to dishonor documents presented with discrepancies.

An important issue emerging from these finds is that in some of the cases banks' are not promptly effecting payment to the remitting bank after releasing the collection documents to the respective importers. Such malpractice is a violation of Article 16 of the URC 522 which calls for payment without delay. The article holds that, amounts collected (less charges and/or disbursements and/or expenses where applicable) must be made available without delay to the party from whom the collection instruction was received in accordance with the terms and conditions of the collection instruction. The repercussions of such malpractice is a serious one that can negatively impact the correspondent banking relationships of banks and further destroy the trust and good business relationships that may exist among Ethiopian businessmen and their overseas trade partners.

5.2.3 INSTANCES OF NONCOMPLIANCE WITH INTERNATIONAL AND DOMESTIC STANDARDS AND DIRECTIVES

Article 4 of the URC 522 states that banks are only permitted to act upon the instructions given in such collection instruction, and in accordance with these Rules. Banks will disregard any instructions from any party/bank other than the party/bank from whom they received the collection. Nevertheless, these finds suggest that, due to a lack of awareness of the uniform rules for collection, most bankers take action on the collection documents based on instruction received from the drawee and at times contrary to the collection instructions of the remitting bank. To illustrate, most collection instructions request the presenting bank to inform the remitting bank by SWIFT the reasons for non-acceptance of documents by the drawee before simply returning the collection documents at the instruction of the drawee. However, seldom do banks' inform the remitting bank of non-acceptance and request for further instruction.

Failure to seek instructions from the remitting bank in case of non-payment and failing to advise the remitting bank of the fate of documents can deteriorate correspondent banking relationships.

There is strong evidence from the respondents that, most of the time, banks do not have the practice of urging customers by way of 1st, 2nd and 3rd reminders to take up documents. However, this can be considered as an instance of non-compliance with the directive of NBE directive.

The results also suggest that, especially at branch level, banks do not consistently advise the remitting bank of the fate of the collection documents by SWIFT. Remitting banks expect the collecting or presenting bank to act in good faith and give information on the fate of documents as and when required. Failing to do so, would certainly damage correspondent banking relationships of the banks.

Article 26 of the URC 522 holds that the collecting bank must send without delay advice of payment to the bank from which the collection instruction was received, detailing the amount or amounts collected charges and/or disbursements and/or expenses deducted, where appropriate, and method of disposal of the funds. From the outcome of the investigation, it can be concluded that, banks' do not consistently advise the remitting bank of payment by SWIFT and failing to do so in one of the factors leading to deteriorating international banking relationships.

Article 26 of the URC 522, states that the presenting bank should endeavor to ascertain the reasons for non-payment and/or non-acceptance and advise accordingly, without delay, the bank from which it received the collection instruction. In contrast, the findings suggest that rarely do the banks send advice of non-payment or non-acceptance to the remitting bank in a timely manner. Such malpractice amounts to non-compliance with the international banking standard which eventually destroys banking relationships.

5.2.4 RISK AREAS WITH RESPECT TO TRADE SERVICE PRODUCTS

It has been found out that buyers seldom sign a sales contract with seller before proceeding with any method of payment because they are not aware of its importance and bankers also fail to make them aware. A contract of sale is a legal contract. It is a contract for the exchange of goods, services or property that are the subject of exchange from seller (or vendor) to buyer (or purchaser) for an agreed upon value in money (or money equivalent) paid or the promise to pay same. There are cases whereby Ethiopian importers have been defrauded by their overseas trade partners in to paying for containers loaded with junk represented by falsified documents showing that actual goods called for in the letter of credit were shipped. Nevertheless, further litigation was impossible because the trade partners have not concluded a formal sales contract in the first place. In the absence of a sales contract, it is very difficult for a buyer to sue an overseas supplier for non-performance or any fraudulent action.

Trade payment methods like the documentary collection and the cash-in-advance expose the trade partners to different risks. For instance, the buyer may refuse to take up the documents sent under a documentary collection after shipment of goods has already been effected; thus, the seller might face the risk of non-payment. On the other hand, a buyer who has effected payment under the cash-in-advance method might end up losing his money if the seller turns out to be a dishonest one and fails to ship the goods as agreed. It is apparent that Ethiopian businessmen engaged in the import and export business are being exposed to risks of non-payment and non-performance by their trade counterpart due to a lack of awareness of the advantages and disadvantages of trade payment methods.

The findings suggest that most of the banks do not rigorously check the creditworthiness of the importer when issuing an L/C with a margin of less than 100%. The foregoing literature review on L/C states that the basic importance of the letter of credit lies in its

role as verification institution. By that it is meant that a bank is in a much better position than seller to obtain financial and reputational information about the buyer, and to evaluate buyer's creditworthiness and integrity. A bank in the normal course is not going to issue a letter of credit at the request of an insolvent buyer, because the bank depends upon the buyer for reimbursement of the funds paid out under the letter of credit. Thus, if such verification of the creditworthiness of the importer is not a rigorous one, it could result in the issuing bank failing to get reimbursement from the applicant after it has honored the seller's drafts and documents.

In the majority of the cases, banks do not have the practice of assessing the marketability of the imported item when granting margin facility. However, the bank ultimately resorts to foreclosure of the consignment, in case where the importer fails to settle the remaining margin and take up the documents. If the marketability of the consignment is not assessed rigorously in the first place, the bank may end up recovering only part of the payment made to the negotiating bank under the L/C and thus incurring considerable financial loss.

The results also suggest that banks do not consistently restrict negotiation to the nominated bank which is the bank stated as a second advising bank on the seller's Proforma invoice. There are cases where a seller utilizes the service of one advising bank for receiving the original L/C and presents final documents yet to another bank for negotiation. In such cases, the charges of the first advising bank remain unpaid by the beneficiary which will be the responsibility of the issuing bank to bear as a last resort. Had negotiation been restricted to the nominated bank or the second advising bank, the issuing bank would not be subjected to bearing charges outside Ethiopia.

From the outcome of the investigation, it can be concluded that banks do not usually send cancellation of reimbursement authorization for the unutilized portion of L/C. However, this could pave way for the possibility that a claim could be lodged by a negotiating bank

and get reimbursement from the reimbursing bank while the amount has been cancelled in the issuing bank's records. The reimbursing bank has the right to claim the amount from the issuing bank as long as it has not received the cancellation of the reimbursement authorization.

On the other hand, the results obtained suggest that banks do not take time to ascertain whether the buyer and seller do have a long-standing business relationship to justify a sale on cash-in-advance basis; instead, they simply proceed with the transaction at the request of the importer. Cash-in-advance method of payment, however, entails the risk that the seller after getting the advance payment may fail to ship the goods as agreed. In fact, the buyer has nothing to depend on except the trustworthiness of the seller for shipment of the agreed consignment. However, it appears that banks are not creating such awareness of the risk of the cash-in-advance payment method amongst the importers. The rationale behind is that financial losses to the customer directly or indirectly harms the business that banks gain from these customers. Secondly, the National Bank of Ethiopia has also a keen interest on each outflow of foreign exchange to see that no foreign exchange is wasted.

It has also been found out that most banks would allow an importer send multiple cash-in-advance payments each not exceeding USD 5,000 to the same supplier and on the same date. However, it is to be noted that the NBE through its directive number FXD/07/1998 has restricted imports by advance to USD 5000. The rationale behind is that cash-in-advance is a highly risky method of payment for the buyer; and such risk should be limited to the amount of USD 5000. In contrast if we allow an importer to send say 10 cash-in-advance payments each worth USD 5,000, the total amount remitted to the same supplier on the same date would amount to USD 50,000; such practice would pave the way for the risk of non-performance by seller- the very thing that the NBE attempts to avoid.

The letter of credit bears the irrevocable undertaking of the issuing bank to honor drafts and documents presented by a bank that has negotiated a complying set of draft and documents of the beneficiary. The seller depends on the credit standing of the usually unknown overseas issuing bank for payment of the value of goods shipped to the buyer's country. It is therefore the duty of the advising banks to ascertain to the extent possible the credit standing of the bank and advise the exporter to request for confirmation of the letter of credit in case when it is found to be not satisfactory. However, the findings suggest that most banks do not have the practice of assessing the creditworthiness of the issuing bank.

On the other hand, most banks simply hand over the L/C SWIFT message to the exporter and simply expect him/her to come up with a complying set of shipping documents. However, the strict compliance principle of an L/C holds that in order for the presentation to be honored, the seller's documents have to strictly comply with the terms and conditions of the letter of credit. It is advisable that banks advise their exporting customers to check whether or not they can comply the terms and conditions of the L/C and if not request the applicant to amend the L/C. It is crucial for the exporter at the time of the receipt of a letter of credit ascertain that the conditions of the L/C are in line with the sales contract with regard to issues such as product, price, currency, terms of delivery, payment maturity, expiry date for the presentation and most importantly, documentary requirements to be met by the beneficiary in order for the credit to be honored. Otherwise, the exporter might face difficulty in coming up with a complying set of shipping documents called for in the L/C

According to the findings, banks are only concerned that the shipping documents are presented just before expiry date of the L/C. However, a delay in presenting documents to the bank after effecting shipment would result in the goods arriving at the port of destination before the documents. Consequently, the seller may be subjected to

unnecessary and at times very high demurrages charges which may prompt him not to take up the documents by citing some trivial discrepancies or negotiate the buyer for a reduced price.

On the other hand, it has been found out that, most of the banks do not make an assessment of the creditworthiness of the exporter and marketability of the consignment nor request the exporter to sign a personal guarantee when negotiating documents bearing discrepancies. A personal guarantee agreement signed between an export and a bank entitles the latter the right to claim the personal assets of the former, in case when the applicant refuses to waive the discrepancies and take up the documents.

Directive No. FXD/22/2004 of the NBE holds that the maximum allowable amount for a single permit shall not exceed USD 30,000 (later amended to USD 100,000) and subsequent permit shall only be issued upon full repatriation of the allowable amount. Thus, banks are expected to see that the proceeds of previous shipments are received before granting subsequent export permits on documentary collection basis. The banks do not usually check that proceeds of previous shipments are received before granting subsequent export permits on documentary collection and consignment basis, according to 77% and 93% of respondents respectively. Failing to do so amounts to a violation of the NBE directives and expose the exporting customers to unnecessary risk of non-payment by the buyer.

Under the consignment method of payment, the exporter depends on the trustworthiness of the consignee or agent for the repatriation of the export proceeds. Similarly, documentary collection method of payment also exposes the export to the risk of non-payment since the buyer may refuse to take up the documents once the goods have shipped. However, according to the findings of the study, in most of the cases banks do not ascertain that the seller and the overseas buyer do have a long-standing business relationship to justify a sale on consignment or documentary collection basis. Secondly,

rarely do the banks make a follow up of exports on consignment to see that the proceeds of previous shipments are received before granting subsequent export permits on consignment basis. Indeed, such practices may expose the exporter to risks of non-payment by the buyer and harm the foreign exchange earnings of the country at large.

5.2.5 FAMILIARITY AND INFORMATION GAPS AMONG TRADE SERVICE STAFF OF THE BANKS

From the research that has been carried out, due to a relatively high staff turnover among the bank staff and the insufficiency or in some cases the lack of periodic training, the level of the job knowledge of most international banking staff is below what is considered sufficient.

Most of the malpractices and instances of non-compliance of banks, however, result from the lack of sufficient job knowledge. More than sufficient job knowledge among the staff is required in order for the bank to avoid such malpractices and violation of local and international standards and regulations.

5.3 RECOMMENDATION

Based on the findings and conclusions, the following recommendations were forwarded to alleviate or at least minimize the operational problems, correct the malpractices, avoid instances of non-compliance with standards and regulations, mitigate some of the risks and fill the knowledge gaps.

5.3.1 RECOMMENDATION FOR PRACTICE

The Ministry of Trade should furnish banks with a detailed listing of imported items and their respective categories that appear at the back of trade licenses. The detailed listing could ease the difficulty banks are facing in deciding whether or not the item to be imported falls under the category of goods indicated on the trade licenses.

The National Bank of Ethiopia, should revise its Open Position directive in such a way that banks would be allowed to account for at least 50% to 60% of their outstanding approved purchase orders as liabilities (in addition to the tolerance up to 15% of paid up capital). In this way, banks can reserved the necessary foreign exchange necessary for the settlement of the related documentary collections.

Further, the following recommendations are put forth to banks with regards to their import procedures. Firstly, international banking practitioners, both at the headquarters and at branch levels, should be reminded that documents presented under a letter of credit are to be checked for discrepancy immediately and any discrepancy should be notified to the presenting bank within 5 banking days. The appropriate training should be provided in this regard. Secondly, reimbursement under a letter of credit and payment under a documentary collection should be effected without delay once the related documents are taken up by the importer. Banks should properly manage their assets and liabilities in foreign exchange so that they will not face liquidity problems upon settlement of letters of credits and documentary collections. Thirdly, banks must heed the collection instruction or seek further instruction from the remitting bank by SWIFT, whenever there is a need to return the documents, replace the documents, or when there arises a disparity between covering letter amount and invoice amount. Fourthly, importing customers should be requested to enter in to a formal sales contract with their overseas trade partner before engaging in any method of payment for imports. Fifthly, there should be a procedure for assessing the creditworthiness of the importer and the marketability of the consignment before issuing a letter of credit. Lastly, it is recommended that, issuing banks restrict negotiation of documents to a nominated bank in order to minimize the risk that the beneficiary avoids paying advising charges of the 1st an 2nd advising banks.

In addition, the following recommendations are offered with regards to export transactions of the commercial banks. First, banks should, to the extent possible, assess

the creditworthiness of the issuing bank, examine the terms and conditions of the incoming letter of credit, and discuss with the exporter if he or she can make a complying presentation. Otherwise, they should advise their exporting customer to request for an amendment before effecting shipment. Second, while negotiating documents bearing discrepancy, banks should first assess the creditworthiness of the exporter, the marketability of the consignment, and request the exporter to sign a personal guarantee agreement. Third, banks must make a follow up of export permits, especially those issued on documentary collections and consignments, to see that proceeds of previous shipment are received before granting subsequent export permits. Forth, banks must take time to ascertain that the buyer and seller do have a long-standing business relationship that justifies sales on documentary collections and consignment sales in case of exports.

Lastly, periodic training should be provided to the international banking department personnel on the mechanism of trade payment methods, Uniform Rules for Collection, Uniform Customs Practice and on the relevant directives of the National Bank of Ethiopia.

5.3.2 RECOMMENDATION FOR FURTHER STUDY

The scope of this study was limited to assessing the trade service products like the letter of credit and the documentary collection that reduce the risk of non-payment by the buyer and non-performance by the seller.

Further research on trade finance is desirable, especially one which studies banks' practices of providing working capital finance both to importing and exporting customers.

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Appendix I

St. Mary's University
School of Graduate Studies
Faculty of Business

Questionnaire

Dear respondent,

The following questionnaire is a research instrument on **International trade finance practices of selected private commercial banks in Ethiopia**. The research is being conducted only for academic purpose. I assure you that your responses will be kept confidential. You are not expected to write your name. Any information obtained in connection with the study will remain strictly confidential.

The quality of this research highly depends upon the genuineness of the answers you provide to this questionnaire. I, therefore, humbly urge you to give your honest and accurate responses. For further clarification and enquiry feel free to contact me through my cell phone number 0911 119819.

Thank you very much for your significant contribution to the accomplishment of the research.

Haddis Said

MBA Prospective Graduate

Part I. Respondent's Background Information

1. Sex

Male

Female

2. Educational Background

Diploma

1st Degree

Masters & Above

3. Working Experience (in years)

1-5

5-10

More than 10

4. Position

Managerial

Professional

Clerical

Part II. Research Related Questions

Section 1. General Trade Service Questions

5. Do you request the buyer to sign a sales contract with seller before proceeding with any method of payment?

All the time

Most of the time

Sometimes

Never

6. Do you advise your customers on the risks and benefits of the intended trade payment method before proceeding with the transaction?
All the time Most of the time Sometimes Never
7. Do you consistently and rigorously check the customer's delinquent status with the NBE?
All the time Most of the time Sometimes Never
8. Do you create awareness among importing customers that they have an obligation to submit proof of entry of goods in to the country to the NBE or otherwise arrange for the repatriation of the foreign currency?
All the time Most of the time Sometimes Never
9. Do you check that the items to be imported or exported are consistent with those listed at the back of the trade license?
All the time Most of the time Sometimes Never
10. Do you check that the consignments covered by the final documents are in line with those stipulated in the import permit (for L/C) or the purchase order (for CAD)?
All the time Most of the time Sometimes Never
11. How do you assess the level of job knowledge of employees at the International Banking Department especially with regards the mechanism of trade payment methods, Uniform Rules for Collection, Uniform Customs Practice for Documentary Credits, and the directive of the NBE ?
Sufficient Moderate Poor

Section 2. Import Letters of Credit(L/C)

12. Does the concerned department of the bank assess the creditworthiness of the importer before issuing an L/C?
All the time Most of the time Sometimes Never
13. Does the concerned department assess the marketability of the consignment when granting margin facility?
All the time Most of the time Sometimes Never
14. Do you ascertain that the pro-forma invoice is a recent/ a fresh one?
All the time Most of the time Sometimes Never
15. Do you make sure that the Pro-forma invoice does indicate a 2nd advising bank?
All the time Most of the time Sometimes Never
16. Do you assist the applicant in properly filling out the L/C application himself/herself?
All the time Most of the time Sometimes Never
17. Do you restrict negotiation to a nominated bank whenever possible?

All the time Most of the time Sometimes Never

18. Do you make a timely examination of documents and notify the presenting bank of any discrepancies within 5 banking days?

All the time Most of the time Sometimes Never

19. What procedures do you follow when handling discrepant documents?

20. Do you send cancellation of reimbursement authorization for the unutilized portion of L/C whenever there is any?

All the time Most of the time Sometimes Never

21. What challenges, problems, malpractices and instances of non-compliance with NBE directives and international standard practice do you observe with regards the handling of import L/C?

22. What possible remedial solutions do you propose in order to meet these challenges, solve the problems, and correct the malpractices?

Section 3. International Standard Banking Practice for Examination of Documents (ISBP)

Do you take in to account **the under listed** International Standard Banking Practice for Examination of Documents (ISBP) guidelines when examining documents and determining whether the documents have discrepancy or not?

23. ISBP Article No. 6-42: **General Principles**

All the time Most of the time Sometimes Never

24. ISBP Article No. 57-67: **Invoice**

All the time Most of the time Sometimes Never

25. ISBP Article No. 91-114: **Bill of Lading**
All the time Most of the time Sometimes Never

26. ISBP Article No. 134-169: **Other Transport Documents**
All the time Most of the time Sometimes Never

27. ISBP Article No. 181-185: **Certificate of Origin**
All the time Most of the time Sometimes Never

Section 4. Import Documentary Collection

28. Do you accept and handle collection documents evidencing that shipment of goods was effected prior to Purchase Order approval?

All the time Most of the time Sometimes Never

29. Do you accept and handle collection documents presented to your bank outside the banking channel?

All the time Most of the time Sometimes Never

30. Do you accept and handle **revised** collection documents presented to your bank outside the banking channel in replacement of previously sent documents?

All the time Most of the time Sometimes Never

31. Are all your actions taken on collection documents solely based on the instruction of the Remitting Bank?

All the time Most of the time Sometimes Never

32. Do you promptly advise customers of the arrival of shipping documents?

All the time Most of the time Sometimes Never

33. Do you urge customers (by way of 1st, 2nd, 3rd letter reminders) to take up documents as early as possible?

All the time Most of the time Sometimes Never

34. Do you advise the remitting bank of the fate of documents by SWIFT?

All the time Most of the time Sometimes Never

35. Do you automatically effect payment to the Remitting Bank once the buyer takes up the collection documents?

All the time Most of the time Sometimes Never

36. Do you send advice of payment to the remitting bank by SWIFT?

All the time Most of the time Sometimes Never

37. Do you send advice of non-payment or non-acceptance with reasons to the remitting bank without delay in the case where drawee fails to take up the documents?

All the time Most of the time Sometimes Never

38. Do you return the collection documents to the remitting bank 60 days after advice of non-payment whenever drawee fails to take them up?

All the time Most of the time Sometimes Never

39. What mechanism do you employ to see that the total outstanding purchase orders approved are within manageable limit? (to secure the bank's liquidity in foreign currency)

40. What challenges, problems, malpractices and instances of non-compliance with NBE directives and international standard practice do you observe with regards the handling of import documentary collections?

41. What possible remedial solutions do you propose in order to meet these challenges, solve the problems, and correct the malpractices?

Section 5. Import Cash-in-advance

42. Do you ascertain that the buyer and seller do have a long-standing business relationship to justify a sale on cash-in-advance basis?

All the time Most of the time Sometimes Never

43. Do you check that the Pro-forma invoice clearly states beneficiary's bank details?

All the time Most of the time Sometimes Never

44. Do you let an importer send multiple cash-in-advance payments each not exceeding USD 5,000 to the same supplier and on the same date?

All the time Most of the time Sometimes Never

45. Do you request the importer to confirm that shipment has not been effected prior to the issuance of import permit?

All the time Most of the time Sometimes Never

46. What challenges, problems, malpractices and instances of non-compliance with NBE directives and international standard practice do you observe with regards the handling of import on cash-in-advance basis?

47. What possible remedial solutions do you propose in order to meet these challenges, solve the problems, and correct the malpractices?

Section 6. Export Letters of Credit

48. Do you assess the credibility of the issuing bank before advising the L/C to the beneficiary?

All the time Most of the time Sometimes Never

49. Do you examine the terms and conditions of the L/C and discuss with the exporter to check if he/she can make a complying presentation?

All the time Most of the time Sometimes Never

50. Do you compare the conditions of the L/C against conditions specified in the sales contract in order to help the exporter meet the conditions?

All the time Most of the time Sometimes Never

51. Do you urge exporters to make presentation immediately after effecting shipment?

All the time Most of the time Sometimes Never

52. On average, how many days does it take before shipping documents are presented after shipment of goods has been effected?

1-10 10-21 More than 21

53. Do you effect payment to exporters (make negotiation) against discrepant documents?

All the time Most of the time Sometimes Never

54. Do you let the exporter sign a personal guarantee when negotiating discrepant documents? (Skip this question if your answer to Q#53 is "never")

All the time Most of the time Sometimes Never

55. Do you have the practice of assessing the creditworthiness of the exporter before negotiating a discrepant document? (Skip this question if your answer to Q#53 is "never")

All the time Most of the time Sometimes Never

56. What challenges, problems, malpractices and instances of non-compliance with international standard practice do you observe with regards the handling of export L/C?

57. What possible remedial solutions do you propose in order to meet these challenges, solve the problems, and correct the malpractices?

Section 7. Export Documentary Collection

58. Do you ascertain that the buyer and seller do have a long-standing business relationship to justify a sale on documentary collection basis?

All the time Most of the time Sometimes Never

59. Do you send a follow up SWIFT message to the collecting/ presenting bank after sending the documents?

All the time Most of the time Sometimes Never

60. Do you make a follow up of exports on documentary collection to see that the proceeds of previous shipments are received before granting subsequent export permits on documentary collection basis?

All the time Most of the time Sometimes Never

61. What challenges, problems, malpractices and instances of non-compliance with NBE directives and international standard practice do you observe with regards the handling of Export documentary collections?

62. What possible remedial solutions do you propose in order to meet these challenges, solve the problems, and correct the malpractices?

Section 8. Export on Cash-in-advance

63. Do you remind exporters to effect shipment of goods on time once they have received the advance payment?

All the time Most of the time Sometimes Never

64. Do you make sure that the purpose of payment of the advance payment is stated in the MT103 or cash receipt and that it matches with the items to be exported?

All the time Most of the time Sometimes Never

65. What challenges, problems, malpractices and instances of non-compliance with NBE directives and international standard practice do you observe with regards the handling of export on cash-in-advance basis?

66. What possible remedial solutions do you propose in order to meet these challenges, solve the problems, and correct the malpractices?

Section 9. Export on Consignment

67. Do you ascertain that the seller and the consignee do have a long-standing business relationship to justify a sale on consignment basis?

All the time Most of the time Sometimes Never

68. Do you make a follow up of consignment sales to see that the proceeds of previous shipments are received before granting subsequent export permits on consignment basis?

All the time Most of the time Sometimes Never

69. What challenges, problems, malpractices and instances of non-compliance with NBE directives and international standard practice do you observe with regards the handling of export on consignment basis?

70. What possible remedial solutions do you propose in order to meet these challenges, solve the problems, and correct the malpractices?

Thank you for filling out the questionnaire!

Appendix II

St. Mary's University
School of Graduate Studies
Faculty of Business

Interview Questions

Part I. Import

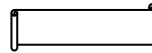
1. Do you advise your customers on the risks associated with the method of payment that they are intending to make use of?
2. Do you encourage importers to enter into a formal sales contract with the seller first before proceeding with the issuance of an L/C or other payment methods?
3. Does the concerned department of the bank have the practice of assessing the creditworthiness of the importer and the marketability of the consignment when issuing import L/C especially against less-than 100 % margin? What other precautionary measures do you take before L/C issuance to make sure that your bank gets reimbursed in full by the applicant?
4. Is your examination of L/C documents based on the under listed International Standard Banking Practice for Examination of Documents?
 - ISBP Article No. 6-42: General Principles
 - ISBP Article No. 57-67: Invoice
 - ISBP Article No. 91-114: Bill of Lading
 - ISBP Article No. 134-169: Other Transport Documents
 - ISBP Article No. 181-185: Certificate of Origin
5. Do you advise importers of the arrival of documents, without delay, and urge them by way of telephone calls and letter reminders to take up L/C or CAD documents in a timely manner?

6. Do you consistently send Advice of Refusal to the presenting bank within 5 banking days in cases where the documents have discrepancy?
7. Do you keep the presenting/remitting bank on board by way of SWIFT correspondences with regards the fate of L/C or CAD documents by SWIFT?
8. Do you consistently effect immediate reimbursement to negotiating bank in the case of L/C and payment to the remitting bank in the case of CAD once the documents are taken up by the buyer?
9. What mechanism do you employ to see that the total outstanding purchase orders approved are within manageable limit in order to secure the bank's liquidity in foreign currency?
10. What challenges, problems, malpractices and instances of non-compliance with international standard practice do you observe with regards the handling of import transactions?
11. What possible remedial solutions do you propose in order to meet these challenges, solve the problems, and correct the malpractices?

Part II. Export

12. Do you ascertain that the buyer and seller do have a long-standing business relationship when engaging in exports on CAD or consignment basis?
13. Do you have the practice of checking the terms and conditions of an incoming letter of credit compare with the conditions stipulated in the sales contract and discuss with the exporter to see if he/she can later make a complying presentation?
14. Do you urge exporters to make timely presentation of the shipping documents once they have effected shipment?
15. What precautionary measures or procedures do you have in place with regards the negotiation of discrepant export documents?

16. Do you make a close follow up on exports on CAD and consignment basis to see that proceeds of previous similar shipments have been received before granting yet another export permits on such methods of payment?
17. What challenges, problems, malpractices and instances of non-compliance with international standard practice do you observe with regards the handling of export transactions?
18. What possible remedial solutions do you propose in order to meet these challenges, solve the problems, and correct the malpractices?



DECLARATION

I, the undersigned, declare that this thesis is my original work, prepared under the guidance of Abebe Yitayew, PhD. All sources of materials used for the thesis have been duly acknowledged. I further confirm that the thesis has not been submitted either in part or in full to any other higher learning institution for the purpose of earning any degree.

Name

Signature

**St. Mary's University
Addis Ababa**

April, 2015

ENDORSEMENT

This thesis, titled “**International trade finance practices of selected private commercial banks in Ethiopia**” has been submitted to St. Mary’s University, School of Graduate Studies for MBA program with my approval as a university advisor.

Advisor

Signature

St. Mary’s University April, 2015
Addis Ababa